FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD
February 25-26, 2015
Room 7C13
441 G Street NW
Washington, DC 20548

Wednesday, February 25, 2015

Administrative Matters

- **Attendance**

The following members were present throughout the meeting: Mr. Allen, Messrs. Dacey, Granof, McCall, Reger, Showalter, Smith, and Steinberg. Ms. Davis represented Ms. Ho. The executive director, Ms. Payne, and general counsel, Mr. Marchand, were present throughout the meeting.

- **Approval of Minutes**

The minutes of the December meeting will be approved following the meeting.

- **Administrative Discussion**

Ms. Payne introduced Ms. Grace Wu, project manager. Ms. Wu joined FASAB staff in January from Deloitte LLP where she was a senior manager. She has extensive federal experience including experience related to direct loans and loan guarantees. Members welcomed Ms. Wu.

Mr. Allen explained that Ms. Ho was attending the annual OECD accruals meeting. Ms. Davis will represent Ms. Ho during the meeting. Mr. Reger noted that Ms. Kearney was also in attendance. He stressed the importance of the annual meeting as it allows us to learn from other countries as well as to share U.S. developments.

In response to the report on "The Bank of America" that was included in clippings, members raised the following points:

1. Both the budget and the financial statements include estimated losses on direct loans. The allowance for losses is based on the net present value of expected cash flows discounted at the risk free rate. The cash flows include expected defaults and are updated annually to include new information and changing circumstances. For some programs such as student loans, borrowers are not able to discharge to debt in bankruptcy and this reduces expected defaults. Also, the government has some collection options that are not available to private lenders such as offsetting tax refunds. All of these factors are included in the estimates.

2. Annual appropriations provide an amount to cover subsidies for new loans. For new loans, the appropriations limit the amount of loans made for the period and the related risk but the limit is based on estimated subsidies. In future years, a permanent indefinite appropriation covers subsidy reestimates; some members noted that this means the amount of subsidy is not constrained over time. Other members noted there is uncertainty inherent in all estimates.

    a. For reestimates that reduce the subsidy, a negative subsidy is reported. This appears as a profit in some cases. Negative subsidies are returned to the Treasury's general fund.

    b. For reestimates that increase the subsidy, appropriations are automatically available to cover the increased cost.

3. Members briefly discussed the distinction between fair value estimates of subsidies and those required by the Credit Reform Act and SFFAS 2. Some suggest fair value better addresses the uncertainty in future cash flows. A GAO

study of the issue is underway and it will include exploring whether there is systemic bias in the estimated cash flows.

4. Some members wondered if this should be addressed in the risk assumed project. Others noted the existing standards and the concern was the uncertainty in the estimates.

Members briefly discussed the warrant process. Unlike state government warrants, a federal warrant does not establish a separate cash account for a component entity. Instead, it signifies that the Treasury will honor a certain amount of agency spending. The Treasury performs cash management centrally rather than each individual agency managing its cash.

Agenda Topics

- **Reporting Model**

The Board continued its discussions on a concepts statement for an ideal reporting model. The initial issue the Board discussed concerned whether: (1) the framework in the concepts statement should be general and assist in the classification and aggregation of flows reported in government-wide or component entity financial statements; or (2) specific rules for classification or aggregation should be included. The Board agreed that concepts should be general; however, members expressed concern that some level of specificity was needed to guide the Board without constraining future standards setting. Members expressed concern about whether the concepts should include illustrations of financial statements and whether concepts should reflect an 'aspirational' reporting model or describe current practice. Consequently, the Board decided to: (1) develop an inventory of concepts and topics that might be included in the concepts statement; and (2) discuss the inventory items during the April 2015 meeting.

Mr. Steinberg states that the concepts statement provides the framework and OMB is authorized by law to establish the "form and content" of the financial statements. The concepts statement needs to be specific enough to guide the form and content, particularly since OMB and the preparers do not have the same time to conceptualize a format and look to FASAB for that piece. Furthermore, OMB's A-136 can provide the flexibility needed to accommodate agencies that cannot conform to the concepts.

The Board began its inventory discussion with concepts that received consensus during the October 2014 meeting. Also, as Board members expressed their views on what concepts and topics should be included in the statement, staff documented their views in an outline. The outline could be used to prepare the concepts statement and includes the inventory of members' views as follows: [1]

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[1] The bolded text indicates the concepts that the Board agreed upon during the October 2014 meeting.

A. **There are different levels of reporting, the government-wide and component levels, and they have different characteristics.**

1. Explain why differences in characteristics are important – that is, that they lead to different users and different information needs at the different levels (Consolidated Financial Report (CFR) and components) of reporting. This is a descriptive topic that explains the relevance of the sections that follow (begs the question, "So what?").

2. Identify in detail the different characteristics of the government as a whole and its components; discuss the users of reports at each level and their needs.

    a. **The government-wide is the economic entity and components are not economically independent entities.**

        - The CFR level is a consolidated inclusive view.

        - Discuss the need to report on tax expenditures at the CFR level.

    b. **The government-wide and components have different financing structures and focus**.

        - Discuss offsetting collections

    c. Individual component reports have limitations. An individual component report cannot tell a reader what happens across multiple component levels (cross-agency priority goals).

    d. The CFR helps readers to understand that multiple organizations frequently provide government services.

    e. Internal management is the focus of the component level and their needs should drive the details reported.

    f. Congress expects highly disaggregated information. This expectation may indicate that the component level report is one means of reporting along a spectrum of useful information.

    g. There are reasons for providing some component level activity to external users. Some components are self-sustaining.

    h. Congress would not look to the CFR for information about an agency. The CFR provides information that is best presented in consolidated amounts, such as financial condition.

3. Discuss what should be communicated at the different levels. What information do we believe is important for the CFR and what information do we believe is important for components, regardless of today's processes for collecting and auditing information for the CFR. Distinguishing what information should be presented at the CFR level versus the component level is important because, in 20 years, it may not be true that the CFR is a consolidation of component level trial balances.

4. **Although it may be challenging for external users to understand, the relationships and differences between the government-wide and component level, the financing should be explained.**

    a. The statement should be revised to state:

       Financing should be explained so that external users understand the differences and relationships between the CFR and its components.

B. Financial reporting should leverage technology to provide information including:

1. The ability to obtain detailed information for selected programs.

2. The ability to disaggregate at various levels within or across organizations.

C. Discuss the reporting model's relationship to reporting protocols such as USASpending.gov and the DATA Act.

D. **The interrelationship among information presented in financial statements** including MD&A and non-financial performance information **should be understandable. This may be self-evident or accomplished through narrative explanation.**[2]

1. Explain how understandable interrelationships can be accomplished. Identify a hierarchy, such as:

    a. Articulation among the statements. There is value in presenting financial statements in a manner such that the relationships among them are self-evident.

    b. If the relationships among the statements are not self-evident, a reconciliation on the face of the statements could be shown.

    c. Disclose the relationships in a schedule.

    d. Describe the statements and their relationships in a disclosure.

[2] Although a normative statement, some members are concerned whether this principal would provide useful guidance.

2. There are different types of financial statements - budgetary, short-term (balance sheet, statement of net cost, etc.) and long-term (statement of social insurance and long-term sustainability). A financial reporting package should explain the kinds of information being reported and the relationships among them.

3. Discuss whether and how financial statements would articulate.

4. Provide examples of how the interrelationships would be provided, such as narratives or charts.

E. **The government-wide should help citizens and citizen intermediaries understand the major goods and services and other activities that the federal government provides and where they can obtain detailed information in components.** The government-wide should also provide information on:

1. How the government is funded (the resources received) and what it does with that funding.

2. What was obtained (assets) and the obligations created as a result of its activities.

3. Details on the sources of funding, such as the different types of taxes.

4. Spending thru the tax code versus direct appropriation.

5. The difference between mandatory and discretionary spending and how discretionary spending is small in relation to mandatory spending.

6. The concept of helping citizens obtain detailed information should be restated to imply electronic links. Accordingly, the concept in E. above should be revised as follows:

> The government-wide should help citizens and citizen intermediaries understand the major goods and services and other activities that the federal government provides and ~~where they can obtain~~ will facilitate their obtaining detailed information in components.

F. With respect to budgetary reporting, discuss the following:

1. To the extent possible, financial reporting should present the relationship of budget expenditures to accrual expenses.

2. Financial reporting should provide information on the use of budgeted resources.

3. To the extent possible financial reporting should provide a budget to actual comparison. Matters that would need to be discussed include:

    a. What is actual? Actual would need to be defined. Currently, the Statement of Budgetary Resources needs to be more understandable. It could be arrayed by programs.

    b. At what level should a comparison be presented?

4. Financial reports should have some recognition of mandatory versus discretionary spending.

    a. Financial reports should present what expenditures have been made against mandatory accounts versus discretionary accounts.

5. Unless budgetary information is related to accrual information, should an accounting standards-setter be involved in budgetary reporting?

6. Discuss the relationship between financial information (cost) and budget functions adopted by law.

G. Regarding performance reporting, discuss the following:

1. Performance metrics and measures

2. Cost of programs and activities

3. The relationship of cost to strategic goals

H. Discuss cost accounting

I. Regarding the sustainability of government programs or services, discuss the following:

1. Financial reporting should provide information to help the public understand what it takes to meet long-term commitments.

2. Financial reporting should provide information to help determine whether we can continue programs as structured. The challenge is that some have their own revenue but others do not.

3. Consider the government's ability to move money around once collected for a designated purpose.

4. The sustainability of revenue. There are limitations on how much governments can tax. Tax income can decrease once the tax rate achieves a particular level.

In addition, the Board deliberated budgetary reporting and what actions should be taken given the issues noted during its December 2014 discussion with budget experts. During that meeting, budget experts noted unique aspects of the federal budget, such as only one-third of federal spending is subject to annual appropriations and they noted that users have difficulty understanding the current Statement of Budgetary Resources. The Board agreed with the staff proposal to defer decisions about concepts and standards related specifically to budgetary reporting until concepts for the other components of the financial reporting model are developed.

> **Conclusions:** During the April 2015 meeting, the Board will discuss the inventory of concepts and topics to include in conceptual guidance for an ideal reporting model.

- **Public-Private Partnership**

Mr. Savini began the session by asking Members to turn to TAB B and noted that staff requests that the Board respond to three questions:

1. Should a public hearing be scheduled?
2. If not, are there individual respondents from whom you wish to seek clarification directly?
3. Does the Board generally agree with the proposed edits as shown at Attachment 2?

Mr. Showalter stated that he did not think a public hearing was needed and the Chairman noted that he too did not believe that a public hearing was warranted. Mr. Allen went on to say that public hearings work better for broad issues, and this P3 project is very specific and technical. Mr. Steinberg concurred. There were no objections to this motion.

At the Chairman's request, staff then asked members to turn to page 5 and proceeded to summarize his analysis of the respondent letters. Staff noted that on balance, the body of the proposed Standard held up well with the exception of the remote risk disclosure requirement.

