



**August 11, 2011**

Memorandum

To: Members of the Board

From: *J. Ranagan*  
Julia Ranagan, Assistant Director

*R. Simms*  
Ross Simms, Assistant Director

Through: *Wendy M. Payne*  
Wendy M. Payne, Executive Director

Subj: Risk Assumed Project Plan – **Tab D**<sup>1</sup>

## **OBJECTIVE**

The objective of this session is to **approve the attached project plan** for the project on Risk Assumed, **so that staff may take action on the next agreed-upon step.**

## **BRIEFING MATERIAL**

The proposed Project Plan is attached to this transmittal memorandum. In addition, there is a separate Appendix containing reference material that provides additional information should you desire more details. You may electronically access all of the briefing material at <http://www.fasab.gov/board-activities/meeting/briefing-materials/>.

## **MEMBER FEEDBACK**

If you require additional information or wish to suggest another alternative not considered in the staff proposal, please contact staff as soon as possible. In most cases, staff would be able to respond to your request for information and prepare to discuss your suggestions with the board, as needed, in advance of the meeting. If you have any questions or comments prior to the meeting, please contact Julia Ranagan at 202-512-7377 or [ranaganj@fasab.gov](mailto:ranaganj@fasab.gov) and Ross Simms at 202-512-2512 or [simmsr@fasab.gov](mailto:simmsr@fasab.gov) with a cc to [paynew@fasab.gov](mailto:paynew@fasab.gov).

Attachments:

Project Plan  
Appendix

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<sup>1</sup> The staff prepares board meeting materials to facilitate discussion of issues at the board meeting. This material is presented for discussion purposes only; it is not intended to reflect authoritative views of the FASAB or its staff. Official positions of the FASAB are determined only after extensive due process and deliberations.

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RISK ASSUMED

PROJECT PLAN



AUGUST 2011

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## Why

Why is a project on risk assumed needed?

- Existing FASAB standards on risk assumed are limited to insurance contracts and explicit guarantees (other than loan guarantees)
- The federal government has a variety of responsibilities and consequently assumes a range of risks
- Current FASAB guidance may not result in full disclosure of the significant risk assumed by the federal government



## What

What questions / issues does the Risk Assumed Project plan to address?

- What are the significant risks assumed by the federal government?
- How should those risks be defined?
- What are the appropriate recognition and measurement criteria for those risks?
- How should those risks be reported?
- Should current FASAB standards be revised?



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## RISK ASSUMED PROJECT PLAN

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**Purpose:** This project is being undertaken by the Federal Accounting Standards Advisory Board (FASAB) because existing FASAB standards on risk assumed are limited to insurance contracts and explicit guarantees (other than loan guarantees). Because the federal government has a variety of responsibilities and consequently assumes a range of risks, it is important that FASAB revisit its existing standards. For example, when implementing policy initiatives to stabilize financial markets and the economy, the federal government explicitly assumed risks previously considered by some to have implied backing of the federal government. It provided financial support to government-sponsored enterprises (GSE) and private sector institutions and purchased or guaranteed troubled assets.

In order to meet the stewardship and operating performance objectives of federal financial reporting,<sup>2</sup> it is important that the federal government reports all significant risks assumed, not just risks related to insurance contracts and explicit guarantees.

For additional information on the project, you may read the Background section in the Appendix to Tab D.<sup>3</sup>

**Applicability:** This project applies to the federal government as a whole and all component entities that present general purpose federal financial reports in conformance with Statement of Federal Financial Accounting Standards (SFFAS) 34, *The Hierarchy of Generally Accepted Accounting Principles (GAAP), Including the Application of Standards Issued by the Financial Accounting Standards Board (FASB)*.

**Objectives:** The primary objective of this project is to study the significant risks assumed by the federal government and develop (a) definitions of risk assumed, (b) related recognition and measurement criteria, and (c) disclosure and / or required supplementary information (RSI) guidance that federal agencies can apply consistently in accordance with GAAP.

**Assigned staff:** Julia Ranagan  
Ross Simms

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<sup>2</sup> Statement of Federal Financial Accounting Concepts (SFFAC) 1, *Objectives of Federal Financial Reporting*, pars. 100, 122, and 141

<sup>3</sup> Progress made in this project could help inform the Reporting Model Project. As part of the Reporting Model project, staff seeks to determine how to present information so that users better understand the distinctions among items of information such as liabilities, risk assumed presented as RSI, and sustainability reporting.

**Other resources:** After a brief initial research phase, staff plans to utilize a multi-disciplinary task force, including sub-groups to address specific topics. See section III. of the Proposed Approach for more information on the timing and proposed use of the task force.

**Timeline: September – November 2011**

- Develop a preliminary inventory and groupings of risk assumed
- Conduct limited research on groupings
- Develop task force plan and organize task force

**December 2011 – January 2013**

- Utilizing task force input, as appropriate, develop risk assumed definitions, measurement and recognition criteria, and disclosure and / or RSI guidance
- Consider whether a phased approach may be more appropriate
- Report to the board as issues are developed that require board decisions

**February – October 2013**

- Develop exposure draft (ED)

**November 2013**

- Issue ED for comment
- Conduct pilot testing

**February 2014**

- Hold public hearing

**March - May 2014**

- Finalize standard

**June 2014**

- Transmit final SFFAS to sponsors for 90-day review

**September 2014**

- Issue SFFAS

**October 2014 – February 2015**

- Develop implementation guidance, if necessary

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## PROPOSED APPROACH

### I. **Consider Existing Concepts, Standards, Other Guidance, and Legislation:**

Project staff will consider existing FASAB concepts and standards, other guidance, and applicable legislation listed below and discussed further in the Appendix to Tab D.