Staff advised that in preparation for the Board meeting, discussions and meetings were held with several respondents and the task force to help identify edits or changes to the exposure draft. The result of that input can be seen at Attachment 2 with each edit or change identified to the sponsoring respondent. Staff noted that in consultation with the Executive Director, to help focus on key matters only edits/changes to the standards will be reviewed as they will "make or break" this document and that members can alter the Statement's introduction and basis for conclusions accordingly, based upon the Board's re-deliberations.

<u>Definition: Refer to ED Q1</u> – Staff, in consultation with the Task Force, advises to leave the definition as-is but clearly notes that that it is subject to exclusions and referred to the additional exclusions discussed below and included at Attachment 2. Mr.

Steinberg stated that he perceived a less than favorable reaction to the definition, which he thinks could be addressed with an introduction stating that this is a three-part definition.

Pending further review, the Board did not take exception to the staff recommendation.

Exclusions: Refer to ED Q2 – Staff recommended adding two additional exclusions proposed by respondents that would exempt (1) routine PP&E procurements and (2) formal as well as informal arrangements or transactions that do not share risks or rewards and are solely designed to foster goodwill, or encourage economic development.

Pending further review, the Board did not take exception to the staff recommendation.

Characteristics: Refer to ED Q3 & Q4 – Because the majority of respondents agreed with the risk-based characteristics, their related classification, and their proposed application, staff, in consultation with the Task Force did not recommended any changes.

Pending further review, the Board did not take exception to the staff recommendation.

The following summarizes Board discussions concerning ED questions Q1-Q4.

Messrs. Reger and Steinberg agreed that what the standard says is that certain arrangements and transactions are not subject to the provisions of this statement. This allows someone to say even though they are in a P3, they do not have to report the P3.

Mr. Steinberg went on to state that the problem is the perception that we are calling everything a P3. He suggested that we say this is a P3 definition limited to, and only for reporting requirements.

Ms. Payne stated that legislatures sometimes use the P3 label because it sounds good and as a result, we have seen a couple of cases where agencies are directed to create a P3 but they do not really meet the P3 definition proposed.

Mr. Steinberg replied that this occasionally happens in standard-setting where for example, something is said to be part of the federal government but it does not meet the standard's requirements and is not part of the federal government for reporting purposes. In short, we are not bound by the legislation.

Turning to Attachment 2, Mr. Showalter stated that he did not have a problem with the language in paragraphs 16 and 17 but he did not think they were part of the definition. Because the language appears to introduce the funnel (i.e., filtering) concept, he wondered if we needed another header section. As he reads 16 and 17, they really discuss how you apply what we are talking about. He thought this would also get to Mr. Steinberg's point.

Mr. Dacey asked whether paragraph 15, specifically the four examples of sharing the risks and rewards, should be aligned with at least the conclusive characteristics. He believes this causes some confusion.

Mr. Savini replied that the four features listed in the definition were separated from a comprehensive list of risk-based characteristics to help illustrate what we most commonly see in federal P3s. So, if an entity basically does not possess any one of these four features, more than likely they do not have a P3. That is the first part of the filtering process. That is, if you meet one of the four or a combination of the four you probably have a federal P3. Then, you look at the risk-based characteristics which represent higher risk profiles; conclusive and suggestive.

Mr. Showalter suggested clarifying that the four features are intended to be filtering criteria.

Ms. Payne noted that the definition was not originally intended to be that hard and fast. It was intended simply to help people understand the sharing of risks and rewards/benefits. They are necessarily broader because they are talking about the whole universe of P3s, which can have some minor non-risky things. As such, they cannot match perfectly to the characteristics. We could certainly change the lead in to make it more firm, but not all inclusive by saying “evidence of the sharing of risks and rewards includes but is not limited to these four things.”

Mr. Showalter then noted that in so doing, preparers could exit here and never get to paragraph 18.

Referring to Mr. Showalter’s point, Ms. Payne noted that this flies in the face of respondent comments that the definition is too broad.

Mr. Allen asked that staff change the introductory wording as Ms. Payne suggests.

Concerning paragraph 20, Mr. Granof asked what we mean by the statement, “would affect the entity qualitatively.”

Mr. Allen stated that “qualitative” is an undefined term and that members should discuss this term in the context of remote risks to which Mr. Dacey agreed.

Mr. Dacey noted that when we talk about qualitative we do not talk at all about its relationship or impact to the financial statements. Materiality is often taken in relation to the financial statements and embodies quantitative and qualitative assessments.

Mr. Allen questioned Mr. Dacey’s notion that materiality is often taken in relation to the financial statements noting that this might not always be the case. For example, what does qualitative mean in relation to the financial statements? How would we even know how to define that? However, qualitative to an organization such as a company or a government is really talking more about the entity’s risk profile to its constituents or the public it serves. That is, the entity says they are going to follow this qualitative assessment and have disclosures even if it is not material in the quantum sense to avoid adverse concerns with its constituents such as not being very open about its relationships. It is adverse publicity that is really what they are going to be qualitatively concerned with.

Mr. Dacey stated that from an auditor perspective when he views qualitative or quantitative materiality he is looking at the sensitivity of a particular issue or area in relation to the financial statements and the users of those financial statements. What this really gets into is the line between this and business risks.

Mr. Granof asked why we even need paragraph 20 because it deals with materiality which we have defined as quantitative and qualitative. All of this is in the concept of materiality. We do not say this in every standard or in every paragraph and we do not say if it is immaterial do this or that or only address this or that if it is material. We have the materiality box and that seems sufficient.

Mr. Allen noted that we did not have it in the original drafts and that staff is just trying to be responsive to respondent concerns.

Mr. Granof stated that he understood staff's intent but that does not make it right. The trouble is once you include this it suggests that in other areas it does not have to be considered. It seems to him that if we want to emphasize materiality it should be done in the basis of conclusions.

Ms. Payne noted and staff stated that he responded to some board concerns early on in the project and this is why the materiality language is here. This is why some respondents have raised questions. As much as Mr. Granof initially cautioned concerning this matter early on in the project, staff was trying to be sensitive to other member opinions that asked that we make clear that we avoid burdening preparers and readers with immaterial P3 disclosures especially given our broad definition. However, staff agrees with Mr. Granof because materiality goes without saying.

Please recall that very early on in the project we had language that if you triggered a conclusive characteristic the P3 had to be disclosed (whereas triggering the suggestive characteristics would only warrant a consideration). However, we had some on the board who objected to this "slam-dunk" approach so that is why we backed off and softened the language to "should consider" while emphasizing that it is subject to materiality. As you may recall, we had a very long discussion about whether or not materiality includes both probability and magnitude and it was finally agreed that materiality includes both. This is how we got here.

Mr. Allen then said that getting back to Mr. Dacey's first point, he would not mind putting in language that says materiality includes a qualitative impact to the entity.

Staff noted that some respondents discussed reputational risks and this is an example of what Mr. Allen is discussing.

Mr. Reger stated that he would agree as long as you can quantify the economic impact, but if you cannot quantify the economic impact he was not sure what an entity would disclose without opening a box that we really cannot define. The economic impact can be either a negative or positive impact. For example, an agency could get more money from Congress and if we knew what the dollar impact was and it has a material impact that would make sense to disclose. However, the ones where we only hurt our reputation would be problematic because we have nothing to measure them against materiality.

Based on the foregoing discussion, Ms. Payne asked if members would then prefer not speaking to materiality in such direct references.

Mr. Dacey replied that the question is do you add or want more of an explanation of materiality. He does not think that it is a real strong statement that one considers materiality in deciding whether you disclose. However, you could say that you should apply materiality, not just consider it.

However, Mr. Showalter noted that this does raise the question of "should disclose" versus "should consider." This question was not only dealing with materiality, it was also trying to get to a "should" answer. If we take materiality out, we would have to go back and revisit "should" or "should consider" which is a softer requirement than "should."

Ms. Payne replied that the language was to remind people of materiality. If we decide materiality is universal, going to "should" is not really a substantive change. Members will have an opportunity to consider this further at a later meeting.

Disclosures: Refer to ED Q5 – Staff recommends eliminating the requirement for amounts estimated to be received and paid during each of the succeeding five years of a P3 and limiting the mix and amount of funding to the reporting year in question.

The following summarizes Board discussions concerning ED question Q5.

Mr. McCall noted an inconsistency in the disclosures beginning with paragraph 24 where we address the mix and amount of P3 funding. Staff is recommending that the mix and amount of funding be limited to the incurred amounts during the reporting period. However, when we look over at roman numeral II on the next page, it speaks to the amounts received and paid by the government during the reporting periods, obviously to date, and the amount estimated to be received and paid over the life of the P3.

Mr. McCall asked others for their advice in this regard because he thought knowing this information for the entire project would be more meaningful.

Staff explained that he was trying to limit agency burden at paragraph 24 by limiting the mix and amount of funding just to the year in question. Staff agreed that Mr. McCall has correctly noted an inconsistency with the other disclosure at roman numeral II.

Mr. Allen concurred with Mr. McCall noting that he cares a lot more about the total project cost as opposed to just what was incurred this year. In this one period it does not seem like there is going to be anything on the financial statements that we are going to be able to match it to. So, why am I just asking for a one year analysis?

Mr. Allen then noted the other change where staff eliminated the requirement to report in five year time-periods.

Staff replied that he thought it was overkill and an area we could ease preparer burden.

Mr. Dacey stated that we have different purposes here because C2 is more about the commitments we have going forward like we do for leases and B is the purpose of the overall project. But then if you get into questions, if these things are 40 or 99 years, it is interesting because then you have got all kinds of different considerations about how you report that.

Mr. Allen liked Mr. McCall's point and asked why we would not just drop 24.B and say we want to know the cost over the life of this project and what the mix will be. What is the cost and how much of that will be paid by the federal and the non-federal entity.

Staff noted that he would make the change to reflect the aggregate amount over the project's life.

Remote Risk Board Position & Alternative View: Refer to ED Q6 – Because most of the respondents (75.0% or more) disagree with the Board and agree with the alternative view, staff recommended 3 edits: (1) adding a new paragraph 21 tying risks to those which are contractual and eliminating business risks that are not material, (2) eliminating "significant exposure" as a concept and replacing it with "significant risk" along with a footnote explanation, and (3) rewriting paragraph 24.d (ii) noting that if a risk is remote but its impact on the P3's estimated cash flows would be significant and material, it should be disclosed.

The following summarizes Board discussions concerning ED question Q6.

As previously discussed, some members questioned whether the language of the materiality filter sufficiently conveys the concept of qualitative materiality whereas some questioned whether a discussion of materiality is even needed.

Primarily regarding the reporting of risk, the respondents clearly favored the alternative view with respect to the discussion of when disclosure of remote risks is required. Mr. Dacey, who authored the alternative view, questioned whether the inclusion of a discussion of remote risks within the discussion of the materiality filters was needed. He suggested that the terminology from SFFAS 5, *Accounting for Liabilities of the Federal Government*, on contingencies (specifically "probability of loss") should be used rather than "remote risks", and was also concerned with the use of "significant" in discussing a higher threshold for the disclosure of remote risks.

Staff noted that follow-up discussions with several respondents – auditors and preparers – revealed that at the end of the day, they would not disagree to the proposition that low probability risks with high impact potential should be disclosed. Although these were informal comments and no one changed their written positions, this coincides with what Mr. Dacey said at previous meetings, that certain risks should be disclosed even if they are remote.

Mr. Dacey stated the edits made regarding business risks imply that material business risks should be reported. This concerns him and he wonders if we need paragraph 21. Instead, D2 could address remote risks.

In terms of D some respondents went even further than the alternative view (AV) and said no remote risks should be disclosed. The AV suggested remote risks where stated in the contract and it is some number larger than what we currently consider material which as he admits, is an allusive concept. Most tended to link to SFFAS 5 which talks about potential future loss. If we are trying to link to SFFAS 5 and use terms that people understand, which is what he thinks many of the respondents asked for, Mr. Dacey thinks it would be helpful to use SFFAS 5 language in the introduction.

Regarding footnote nine, which is the audit definition related to the risk of material misstatement, Mr. Dacey does not think that is the same risk we are dealing with and he still struggles with a definitive way to describe this higher level of materiality for disclosures, other than to say it is really material or something like that.

The GAO letter has a suggestion which is more akin to where FASB was in its proposal; something that is fundamental to the agency or entity, something that really would be big to them if it occurred in terms of their operations as opposed to simply being over some number which we generally think of in terms of for example, a three percent materiality basis in our audits.

Mr. Dacey is not sure if we can adequately define significant. He knows we use it in the standards inconsistently already. He thinks we could make that a little more clear.

Mr. Allen asked Mr. Dacey what wording he would propose and if he proposed just eliminating paragraph 21 in its entirety.

Mr. Dacey replied that he would propose eliminating 21 and adding a little bit more in D2 about the contractual term.

Mr. Granof sought clarification concerning the elimination of paragraph 21.

In reply, Mr. Dacey said that we can cover his concern under D2 and we can include under the terms of the contract in the introduction. In terms of the remote risk referenced in D2, he believes we could work that wording into D2.

However, Mr. Allen noted that Mr. Dacey did not like the word “significant.”

Mr. Dacey stated that he did not think the word “risk” is consistent with the current structure of SFFAS 5, which talks about losses, and there seems to be some support for trying to parallel SFFAS 5 to the extent possible.

Staff replied that he was prepared to tell the Board that SFFAS 5 is an anachronistic standard but in reality, staff believes the problem is the way people think about SFFAS 5. The respondents with whom staff has spoken with, whether they are auditors or preparers, look at SFFAS 5 in the area of remote risk and they stop where it says remote risks need not be reported.

However, when you take their eyes a little further into the paragraph you see that remote risks are permitted to be reported. As such, referencing to SFFAS 5 is perfectly acceptable because it is our standard, but staff believes we must communicate clearly that preparers may perceive a right not to disclose a remote risk under SFFAS 5, but they also have an obligation as well. As public stewards we need to convey that obligation in this project.

Mr. Allen said that what the Board was agreeing to is that we were going beyond SFFAS 5, which we already know. The Chairman thought what Mr. Dacey was saying was just to the extent we can we use the language from SFFAS 5 we should do so.

Mr. Dacey replied that if you had a specific requirement for disclosure of certain remote risks, he thought that would override SFFAS 5, and if we had to make an amendment to SFFAS 5 we could do that. Therefore, if one goes to SFFAS 5 they would be pointed back to here with respect to P3 risk disclosures. Mr. Dacey thought we could do that.

Mr. Allen did not think we needed to modify SFFAS 5 and stated that we could just leave it alone.

Additionally, Ms. Payne made clear that SFFAS 5 focuses on loss, whereas this project focuses on risk – two distinct concepts – where loss is a downside but risk can have an upside or a downside.

In reply, Mr. Dacey said that we can clarify the concepts and thought it would be important to clarify that difference if we are talking about gain or loss. SFFAS 5 focuses on the loss but he said he would be happy to address the gain, noting however that we have to be careful about gains because auditors and some of the accounting professionals are a little shy on even disclosing gains.

Ms. Payne said that the subtle point is to think about risk versus loss and to her, risk is a broader concept than loss.

Mr. Allen said that auditors know that subtle point.

Mr. Dacey stated that he appreciated Ms. Payne’s point.

Staff noted that there are agencies currently such as DoD that are reporting remote risks. They talk about remote risks and give dollar amounts. So, we have some agencies that are already meeting their obligation under SFFAS 5. It is an inherent and maybe silent obligation, but it is there and he applauds them. Mr. Savini went on to thank Ms. Payne; noting that it is a privilege and an honor to serve this Board. Moreover, he finds it humbling to have someone like Mr. Dacey take an AV, which in a way means that he sees that there is some merit in staff's work, and thanked Mr. Dacey and the Board accordingly.

Mr. Dacey acknowledged staff's compliment noting that although his AV took some time to write, he believes it was worth the effort.

Aggregate or Group Disclosures: Refer to ED Q7 – Because the majority of respondents agreed with this proposal and some saw potential benefit, staff does not advise making any changes.

Pending further review, the Board did not take exception to the staff recommendation.

Comments or Suggestions: Refer to ED Q8 - Staff recommends adding illustrative examples concerning disclosures and adding a footnote describing the term "private sector" as follows:

> "Private sector refers to individuals and entities acting in their private capacities outside of the authority and control of Federal, State or local governments and encompasses for-profit businesses and non-profit organizations that are outside of the authority and control of Federal, State or local governments."

Pending further review,[3] the Board did not take exception to the staff recommendation.

The following summarizes general member comments.

Members suggested that staff better convey the approach of applying a series of filters from the universe of all P3s to those that are ultimately reportable; those requiring disclosure. Members generally noted that the filters include: the exclusions, the conclusive and suggestive risk-based characteristics, and consideration of quantitative and qualitative materiality.

Mr. Showalter suggested inclusion of a graph and Mr. Reger suggested expanding the outreach to seek clarification from additional respondents. Concerning outreach, Mr. Allen proposed that subject to due process protocols, sending a letter to respondents thanking them for participating in our due process and sharing with them some of the things that we've done to try and address and inviting them to provide specific comments or specific wording changes.

[3] On February 23 Mr. Showalter offered several suggested edits to the ED one of which was the elimination of the second use of the word "private"; change from "…in their private capacities…", to "…in their capacities…"

There were no objections to the Chairman's suggestion but Mr. McCall noted that in terms of the letters themselves, many of the letters seemed agency specific and it is hard to write a standard for all agencies when every agency has a different thought. Staff has done a good job of trying to get us where we are, however remote risk or deciding what is significant either quantitatively or qualitatively material are areas that trouble him. Although he agreed that we should go back to the agencies he noted that at some point the Board is going to have to confront the fact that some people and their agencies will still not be ready for this standard.

Conclusions:

- Conduct additional outreach
- Revise ED to further include edits as a result of this meeting's re-deliberations.

- **Leases**

Ms. Valentine opened the discussion reminding the Board that they had previously directed staff to use the Governmental Accounting Standards Board's (GASB) Preliminary Views (PV) on Leases as a platform for developing standards on non-intragovernmental leases – the GASB PV was released for comment in November 2014. At the December 2014 meeting, staff presented a discussion paper analyzing the first three chapters of the PV so that the Board could discuss the GASB concepts as it relates to the development of federal non-intragovernmental lease standards. Staff presented to the Board another discussion paper on the last six chapters of the GASB PV at the February 2015 meeting.

GASB PV Chapter 4 – Lessee Accounting

Recognition and Measurement for Lessees

The GASB Lease PV would recognize a lease liability and an intangible lease asset at the beginning of a lease, unless it is a short-term lease. Staff noted that although the GASB PV proposes that the underlying asset be recognized as an intangible asset, FASAB standards do not specifically require assets to be classified as tangible or intangible.

Staff recommended that the Board propose that federal lessees of non-intragovernmental lease arrangements recognize a lease liability and leased asset at the beginning of a lease, unless it is a short-term lease. Additionally, to remain consistent with the existing capital lease standards, staff recommends that the right to use leased assets be classified as a PP&E asset.

There were no Board objections to staff's recommendation.

Reporting the Lease Liability

According to the GASB Lease PV, a lessee would measure the lease liability initially at the present value of payments to be made for the lease term. Measurement of the lease liability would include the several types of payments that might be required by a lease.

Staff recommended that the Board adopt GASB's PV lessee initial measurement of the lease liability for non-intragovernmental leases at the present value of payments to be made for the lease term.

Mr. Dacey asked staff which definition of "probable" we would be using in the Lease standard, since the FASAB definition is different from GASB's definition. Ms. Valentine reminded the Board that at a previous meeting the Board decided to stay with the FASAB definition of "probable" for consistency.

There were no Board objections to staff's recommendation.

<u>Lease Liability Discount Rate</u>

In the GASB PV the future lease payments would be discounted using the rate the lessor charges the lessee. The *[GASB]* Board believes that this is appropriate because it is the rate at which the transaction is made. However, if that rate cannot be readily determined by the lessee, the lessee would be permitted to use its own incremental borrowing rate.

Staff noted that SFFAS 5 par. 45 outlines the current guidance related to calculating the lease liability. "The discount rate to be used in determining the present value of the minimum lease payments ordinarily would be the lessee's incremental borrowing rate unless (1) it is practicable for the lessee to learn the implicit rate computed by the lessor and (2) the implicit rate computed by the lessor is less than the lessee's incremental borrowing rate. If both these conditions are met, the lessee shall use the implicit rate. The lessee's incremental borrowing rate shall be the Treasury borrowing rate for securities of similar maturity to the term of the lease." This language is consistent with the FASB lease standards in effect when FASAB developed its standards.

Staff recommended that the Board adopt GASB's PV when discounting the lessee future lease payments by using the rate the lessor charges the lessee, unless that rate cannot be readily determined by the lessee; then the lessee would be permitted to use its own incremental borrowing rate.

Mr. McCall asked what is the benefit to adding additional assets and liabilities to the Balance Sheet when the interest expense and amortization expense will still be the same. He also noted that with the grossing up of the Balance Sheet, are there any federal entities that would have to be concerned about their capital asset/net worth ratio (capital targets). Ms. Valentine replied that she was not aware of any entities that would be affected, but that she would specifically ask the task force. Mr. Reger suggested that staff include a question in the exposure draft (ED) addressing this issue.

Mr. Dacey reiterated his point from the December 2014 meeting, suggesting the cost differential between the cost of borrowing at the government's incremental rate vs. a vendor's implicit rate to lease be determined. This cost differential would highlight the cost of leasing when purchasing is an option.

Mr. Dacey suggested that the guidance specifically state that the federal lessee's incremental borrowing rate be the Treasury borrowing rate for securities of similar maturity to the term of the lease.

The Board agreed with staff's recommendation and the Board members' suggestions.

Amortization of the Discount on the Liability

In the GASB PV at subsequent financial reporting dates, the lessee would calculate the amortization of the discount on the liability and report that amount as interest expense (or expenditure, as appropriate) for the period. Any payments made would be allocated first to the accrued interest expense and then to the lease liability.

Staff noted that the current capital lease standards state that the interest method be used to calculate the amortization of the discount on the lease liability. Staff recommended that the Board propose the interest method of amortization be used to calculate the amortization of the discount on the lease liability and that the interest method be specifically mentioned.

Mr. Steinberg suggested that the interest method be explicitly illustrated in the standard (or appendix) to both educate and assure that readers know how to apply the method.

The Board agreed with staff's recommendation and Mr. Steinberg's illustration suggestion.

Remeasurement of the Lease Liability and the Discount Rate

In the GASB PV at subsequent financial reporting dates, the lessee would consider remeasurement of the lease liability and the discount rate if certain changes have occurred, unless the result of the change is not expected to be significant.

Staff recommended that the Board adopt GASB's PV requirements for the remeasurement of the lease liability and reassessment of the discount rate used to measure the lease liability for non-intragovernmental leases.

Mr. Showalter asked if the remeasurement of the lease liability is a normal practice in the federal sector. Ms. Valentine noted that she was not aware of the prevalence of remeasurement with federal entities, but she would ask the task force.

Chairman Allen suggested adding language to specify that only significant changes would require remeasurement.

The Board agreed with staff's recommendation and Chairman Allen's suggestion.

Reporting the Lease Asset

According to the GASB PV, a lessee would initially measure the lease asset as the sum of the amount of the initial measurement of the lease liability; the lease payments made to the lessor at or before the beginning of the lease, less any lease incentives received from the lessor; and the initial direct costs that are ancillary charges necessary to place the asset into service. The lease asset generally would be amortized in a systematic and rational manner over the shorter of the lease term or the useful life of the underlying asset as amortization expense. This would be the case even if the underlying asset is a nondepreciable asset, such as land.

Staff recommended that the Board adopt GASB's PV requirements for the initial measurement of the lease asset and the amortization of that leased asset for non-intragovernmental leases.

Mr. Granof reminded the Board that using the interest method to amortize the lease liability and the straight line method to amortize the lease asset will cause the value of the asset and liability to be different. The use of the interest method to amortize the lease liability will also cause higher interest expense in the earlier years (i.e., frontloaded the interest expense). Mr. Smith noted that this approach is analogous to financing the purchase of a long-lived asset.

There were no Board objections to staff's recommendation.

Lease Contains a Nonbargain Purchase Option

According to the GASB PV, if the lease contains a nonbargain purchase option that the lessee has determined is probable of being exercised, the lease asset would be amortized over the useful life of the underlying asset. If that purchase option is probable of being exercised and the underlying asset is not depreciable, the lease asset would not be amortized.

Staff recommended that the Board adopt the GASB PV requirements when the lease contains a nonbargain purchase option that the lessee has determined is probable of being exercised, the depreciable lease asset would be amortized over the useful life of the underlying asset and a non-depreciable asset would not be amortized.

There were no Board objections to staff's recommendation.

Lease Asset Meets the Definition of an Investment

According to the GASB PV, if the lease asset meets the definition of an investment, a lessee would follow the accounting guidance for investments.

Staff noted that FASAB standards currently do not address "investments" other than investments in Treasury securities. Since the standards are silent on the accounting for investments, staff believes that if a federal entity leases a non-financial asset as an investment, the lessee should consider the lease as a financing purchase and not apply the requirements of the lease standard.

Several Board members asked staff if she was aware of any known cases of federal entities leasing assets for investment purposes. Ms. Valentine noted that she was not aware of any instances, but would specifically ask the task force.

There were no Board objections to staff's recommendation.

Remeasurement of the Lease Asset

According to the GASB PV, if a lease liability is remeasured, the corresponding lease asset generally would be remeasured by the same amount. Most changes to the lease liability would result in a change in the amount the lessee is paying for its intangible asset; this is a change in an estimate. However, if the remeasurement of the lease liability results from a change in an index or rate that is attributable to the current period, the change should be reported in the resource flows statements for the period. If the carrying value of the lease asset has been reduced to zero, any further remeasurement of the liability should be reported in the resource flows statements.

Staff recommended that the Board adopt the GASB PV requirements. If the remeasurement of the lease liability results from a change in an index or rate that is attributable to the current period, the change should be reported in the Statement if Net Cost (SNC) for the period. If the carrying value of the lease asset has been reduced to zero, any further remeasurement of the liability should be reported in the SNC.

Mr. Granof noted that the consequence of adjusting both by the same amount is that the reported value of the asset is totally meaningless and devoid of any conceptual basis. At the extreme, for example, it results in a negative value (and hence the need for the floor to be a zero value with an adjustment in the SCN). He suggested that both the asset and the liability be restated at their fair values in that case.

Mr. Dacey asked staff if the plan is to use the same criteria that GASB is proposing to remeasure the asset. Ms. Valentine said yes. Mr. Dacey suggested talking with those federal entities that would be affected by this requirement to get their thoughts on the triggers for remeasurement and to see if there are any concerns.

Chairman Allen suggested adding language to specify that only significant changes would require remeasurement.

The Board agreed with staff's recommendation and Chairman Allen's suggestion.

<u>Impairment of the Lease Asset</u>

According to the GASB PV, the lease asset, as an intangible asset, would be subject to the impairment guidance in Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries.*

Staff recommended that the Board adopt requirements similar to the GASB PV as it relates to the impairment of the leased asset and propose that the leased asset would be subject to the impairment guidance in *SFFAS 44 Accounting for Impairment of General Property, Plant, and Equipment Remaining in Use*.

Chairman Allen questioned the likelihood of a federal leased asset being materially impaired. Mr. Steinberg noted one instance in a federal entity's financial report.

The Board agreed that the lease guidance should simply direct the reader to SFFAS 44 for guidance on the impairment of a leased asset.

<u>Capitalization Thresholds and Immaterial Items</u>

The GASB PV considered suggestions to propose a capitalization threshold or an exception for leases of individually small items. These are specific applications of the general provision in all GASB pronouncements that guidance does not need to be applied to immaterial items. The use of a capitalization threshold would be a matter of accounting policy for each government based on its facts and circumstances, consistent with treatment of other long-lived assets.

Staff recommended that the Board adopt the GASB PV approach for immaterial non-intragovernmental leases and the use of capitalization thresholds. Staff also agreed to clarify the language in this section.

The Board agreed with staff's recommendation.

<u>Disclosures for Lessees</u>

According to the GASB PV a lessee should disclose the following about its lease activities:

a. A general description of its leasing arrangements, including:

(1) The basis, terms, and conditions on which variable lease payments not included in the lease liability are determined

(2) The existence, terms, and conditions of residual value guarantees provided by the lessee

b. The total amount of assets recorded under leases, and the related accumulated amortization, to be disclosed separately from owned assets

c. The amount of assets recorded under leases by major classes of assets underlying its lease assets

d. The amount of expense recognized for the period for variable lease payments not previously included in the lease liability

e. The amount of expense recognized for the period for other payments, such as residual value guarantees or penalties, not previously included in the lease liability

f. A schedule of future lease payments to be made in each of the subsequent five years and in five-year increments thereafter, with reconciliation to the lease liability for the discount (that represents interest)

g. Commitments under leases (other than short-term leases) that have not yet begun

h. The components of any net impairment loss (gross impairment loss less change in lease liability) recognized on the lease asset during the period.

Staff noted that current standards require disclosures similar to bullets a., b., c., f., and g from the GASB PV as noted above. Staff recommended that the Board adopt the GASB PV on lessee disclosures adding disclosing the amount of total lease expense recognized that relates to non-intragovernmental leases and the discount rate used to measure the lease liabilities.

Chairman Allen suggested that disclosure bullets e., g., and h. be eliminated from the required lessee disclosures. Mr. Steinberg suggested that disclosure bullet c. also be eliminated as a required disclosure. Mr. Dacey suggested that total lease expense be disclosed in total as well as the discount rate used to calculate the lease liability.

The Board agreed with the suggested changes proposed by the Board members.

GASB PV Chapter 5 – Lessor Accounting

Recognition and Measurement for Lessors

According to the GASB PV, lessors should recognize a lease receivable and a deferred inflow of resources at the beginning of a lease, unless it is a short-term lease.

Reporting the Lease Receivable

According to the GASB PV, a lessor would measure the lease receivable initially at the present value of lease payments to be received for the lease term, reduced by any provision for uncollectible amounts. Measurement of the lease receivable would include several types of payments that might be required by a lease.

Remeasurement of the Lease Receivable

According to the GASB PV, at subsequent financial reporting dates, the lessor would consider remeasurement of the lease receivable if certain changes occur, unless the result of the change is not expected to be significant.

Reassessment of the Discount Rate

According to the GASB PV at subsequent financial reporting dates, the lessor would consider reassessment of the discount rate used to measure the lease receivable if certain changes occur, unless the result of the change is not expected to be significant.

Staff recommended that the Board adopt GASB's PV lessor initial measurement of the lease receivable for non-intragovernmental leases at the present value of payments to be made for the lease term. Additionally, staff recommends that the Board also propose that the interest method be used to calculate the amortization of the discount on the lease receivable and that the interest method be specifically mentioned.

The Board did not object to staff's recommendation.

Reporting the Deferred Inflow of Resources

According to the GASB PV, a lessor would measure the deferred inflow of resources at the initial value of the lease receivable, plus the amount of any payments received at or prior to the beginning of the lease that relate to future periods. A remeasurement of the lease receivable generally would result in the deferred inflow of resources being adjusted by the same amount.

Staff noted that the GASB PV proposes that the lessor recognize a “deferred inflow of resources” along with the lease receivable. FASAB standards do not use the term “deferred inflow of resources,” however unearned revenue can be used to recognize future lease income to the lessor for non-intragovernmental leases.

Staff recommended that the Board propose that the lessor recognize unearned revenue along with the lease receivable to recognize future lease income to the lessor for non-intragovernmental leases. As GASB notes in the PV, this approach represents a cost effective approach in light of the complexity in valuing derecognized assets partially leased.

The Board did not object to staff’s recommendation.

Reporting the Underlying Asset

According to the GASB PV, a lessor should not derecognize the underlying asset in the lease, which is a better alternative from a cost-benefit perspective.

A lessor would continue to apply other applicable guidance to the underlying asset, including depreciation and impairment, except in certain circumstances. However, if the lease agreement requires the lessee to return the asset in its original or enhanced condition, a lessor would not depreciate the asset during the lease term.

Staff recommended that the Board adopt the GASB PV approaches allowing the lessor to continue to apply other applicable guidance to the underlying asset, including depreciation and impairment and not to require derecognition of the leased asset.

Mr. Steinberg asked if service concession agreements would be within the scope of the lease standard. Ms. Valentine stated that she would research the topic.

Chairman Allen disagreed with the GASB approach to not depreciate the leased asset when the lease agreement requires the lessee to return the asset in its original or enhanced condition – changing the language to say, “…..a lessor may not have to depreciate the asset during the lease term.” The Board agreed with Chairman Allen’s suggestion.

Disclosures for Lessors

According to the GASB PV, a lessor should disclose the following about its lease activities:

a. A general description of its leasing arrangements, including the basis, terms, and conditions on which any variable lease payments not included in the lease receivable are determined

b. The cost (and carrying amount, if different) of assets on lease or held for leasing, by major classes of assets, and the amount of accumulated depreciation

c. The total amount of revenue (including lease revenue and interest revenue) recognized in the reporting period from leases

d. The amount of revenue recognized in the reporting period for variable lease payments and other payments not previously included in the lease receivable, including revenue related to residual value guarantees and termination penalties

e. A schedule of the future lease payments that are included in the lease receivable for each of the subsequent five years and in five-year increments thereafter, with reconciliation to the lease receivable for the discount (that represents interest)

f. If the government has issued debt for which the principal and interest payments are secured by the lease payments, the existence, terms, and conditions of options by the lessee to terminate the lease.

Staff recommended that the Board adopt the GASB PV on lessor disclosures with the exception of not disclosing the amount of interest income recognized that relates to non-intragovernmental leases and the discount rate used to measure the lease receivables. Staff believes that these additional disclosures would be essential information for users of federal financial statements.

Mr. Showalter asked if disclosure bullet f. was applicable in the federal sector. Ms. Valentine stated that she was not aware of any specific situations, but that she would ask the task force members. The Board agreed that if that situation was not applicable in the federal sector, it would not be included in the exposure draft.

The Board agreed with staff's recommendation and Mr. Showalter's suggestion.

GASB PV Chapter 6 – Short-Term Lease Exception

According to the GASB PV an exception for these short-term leases could provide cost relief without sacrificing significant information about a government's leasing activities.

Definition of a Short-Term Lease

According to the GASB PV a short-term lease should be defined as a lease that, at the beginning of the lease, has a maximum possible term under the contract of 12 months or less, including any options to extend. The GASB PV on the accounting for short-term leases does not include the recognition of interest revenue or expense/expenditure. A lease should be evaluated for its maximum possible term, including any options to extend, regardless of the probability of extension.

Staff recommended that the Board extend the short-term lease exception to two years to remain consistent with the existing criteria of a 2-year useful life for PP&E capitalization (SFFAS 6).

Mr. Smith suggested that the probability of extending the lease beyond the initial lease term be assessed when determining if a lease meets the definition of short-term.

The Board agreed with staff's recommendation and Mr. Smith's suggestion.

Accounting for Short-Term Leases

According to the GASB PV, any lease that meets the definition of a short-term lease would be required to follow the accounting guidance described below.

Lessee Accounting

According to the GASB PV, a lessee should recognize short-term lease payments as expenses or expenditures based primarily on the payment provisions of the contract. A lessee would not recognize a lease asset or liability for a short-term lease.

Lessor Accounting

According to the GASB PV, a lessor should recognize short-term lease payments as revenue based primarily on the payment provisions of the contract. A lessor would not recognize a lease receivable or deferred inflow of resources for a short-term lease. A lessor would not be required to make any disclosures related to short-term leases.

Staff recommended that the Board adopt GASB PV requirements for the lessee and lessor accounting for short-term leases.

The Board did not object to staff's recommendation.

GASB PV Chapter 7 – Lease Terminations and Modifications

According to the GASB PV the accounting should be different when a lease is terminated or modified.

Distinguishing between Lease Terminations and Modifications

According to the GASB PV, an amendment to a lease contract should be considered a modification unless the lessee's right to use the underlying asset decreases. The [GASB] Board believes that an amendment that diminishes (but does not fully end) the lessee's right to use the underlying asset should be accounted for as a partial lease termination. In contrast, an amendment that retains the lessee's right to use the underlying asset should be accounted for as a lease modification.

Accounting for Lease Terminations

According to the GASB PV, a lessee generally should account for the full or partial termination of a lease by adjusting the carrying values of the lease asset and related liability and recognizing a gain or loss for the difference.

According to the GASB PV a lessor should account for the full or partial termination of a lease by adjusting the carrying values of the lease receivable and related deferred inflow of resources, and recognizing a gain or loss for the difference.

Accounting for Lease Modifications

According to the GASB PV, a lessee should account for a lease modification by remeasuring the lease liability and adjusting the lease asset by the difference between the modified liability and the liability immediately before the modification.

According to the GASB PV, a lessor should account for a lease modification by remeasuring the lease receivable and adjusting the deferred inflow of resources by the difference between the modified receivable and the receivable immediately before the modification.

Staff recommended that the Board adopt GASB PV requirements for the accounting for lease terminations and modifications.

Mr. Steinberg asked staff to clarify the lease modifications language.

The Board did not object to staff's recommendation or Mr. Steinberg's suggestion.

Chapter 8 – Subleases and Leaseback Transactions

Subleases

According to the GASB PV, subleases should be accounted for as transactions separate from the original leases. Therefore, the lessee in the original lease would recognize a lease asset and liability as lessee in the original lease and a receivable and deferred inflow of resources as lessor in the new lease (sublease). Because there are two separate transactions involving different parties, netting of the elements of each transaction would not be appropriate. Information about subleases would be included in the general description of lease arrangements that is a proposed disclosure for both lessees and lessors.

Sale-Leaseback Transactions

According to the GASB PV, a sale-leaseback transaction should include a qualifying sale in order to be eligible for sale-leaseback accounting. The sale and leaseback portions of a sale-leaseback transaction should be accounted for separately as a sale transaction and a lease transaction, except that any gain or loss on the sale should be deferred over the term of the lease. A seller-lessee would be required to disclose the terms and conditions of sale-leaseback transactions.

Lease-Leaseback Transactions

According to the GASB PV, a lease-leaseback transaction should be accounted for as a net transaction, with disclosure of the gross amounts for each portion of the transaction. In a lease-leaseback, each party is both a lessor and a lessee.

Staff recommended that the Board adopt GASB PV requirements for the accounting for subleases and leaseback transactions. Staff also recommends that the Board specifically state that when the sublease lessor and the sublease lessee are both federal entities the intragovernmental lease accounting standards would apply.

The Board did not object to staff's recommendation.

Chapter 9 – Leases with Related Parties and Intra-Entity Leases

According to the GASB PV, leases with related parties and intra-entity leases is that existing literature provides guidance on these types of leases and that guidance remains appropriate.

Staff recommended that the Board adopt the GASB PV approach that leases between related parties should be recognized based on the substance instead of the form of the transaction. Additionally, if the related party does not meet the definition of a consolidation entity as defined by SFFAS 47, the lease transaction should be considered a non-intragovernmental lease and would follow the non-intragovernmental lease standards in addition to the SFFAS 47 disclosure requirements.

Mr. Steinberg suggested that illustrative journal entries be included in the standard or appendix explaining the accounting for subleases and leaseback transactions.

The Board did not object to staff's recommendation or Mr. Steinberg's suggestion.

Staff noted that the Board has previously agreed that intragovernmental lease arrangements should be accounted for differently than leases between federal entities and non-federal entities and standards are being developed to address intragovernmental leases.

Conclusions: Staff will be meeting with the task force to discuss the Board's tentative decisions. Staff will also begin drafting an exposure draft.

- **Tax Expenditures**

Ms. Payne began the discussion by noting that members thoughts on the definitional challenges identified in the briefing memo will affect the project plan. She noted that definitional challenges might be considered measurement challenges, as well, because the definition is so critical to measurement. She indicated that the core issue is whether members will accept the existing definitions and estimates so that the focus would be on narrative and potentially identifying amounts for presentation. The first two options in the memo do not envision the Board affecting the measurement and estimation process as they rely on existing processes. The distinction between the two is that the first (A) would not require presentation of amounts but might refer to a source for estimates while the second (B) would require presentation of estimates.

The third option (C) is a bigger effort in which the Board would dictate definition and estimation. She noted that most members had previously indicated a preference for the second (B) option.

Member comments included:

1. Words alone cannot describe the magnitude of an issue. Amounts are needed but a financial statement is not needed. There is some appeal to Dr. Marron's six categories but even these may not be needed. The notion would be to rely on the existing definitions and estimates so this member supported Option B.

2. Some concern exists regarding the practicality and/or the methodology for the estimates even if we are relying on existing definitions and estimates. This member did

not support waiting but thought it would be inappropriate to ignore that we may want to have some influence on what is measured, captured, and eventually displayed.

3. A member supported Option A as a minimum and noted that placement of information as basic or required supplementary information would influence his views regarding display of estimates. He was concerned not only about auditability but also about what the estimates actually represent and the caveats included in the narrative.

4. Another member viewed this as a first stage; identifying the information that we need. So, the member supported using the present definition. He preferred Option B because there should be estimates and we should have a sense of where the numbers are coming from. Narrative should help people understand that these are broad estimates. This would enhance awareness of the issue and build a base for a future stage.

5. Another member supported Option B because amounts are needed. We could go down the route of identifying an acceptable source by creating some criteria about what type of organization would do the estimates. The member was unsure about the ability to create some criteria about what the organization would have to do; that is, what type of due diligence they would have to go through to be able to establish estimates. The goal is to constrain the presentation of numbers so there is some level of discipline.

6. A member expressed the desire to recognize tax expenditures as part of the financial statements but acknowledged that the perfect should not stand in the way of the good. The member supported Option B.

7. Another member supported Option B and suggested identifying the most significant tax expenditures for which estimates should be reported. He further noted that grouping tax expenditures may be helpful.

8. A member noted the need for numbers if we want to provide an understanding of the full economic cost. He noted that groups of expenditures could be associated with components. For example, identifying the top few that relate to housing and then identifying these with the department's goals would enable people to see the full cost of trying to achieve that goal. The Board’s starting point should be to determine the point that we want to get across and then figure out what we need to do to get there. He thought this was Option B.

9. One member supported Option A but did not object to Option B.

Ms. Payne noted that Option A was the staff recommendation because of the challenges in adding estimates together due to the interrelationships. She indicated that members’ supported option B and that their additional thoughts would inform the charge to the task force and the project plan. The plan will include a strong emphasis on identifying amounts and ways to explain how to consider the amounts as well as what inferences you should not draw from the amounts.

In response to a member's question about placement in notes or RSI, Ms. Payne said that if asked today she would propose requiring a discussion of tax expenditures in MD&A that refers readers to the source of comprehensive tax expenditure estimates. To include numbers in MD&A, she would focus on the top five and not require them to be added together in any way or by any grouping. In the notes on revenue, she would require narrative explaining the role of tax expenditures with absolutely no numbers required.

Members discussed individuals who might join the task force.

Conclusions: Staff will develop a project plan for Board comment and begin forming a task force.

- **Steering Committee Meeting**

Ms. Payne explained that revised salary amounts are not available yet. For the April meeting, she expects to provide updated FY2015 and 2016 amounts as well as FY2017 needs.

Adjournment

The Board meeting adjourned for the day at 5:30 PM.

Thursday, February 26, 2015

Agenda Topics

- **Department of Defense Request for Implementation**

Ms. Loughan explained the objective of this session is to discuss progress on the Department of Defense (DoD) Implementation Guidance Request project. Ms. Loughan explained in regards to the research and development area, staff held a kickoff meeting with DoD. Staff explained several participants asked about the origin of this particular issue and questioned whether this was an area that needed guidance.

Based on the feedback at the kickoff meeting, FASAB suggested DoD take time to assess whether FASAB assistance within the GAAP hierarchy is needed. Ms. Loughan explained it appeared that most of the issues related to internal use software. DoD agreed and the research and development portion of the DoD Implementation Guidance Request Project will be paused unless further information comes up that warrants FASABs guidance will be necessary in this area. However, Ms. Loughan explained that after the briefing materials were distributed, FIAR requested a FASAB liaison for each of their working groups to assist on discrete issues. FASAB's role will be to assist if there is a need for GAAP guidance.

Next, Mr. Jackson provided an update on the valuation of legacy inventory and operating materials and supplies. He explained that he provided an update (electronic and hard copies were available) to the materials provided for the meeting. The updates included the following:

1. Updated status of information requests from the branches

2. End User Observations

3. Ability to Provide Historical Turnover Rates Observations

Mr. Jackson explained that the updated materials included excerpts from the IPSAS No. 33, *First Time Adoption of Accrual Basis International Public Sector Accounting Standards*. Mr. Jackson also provided a summary recommendation on accounting for inventory and related property at transition from a non-GAAP to a GAAP state with the materials for the Board's consideration.

Mr. Jackson summarized research in various areas as it pertained to inventory and operating and materials and supplies and the understanding of accounting and valuation processes at each branch. He explained that the project used an extensive questionnaire process to determine how the Military Departments accounted for inventory historically. This included determining the population of legacy systems and the valuation methods used by those systems.

Mr. Jackson explained that nothing has really changed from what he discussed in December regarding that information. Based on the information gathered, DoD legacy systems do not track the historical cost of inventory. Instead, most DoD legacy systems valued inventory and related property at latest acquisition cost or standard cost (selling price). He explained that legacy systems do not maintain a record of the cost of previous purchases. Mr. Jackson noted that this effectively makes it all but impossible for the Military Departments to revalue inventory and related property held at transition from a non-GAAP to GAAP state to historical cost.

Mr. Jackson explained that the Military Departments also advised that they do not have the information to provide historical turnover rates for the purpose of identifying stock items that have turnover rates such that the valuation would approximate historical cost. He also added that all the legacy systems have been sunset, though there are a few exceptions. DoD no longer has a data base from which it could provide turnover rates.

Mr. Jackson explained that Defense Logistics Agency (DLA) migrated to an Enterprise Resource Planning (ERP) system several years ago and accounts for inventory at moving average cost. Generally speaking, DLA has all the inventory items that the Military Departments have since it is the principal supplier. Because the military departments said they could not provide turnover rates, he asked if DLA might be able to provide turnover rates. He noted that this information might be useful in determining the turnover rates for inventory and related property held by the Military Departments. DLA indicated that they felt they could provide the turnover rates. Mr. Jackson noted that developing turnover rates and comparing DLA data to inventories held by the Military Departments would be no small undertaking. The Army has over 100,000 individual national stock numbers in their working capital fund inventory and the Navy has over 300,000 national stock numbers in its working capital fund inventory.

A member asked if the database could be manipulated. Mr. Jackson suggested that it might be possible at DLA on a select basis. However, he struggles with breaking inventory down in such a manner because certain information (such as munitions) is not maintained in a system such as the one at DLA. Mr. Jackson also explained that while DLA's response was yes, he questions the value of this information. If the information was available, how would that impact a standard revision that recognized the acceptability of using something other than historical cost at transition to an acceptable methodology?

Members asked if the current processes correctly account for the new purchases. Mr. Jackson explained that the current processes as they have been described account for new purchases properly.

The Board discussed the transition period. Mr. Jackson explained "transition period" is necessary because the Military Departments did not transition all inventory and related property to systems that have moving average cost functionality at one time.

Mr. Smith asked if one simple approach would be to say that at the start of adoption, they could use present purchase price and disclose that in the financial statements so that any reader in the financial statements knows that this is not historical cost. He explained that going forward, there would be moving average cost. He believed over a period of time, it is going to work itself out and it did not appear to be worth more effort. Mr. Allen agreed with Mr. Smith and explained this was similar to the deemed cost approach.

Mr. Jackson explained that is the reason deemed cost is so important. He explained the transition period is the period over which an entity can transition to full compliance. He explained that he does not know when a military department might be in full compliance with the existing inventory standard. He explained with a deemed cost approach and disclosure of this valuation method at transition, DoD will have achieved a principal objective and evolved to compliance with the accounting standard.

Mr. Allen explained that he thought the transition period meant you have three years to transition and that it is a safe haven for those three years.

Mr. Smith explained he interpreted the transition period to be a three-year period with the starting point at any point in time in that three-year period, but the deemed cost is just for the initial transition, not for new purchases. Once you transition, every additional inventory item you add to the system has to be at cost.

Mr. Reger explained that his understanding is that a transition period is for the cost system valuation to provide assurance and those that use deemed cost continue as long as the inventory stay at deemed cost.

Mr. Jackson explained the transition period is needed because there are military departments that are at different points at transition and some that have already transitioned. The importance of the transition period is they have to transition within this period of time. If you have transitioned from a legacy system to an ERP that is compliant, this provision does not apply. However, when you do make that transition, you can transition following this guidance within a window of 36 months (or a to be determined timeframe) or some may have transitioned prior to the 36 months. The transition period is to give them time to bring the inventory that they currently have in a non-compliant state into a system that is a compliant system.

Mr. Granof noted that DoD's $200 billion in inventory is not trivial, but he questioned the notion that the Board is discussing the value for a transition period for a couple of years. He wondered why the Board is discussing the difference between basically an exit value or an entry value and if they should be debating this issue? Mr. Jackson understood his point and stated it aligns with Mr. Smith's views. In essence some could question the value of spending a large sum of money to try to perfect a value that may be fleeting. DoD needs help to get over the transition point from the past to the present, without spending large sums to perfect past information that makes no managerial difference.

Mr. Granof agreed but he does not see why the Board must specify which valuation method is acceptable when the Board is concerned with promoting good accounting and encouraging DoD to get on the right track. Mr. Jackson explained that the current standard states they will account for inventory using historical cost so the Board needs to get them over that ledge. The standard would state that using some other method is okay for a transition period.

Mr. Reger explained that he had many of the same questions as Mr. Granof regarding why the Board is spending money, effort, and time around something that granted may be somewhat a simple solution for DoD. Mr. Jackson explained that the Board needs to lay out a simple solution to this particular issue. However, the simple solution is one that the international standards setters addressed through the acceptability of deemed cost.

Mr. Reger asked if there are things that would be subject to the transition period and some that would not. Mr. Jackson explained that he believes it is a universal solution and would not recommend breaking things into cohorts. We are trying to provide relief for the legacy transition. Everything that transitioned would be subject to it, not some subset of it.

Mr. Dacey explained that SFFAS 3 requires inventory and related property to be capitalized when certain conditions are met, and historical cost is the basis. As he understands what is proposed, it is a proxy for historical cost because as the new items come in DoD has switched to moving average cost. Therefore it appears DoD will have a legacy or a base layer of inventory at something other than historical cost. Mr. Dacey explained that over time that will work itself out. He does not believe there is a need for any permanent change to historical cost if in fact the theory is that they will eventually get to historical cost once the inventory turns over. The question is what to do in that interim period. Mr. Dacey explained that if the Board says they can use some other basis, it raises the question if that basis is auditable. Simply because it says it is measured at latest acquisition cost at the transition, it does not mean it really was latest acquisition cost if there is not supporting evidence.

Mr. Dacey also explained that there is the issue of disclosure and what to tell the reader about the accounting method. He explained it becomes a challenge because there is a blended inventory valuation method.

Mr. Granof explained if a clean opinion is several years anyway, then the issue would take care of itself and almost disappear. Mr. Dacey explained he thought it would and that is why turnover rates are important.

Mr. McCall brought up another question on turnover. He asked if they are only turning over the newest things would not there also be an issue of the quality of the inventory. Mr. Jackson explained that deals with the impairment of the inventory and certain types of inventory if it does not turnover becomes obsolete. For example, certain types of munitions could pose a danger if they do not turnover rapidly and would be subject to destruction and a write down process.

Mr. Allen asked the Board members to provide input on the recommendation. Ms. Payne noted that the recommendation allows the use of replacement cost, which can be LAC or net realizable value (selling price less any material cost). She asked if some branches transitioned using selling price. Mr. Jackson explained that they did. For example, the Army system has selling price data in it. The selling price is used by working capital fund and it is the price the fund charges the user and that price is reestablished every year. Mr. Jackson explained for the working capital fund, the selling price is the net realizable value. Staff noted that current replacement cost is not precisely the same as latest acquisition cost because current would be interpreted as of the reporting date. If the goal is to approximate historical cost, then the latest acquisition cost 10 years ago is closer to historical cost than current replacement cost. She asked that the Board confirm that they approve the latest acquisition cost as a proxy for historical cost at transition and selling price as a proxy and there was no objection.

Mr. Allen asked the Board members to provide input on acceptable valuation methods (options include LAC, Selling price (standard price), Deemed cost, other) and their thoughts on the application of an acceptable transition period.

Mr. Smith explained because we are allowing a transition to go forward, he is fine with all three methods. He explained the Board could include a preference of the order in the standard; but be permissive as long as they disclose it.

Mr. Showalter asked if the Board may potentially have to consider this again regarding another issue with DoD. Are there other areas with which DoD or other entities may have GAAP compliance issues? He suggested that it may make more sense to issue a standard on transition that would be broad enough that it would cover this and other potential areas. Mr. Showalter explained he wanted to be clear he is supportive because he knows timing is an issue but wanted to add the suggestion to broaden the scope of coverage of a transition standard.

Mr. Jackson agreed it is a good point for consideration especially considering the unknown issues at DoD. Perhaps a transition standard such as the IPSAS standard makes more sense than trying to amend SFFAS 3. He suggested that he could work with FASAB staff on determining the best mode and perhaps there could be value in speaking with DoD on whether there are other areas that may have transition valuation implications.

Mr. Smith also indicated support for broadening to all assets. He suggested that we may need to spend some more time to think about it, but at this point he would be open to consider that as well.

Ms. Payne explained that Mr. Showalter's point is well taken and internal use software (IUS) could be another area because with IUS, the Board did it prospectively. DoD may be at a point where other entities implemented SFFAS 10, so DoD has a 10 or 12-year gap. In addition, there may be other places that we need to consider the transitioning issue.

Mr. Reger explained that he is supportive and would want to cover more so that we do not have to come back and have the same discussion on other classes of things provided that on a day certain they are doing the right accounting going forward. Mr. Allen explained that he supports what Mr. Reger said.

Mr. Dacey explained that he was not sure modifying SFFAS 3 was the right answer and perhaps the Board should consider another vehicle. He questioned from a conceptual standpoint if it had to be in a standard, particularly considering it relates primarily to one entity. Mr. Dacey explained that he agreed that valuation for the legacy inventory at the point of transition is important and the transition period is also very important. It becomes a technical point in which you declare transition. Mr. Dacey explained that it gets back to how you measure that. If there is enough data in the new system and they can analyze turnover and can see that the legacy cost is pretty much flushed out of the system, then it may be safe to say it is done.

Mr. Jackson explained that their thoughts for transition periods are different. Mr. Jackson explained he was not talking about transition to mean that old cost is flushed out of the system. He was referring to transition in the context of it being permissive to use a legacy value at the moment you move to a compliant system. Mr. Dacey asked to what extent they are not transitioned already. Mr. Jackson explained the munitions in the Army have not been moved and there are things in the Navy that have not been transitioned. Mr. Jackson explained that is what the transition period would apply to; it has nothing to do with the imperfect state of the data. Mr. Jackson explained that it is possible that the Board may want to provide a term for inventory during the period during which inventory was valued on a mixed basis such ‘modified historical cost.’ That term could be used to describe inventory until there was evidence it was strictly moving average cost.

For example, DLA went through a very exhaustive exercise to move their inventory to their ERP. However, DLA may not have data yet that would indicate that the data was fully moving average cost compliant. In that particular case, DLA could use the term ‘modified historical cost,’ if the Board chooses to go that route. They would need to go through an analysis to see for example if inventory turnover rates were such that they could assert that they were in full compliance with SFFAS 3.

Mr. Dacey explained that is his point, it really is what the basis of accounting is when they switch over. Mr. Jackson explained that he is not certain that there are many other alternatives if the Board is going to offer assistance. He believes it is best to view this as a period of time to move from a non-compliant to a compliant system and the data in that compliant system will be mixed data for a period of time. During that time, it could be described as modified historical cost. The point at which it could be referred to as historical cost would be dependent upon the ability to demonstrate that the data represented historical cost.

Mr. Dacey asked if the transition period is something that DoD would prospectively determine or are they effectively in that already? He noted that in the international standards, the entity establishes that initial point of transition. Mr. Jackson explained that the way it is referred to in his recommendation is that it would not be a DoD decision. Instead, it is the effective date of the standard, then DoD would have three (or some other number) years to bring data from legacy systems to systems that had the capability to comply with historical costs. Mr. Jackson explained that his recommendation was trying to address that you do not allow this to go on infinitely. Instead, standards would encourage behavioral change and push the entity because they are trying to get an opinion.

Mr. Dacey noted the issue of documentation had been raised and what would they need to support historical cost. Mr. Jackson explained that the existence of documentation is an area of concern where transition from legacy systems occurred in past years. At this time he does not have a proposed solution for this issue.

Mr. Allen suggested that issue be considered further. Mr. Allen explained that he supports the recommendations for valuations alternatives at transition and also broadening if necessary. However, he questions a lengthy transition period because based on what has been described it appeared that DoD has either already done it or they are in the process of doing it. However, he recognized a transition period may be necessary, especially if it is broadened.

Ms. Davis voted for the recommendations as explained.

Mr. Steinberg voted for the recommendations, but wanted to confirm that deemed cost would include latest acquisition cost.

The Board agreed that deemed cost should be written broadly or generically and so that it works for DoD. It will embrace the ideas discussed such as latest acquisition cost and offer options for DoD.

Mr. McCall explained that he was in favor of the transition period and deemed cost. He explained DoD should make a decision if they use a deemed cost so they are consistent as much as possible within the branches of service and what is best for them.

Mr. Granof voted for the recommendations and explained that he believes it is going to work itself out in a few years. Mr. Allen suggested that if the scope is broadened to PP&E, it may take more than a few years. Mr. Granof explained that even with PP&E, it will eventually work itself out.

Mr. Reger suggested that the Board be cautious and consider the implications for other organizations that might get swept into a standard such as this. He asked if it might apply to others in their entirety with the reporting entity standard. Mr. Reger explained that he is incredibly supportive of coming up with a transition process but wanted to ensure it be done in a thoughtful manner. Mr. Dacey explained that the practical side of that is virtually all the agencies --when you consider material dollars--are already audited. This would affect any new entity adopting FASAB standards or new reporting entities.

Conclusions: It was agreed staff would consider the Board member comments regarding acceptable valuation methodologies for Inventory and Operating Materials & Supplies at transition to systems capable of accounting in accordance with SFFAS 3 when historical cost information is unavailable and develop a draft proposal for the Board's consideration at the April 2015 Board meeting. For example, the Board agreed that deemed cost should be written broadly or generically so that could be adapted to DoD. In addition, staff will consider broadening the scope (such as a first-time adopter standard and/or if it should be for all assets) and determine the best approach (standard, technical bulletin).

- **Risk Assumed-Insurance Programs**

<u>The following was discussed in relation to **Question 1**—Does the Board agree with the revised scope section?</u>

Ms. Gilliam presented the following update to the scope section #2:

This Statement provides general principles that should guide preparers of GPFFRs in accounting for and reporting on premium revenue, related claims and liabilities and other losses of insurance programs. ***Matters not addressed in this Statement should be reported in accordance with other standards.***

The Board agreed with the revision, but requested that staff include qualifying language in relation to the last sentence **(bolded)**. The qualifying language should address accounting for such items as borrowing, investing and appropriations that are found in other Statements.

Staff will update.

The following was discussed in relation to **Question 2**—Does the Board agree with how the criteria for insurance programs were modified?

Ms. Gilliam explained that the criteria for insurance programs were so broad that they would not exclude or include any programs meeting the basic definition. She reviewed how the criteria, as originally presented in the October 2014 proposed standards, were relocated to other sections from the original:

1. Staff will include **a.i**. in the basis for conclusions because Board members pointed out that most insurance programs are *administered by an agency established to do so or within an agency that administers many programs* and does not need to be a specific criteria for insurance programs.

2. Staff consolidated the criteria in **a.ii**. into the premiums definition.

3. Staff consolidated the criteria in **a.iii – v** into the insurance contract definition.

Mr. Showalter was concerned that **a.ii.** was not all accounted for:

> *Insurance programs collect exchange or non-exchange revenue that may be earned through, but is not limited to, any or all of the following: premiums, fees paid, assessments, excise taxes, penalties and/or fines, recoveries, interest received from investments and/or receivables, and/or budget authority including appropriations and borrowing authority*

Ms. Gilliam confirmed that she should have identified where each piece of **a.ii.** was moved to, and therefore explained:

- Exchange criteria were moved to the premiums definition,
- Nonexchange will be presented in a future version,
- Recoveries became its own definition, and
- Investment income and budget authority was moved to the disclosure section.

The Board agreed with how the criteria for insurance programs were modified.

The following was discussed in relation to **Question 3**: Does the Board agree with the insurance program classifications?

Staff recommended the following classifications for the insurance program standards:

1. Exchange Transaction—Insurance
2. Exchange Transaction—Life Insurance
3. Nonexchange Transaction—Insurance

Mr. Showalter recommended the following classifications:

1. Short-duration
2. Long-duration

Ms. Gilliam said that staff would like to defer this discussion until after more research is done and she could present classifications that will capture all current and future insurance programs.

Mr. Steinberg asked if everything will be in one Statement. Mr. Showalter said that he wanted to make sure that we were not constricting the standards and wanted to create bigger buckets. Ms. Gilliam explained that this will be one Statement modeled after SFFAS 5[4] and how it distinguishes the different types of liabilities. Ms. Gilliam confirmed that we hoped not to constrict the standards..

Mr. Smith noted that the only difference between #1 and #2 is that #2 is long-term. He also asked about hybrids, such as part exchange, part nonexchange. Ms. Gilliam said that staff research and recommended classifications will address hybrids, for example, the terrorism risk insurance, as well as contract duration.

In order to simplify the standard, Mr. Allen recommended the term "exchange-like" for those exchange/nonexchange hybrids. Ms. Gilliam said that staff will review the recommendation to ensure compliance with SFFAS 7[5] that identifies these types of revenues.

Members agreed that staff should continue researching in order to develop the insurance categories.

The following was discussed in relation to **Question 4**: Does the Board approve the name Liability for Losses for Remaining Coverage?

Ms. Gilliam presented the name Liability for Losses for Remaining Coverage as an alternative to Liability for Premium Deficiency.

Mr. Showalter suggested the name Estimated Losses on Remaining Coverage.

Mr. Allen asked if there were any other recommendations. Mr. McCall suggested Liability for Losses beyond Intended or Established Coverage.

[4] SFFAS 5: Statement of Federal Financial Accounting Standards 5—Accounting for Liabilities of the Federal Government.

[5] SFFAS 7: Statement of Federal Financial Accounting Standards 7—Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting.

Members agreed that, as a line item on the financial statements, that it clearly indicates that this liability is a net amount.

Members recognized that the term “losses “is used in other standards and signifies an amount net of recoveries.

Mr. Allen took a vote and a majority of the members approved the name: Liability for Losses for Remaining Coverage.

Mr. Smith requested that staff include a definition. Ms. Payne explained that staff did not include a definition because defining a liability generally extends to notions of recognition and measurement. Such guidance normally goes into that section without an additional definition. Mr. Smith noted that most of the definitions are more generally accepted and this one is newly created and should be included in this Statement as a definition. Other members agreed.

Ms. Gilliam referred members to Attachment 1, paragraph 21 as the current definition. Mr. Smith requested that staff provide a shorter and more concise definition without the accounting information.

The other members agreed; staff will add a definition.

<u>The following was discussed in relation to **Question 5**: Does the Board approve the disclosure for breaking out insurance program information?</u>

Ms. Gilliam presented Mr. Showalter’s concern with the word “major” in paragraph 23:

*For each **major** insurance program and collectively for all other insurance programs the following information should be disclosed:*

Noting that the word “significant” is more widely used in the standards and does the word “major” provide clarity for auditing.

Mr. Dacey noted that this is similar to the note break-out for dedicated collections. Other members agreed.

Ms. Payne said that for dedicated collections, the standards provide a paragraph of guidance on selecting the funds to be presented individually noting that this requires judgment and allowing use of quantitative factors, such as: percentage of revenue from dedicated collections, cumulative results of operations for the funds, and qualitative factors, such as: is it an immediate concern to constituents, is it politically sensitive, is it accumulating large balances, and whether the information in the financial statements would be the primary source of financial information.

She noted that the factors might be different for insurance but asked if this is the type of guidance the Board envisions?

Some Board members said that as standard setters we cannot define “program.” Ms. Payne asked if we could change the word to something like, “major category of insurance.” The Board did not disagree.

The members continued to discuss what items to show and possibly to break out on the CFR.

Ms. Gilliam asked the Board if the recommended breakout would provide more clarity to the existing insurance note on the CFR. In addition, she asked the members if they want FASAB to move forward with combining financial information with performance information, noting that staff used the dedicated collection disclosure as a model because insurance revenue is dedicated to paying for insurance losses. She pointed out that there was no negative input from the task force on this break out.

Mr. Dacey asked where we want to see this level of detail. For the consolidated financial report (CFR) there is one line item for the liability. What do we want to see in the notes and what is the materiality consideration? While the standards are applicable from the program up through the department and to the CFR, currently for details users are directed to the agency’s statements

Ms. Davis said she was not sure that the CFR would support a dedicated collection type of note for insurance programs.

Ms. Payne suggested that for the government-wide, you might see insurance programs in general not being significant enough to even want major ones shown individually. Or, you might just have the liability information rather than the programmatic performance type information.

Mr. Dacey said that today we have line items for a couple of the major programs like FDIC that are separately identified as components in the footnote of the liability. Do we want Agriculture to break out crop; DHS to break out flood?

Ms. Gilliam said that DHS does disclose information about flood insurance; however, it is not in this format.

Mr. Reger noted that we take Pension Benefit Guarantee out of Labor stating that it depends on how much concentration you want around one of these programs in a display that large.

Ms. Gilliam asked if this is a precedent the Board wants to set moving forward with the other phases of risk assumed.

Members said they want to make sure we are displaying risk appropriately and that the performance information will not present a negative picture on the people running the program because the program structure may be set up to provide for subsidy funding.

No decision was made by the Board.

The following was discussed in relation to **Question 6:** Does the Board have any additional comments on the proposed standards?

Revenue and Measurement line 17, page 4 of 8: Ms. Gilliam presented Mr. Steinberg's request to remove the word "liability" from unearned revenue, because he did not feel it is a liability, that it is just on the liability side of the balance sheet.

The Board agreed to remove the word "liability." Staff will update.

Paragraph 16: Ms. Gilliam addressed Mr. Allen's concern that the word "billed" was incorrect for deferred revenue and should be replaced with the word "collected" because it is referred to as revenue collected in advance of services provided. Ms. Gilliam noted that when the premiums are billed, the program sets up a receivable and then earns the revenue over the period of the contract. Mr. Showalter noted that the program does not have a legal right to the revenue if the bill date is prior to the contract inception date.

Members agreed that the correct wording should be "collected or due." Staff will update.

Paragraph 17: Ms. Gilliam addressed Mr. Granof's concern that adjustment to premiums should be reported as a prior period adjustment.

> *If premiums are adjusted after the contract period as a result of, but not limited to, claim experience or other experience ratings, the adjustment should be recognized in the reporting period during which the adjustment is made*.

Mr. Granof said that if the premiums are clearly applicable to period one—the period that we offered the service—then they should be recognized in period one. He asked that, for example: if you have a water company that bills in period two for water used in period one, when would members recognize the revenue? Members said period one. Now, instead of collecting zero revenue in period two, they collected part of the revenue in period one and then made a final adjustment and collected in period two. Would you still recognize the revenue in period one? Mr. Smith said we would want to recognize the revenue in period two when we make the adjustment.

Ms. Payne said we need to consider the type of insurance programs we are dealing with. Flood insurance is the only source for people and they are often required to have flood insurance to maintain their mortgage coverage. Then flood has a bad year and changes their experience rating and adjust the rates. Are they adjusting losses from the prior year -correcting an error- or adjusting estimates going forward?

As another example, if the National Credit Union Administration (NCUA), as the regulator of the credit unions' insurance had a bad year, are they recovering losses in future years by changing estimates or correcting a previous year's error (revenue)?

In an environment where the program is the only source or a regulated source, where people/organizations are required to participate, and then legally able to recuperate prior losses, do we want to challenge these programs to figure out if they are adjusting a premium based on prior experience?

Members agreed that future adjustments to premiums based on experience ratings are not correction of errors and should be recognized as normal premium revenue over the future contract period.

Members decided to remove paragraph 17. Staff will make that change.

Paragraph 18b: A number of Board members requested that the second sentence **(bolded)** be restated as a requirement instead of a fact as presented by staff.

> *If an estimated recovery exceeds the related claim(s) then recognition is limited to the amount of the related claim.* ***Recoveries are not recognized as revenues since they reduce claims expenses.***

Mr. Granof suggested that staff amend the sentence to read:

> *Recoveries should not be recognized as revenue, but rather as reductions of claims expense.*

The Board agreed; staff will update.

Paragraph 21: Ms. Gilliam presented Mr. Showalter's concern that the lead paragraph does not clearly state how to calculate the liability. She suggested that staff change the word "less" to "over."

> *The amount of the liability is the excess of the estimated settlement amount for probable claims to be incurred during the remaining open contract period* ***~~less~~ over*** *the unearned premium at the end of the reporting period.*

The Board agreed; staff will update.

Paragraph 21 a- d: Ms. Gilliam presented Mr. Allen's concern that the items were not presented clearly because they were a mix of SSFAS 5 in (a) and expected cash flow approach in (d).

a) Claims are probable if it is more likely than not that an adverse event will occur during the remaining open contract period for which beneficiaries will be eligible to receive compensation.

d) If the portfolio includes a large population of contracts, outflows may be estimated by weighing all possible outcomes by their associated probabilities; that is, the expected value.

Mr. Allen said that we are using estimated cash flows to measure claims. However, under **21.a** when we use SSFAS 5 language, 'more likely than not,' in most cases these events would always be zero because they are not probable. He does not like the language in (a), nor does he like the reference to the large population. He recommends that we measure using expected cash flows despite the size of the population. He wants staff to start out with (d), noting that where there are claims, this is a good way to measure the expected amount for associated obligations.

Ms. Payne asked Mr. Allen if he would use the expected value concept for all insurance arrangements, unless we could not. Mr. Allen said yes unless the program writes one contract covering one company for one circumstance—that would be an exception.

Members agreed the need to establish a probable threshold in order to estimate what claims are going to be based upon past patterns.

Mr. Allen recommended that we take "more likely than not" out of (a) and "large population" from (d) and say they can be measured using outflows.

Mr. Dacey suggested that staff review FASB's literature in order to see how they normalize expectations based upon history, address questions on the timing of the estimate, and whether or not there has been a big event. He said he would forward the FASB wording and citation to staff.

The members agreed that staff should rewrite this section to delete the word "probable" and focus on measuring liabilities using the expected value of estimated outflows net of remaining insurance coverage recognized at the end of the reporting period. Staff will update.

Paragraph 21.b: Members discussed the wording in 21.b.

Management's judgment supplemented by experience with similar transactions and, in some cases, the views of independent experts will be needed.

Mr. Granof suggested:

Management's judgment based on trend experience, and in some cases, the views of independent experts.

Members agreed; staff will update.

Paragraph 21.e: Ms. Gilliam presented Mr. Showalter's concern that using a mid-point instead of the minimum point of a range was a significant departure from SFFAS 5 and therefore could impact all of the FASAB Statements causing inconsistency throughout the standards. Did staff plan to amend SFFAS 5 for consistency?

*If the estimate is a range of amounts and, if due to uncertainty, no amount within the range is a better estimate than any other amount within the range, then **using the mid-point of the range is appropriate**.*

Members were interested to know how staff decided to use the mid-range instead of the minimum point, especially because the minimum point is the FASAB standard.

Staff pointed out that a number of members on the task force preferred the mid-range.

Ms Payne said that in the context of probabilities if you have numbers 1 to 100, every number in that range has exactly the same probability. If we were to calculate an expected value based on probability of hitting a number, my expected value is 50— a simple average.

Members discussed this and agreed to remove the reference to a range because paragraph 21 will be rewritten to focus on the expected value and all numbers for expected value carry the same weight. Staff will make this change when updating paragraph 21.

Paragraph 22: Mr. Steinberg pointed out that adjustments could result in gains. Therefore, Ms. Gilliam will update to paragraph 22 to read:

*Adjustments to the liability for remaining insurance coverage should be recognized as losses **or gains** on remaining insurance coverage.*

Paragraph 23: Mr. Steinberg recommended including a brief description of the insurance programs similar to what the standards require for the loan programs.

Members agreed; staff will update.

Paragraph 23.c: Mr. Steinberg recommended changing "paid claims" to "payments."

Members agreed; staff will update.

Conclusions:

- Staff will update the proposed standards with all noted changes and develop options for consideration in areas where no decision was reached.

- Board members should provide any additional comments on the proposed draft, and especially Question 5, by COB, Friday, March 27, 2015.

- **Three-Year Plan**

Ms. Payne opened the discussion of the three-year plan with a focus on the milestones for 2015. She noted there is little room to add to the current state of projects unless members wish to stop work on an active project. She emphasized the need to focus on implementation guidance and that Ms. Wu and Ms. Loughan are presently addressing critical needs.

In response to members' questions, Ms. Payne noted that the input on the three-year plan was consistent with prior years and the members would have a chance to discuss priorities again in June when the draft three-year plan for 2016-2019 is provided. A better sense of progress on the reporting model at that time would help in revising next steps and priorities.

A member asked if resources for implementation were sufficient. Ms. Payne responded that implementation of reporting entity and the changes Treasury envisions regarding the general fund may bring surprises but she did not see an immediate need to realign resources. When issues emerge, they may affect timelines on existing work.

Mr. Allen asked Mr. Dacey and Mr. Granof about IPSASB and GASB projects underway. Mr. Dacey noted that IPSASB has not met since the December FASAB meeting. He added that there is a project on unique assets and liabilities in the government like seigniorage (revenue from the manufacture of coins calculated as the difference between the face value and the metal value of the coins) and monetary goals. They are exploring the measurement and disclosure related to those. Mr. Dacey offered to provide a briefing on these topics.

Mr. Granof noted the GASB project on other post employment benefits (OPEB). He asked how that compares to federal practices. Members noted that the federal government recognizes pensions and OPEB liabilities fully.

Mr. McCall indicated that people do not understand fund receivables and payables. The monies collected for future pension payments and Social Security are used for current operations. They do not understand that we have a liability for federal employees and veteran's benefits of $6 trillion. That it is shown as a liability. In any other government, you would see an asset there for the amount set aside to cover these costs down the road. He thought that is passing these costs into future taxpayers. He was not sure we explain the reasons, the justifications to why it is being done as opposed to how everybody else in the world does it. That is a broad statement there.

Members agreed that it is hard to understand. Ms. Payne asked if he was suggesting that there be an explanation of why the federal government does not invest the funds in an external investment pool.

A member noted that this focuses on the wrong number. Intergovernmental borrowing is one amount, but the bigger number is the total deficit.

Another member noted that technically pension funds are invested in US Treasury certificates. The US Treasury certificate is a letter issued by the Treasury Department that says you have invested this money with us. But they count towards the obligations of the US Treasury. The US Treasury funds them as they come due.

In response to a comment that these are not assets at the consolidated level, a member noted that the cash is invested in the most conservative investment available – US Treasury Securities. They are invested in the full faith and credit of the US and they are paid as they come due. He agreed the focus should be on the totality of debt because that is technically included in our ability to do cash flows.

Some members noted that the pension plan’s investment in Treasury securities is quite small in comparison to the total liability and that liability is presented on the balance sheet.

Members pointed to two provisions intended to aid users in understanding these challenges – the comprehensive long-term fiscal projections and the presentation of dedicated collections information. (Dedicated collections are those collected in advance and available for use in the future by the fund that collected them.) The positive net position of $3.2 trillion from dedicated collections is presented separately from the net position from general operations.

One member noted that the concern about unfunded pension obligations is a budget policy concern rather than an accounting concern.

Members noted their concern that the financial statements are not more widely read.

> **Conclusions:** Members will update the three-year plan in June.

Adjournment

The meeting adjourned at 2:00 PM.