#### Concepts

- Statement of Federal Financial Accounting Concepts (SFFAC) SFFAC 1, *Objectives of Federal Financial Reporting*:
  - Stewardship (pars. 100 and 141);
  - Systems and Controls (par. 103);
  - Operating Performance (par. 122);
  - Financial Condition (par. 181);
  - Levels of Financial Controls (par. 263);
- SFFAC 2, *Entity and Display*:
  - Determining Basic Information versus RSI (par. 73E);
- SFFAC 3, *Management's Discussion and Analysis*:
  - Use of Estimates (par. 30);
  - Current Demands, Risks, Uncertainties, Events, Conditions, and Trends (par. 30);
  - Future Effects of Current Demands, Risks, Uncertainties, Events, Conditions, and Trends (par. 32);
  - Future Effects of Anticipated Future Events, Conditions, and Trends (pars. 33-34); and,
- SFFAC 5, *Definitions of Elements and Basic Recognition Criteria for Accrual-Basis Financial Statements*:
  - Basic Recognition Criteria (par. 5)

#### Standards

- SFFAS 5, *Accounting for Liabilities of the Federal Government*:
  - Nature of Federal Insurance and Guarantee Programs (pars. 97-103);
  - Accounting For Liabilities of Federal Insurance and Guarantee Programs (pars. 104-105);
  - Additional Disclosures for Insurance and Guarantee Programs Administered by Government Corporations (par. 106);

- Illustrations of the Application of the Standard (pars. 107-114);
- Conclusion on Insurance and Guarantees pars. 185-190;;
- SFFAS 15, *Management's Discussion and Analysis*, par. 21: Forward-looking Information;
- SFFAS 25, *Reclassification of Stewardship Responsibilities and Eliminating the Current Services Assessment*:
  - Risk Assumed (pars. 20-21); and,
  - Factors to Consider (pars. 40-50).

#### Other Guidance

- OMB Circular A-136, *Financial Reporting Requirements*<sup>4</sup>
  - II.4.9.20 Note 20 Commitments and Contingencies
  - II.4.9.32 Note 32 Undelivered Orders at the End of the Period
  - II.4.11.8 Risk Assumed Information

#### Legislation

- Housing and Economic Recovery Act of 2008; and
- Emergency Economic Stabilization Act (EESA) of 2008

## **II. Resources**

In addition to FASAB resources, staff plans to utilize:

- a task force to help develop accounting and reporting guidance. The task force will include practitioners and experts in risk management and economics.
- the results of research in the area of expected cash flows and pricing uncertainties conducted as part of the International Accounting Standards Board (IASB) and FASB insurance contracts project

## **III. Research Steps**

- A. To achieve the primary objective of this project, staff will broadly consider significant risk assumed from the expected costs (cash flows) arising from:
  1. existing contracts (insurance and guarantee) based on a probabilistic estimate (the full cost of explicit risk assumed);
  2. implied guarantees resulting from:

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<sup>4</sup> OMB Circular A-136 is available at <http://www.whitehouse.gov/omb/circulars/>

- a. disaster/relief programs
  - b. certain assistance programs (particularly where a qualifying event may lead to long-term assistance)
  - c. regulatory actions
  - d. related party involvements
  - e. other existing policies or programs;
3. commitments such as:
    - a. contractual commitments requiring future resources or that may require future resources
    - b. treaties and other international agreements;
  4. inter-governmental financial and programmatic dependency; and,
  5. other potential risks assumed.
- B. Search for and identify all relevant literature from other standards-setters that may be relevant to the topic.
- C. Develop a preliminary inventory of risk assumed, considering:
1. results of literature research in step B.
  2. characteristics of federal insurance and guarantee programs discussed in SFFAS 5,
  3. existing FASAB research on risk assumed and other identified fiscal exposures,
  4. Office of Management and Budget (OMB), Government Accountability Office (GAO), and Congressional Budget Office (CBO) reports and documents regarding fiscal exposures and recent government intervention actions,
  5. the different types of potential related party relationships identified in the Federal Entity project and risks inherent in those relationships, and
  6. current events and news reports from U.S. and world governments.
- D. Group the risks by government activity with similar attributes, such as contracts, guarantees, and relationships.
- E. Using conceptual guidance (factors in SFFAC 2, Table 1: Factors to Consider in Distinguishing Basic Information from RSI and SFFAC 5 basic recognition criteria), categorize the inventory into potential candidates for basic financial statement, note disclosure, and RSI.
- F. Conduct limited research on groupings and develop a task force plan considering
1. reporting objectives from SFFAC 1,
  2. user needs results from the Reporting Model project,

3. current thoughts on measurability (inquire of agencies, OMB, GAO, and CBO),
  4. status of system capabilities (interview agencies),
  5. the purpose of risk assumed reporting and its distinction from sustainability reporting, and
  6. the amount of uncertainty and comparative advantage (staff may recommend a phased approach based on preliminary research and analysis).
- G. Organize a multi-disciplinary task force to develop definitions; assess measurement issues; determine measurement methods, attributes, and approaches; and discuss disclosure and / or RSI options.

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## POTENTIAL PROJECT MANAGEMENT CONCERN

### Resources

A broad effort would be necessary and require that we engage advisors with diverse experience and professional training. For example, the SFFAS 5 basis for conclusions notes that measuring risk assumed was difficult and despite some interest among budget experts in applying credit reform approaches to insurance programs, such changes have not been made. However, the economic stabilization activities and recent regulatory changes have generated more data for academic research regarding valuing explicit and implied guarantees. Generally, we could expect to recruit a knowledgeable task force to assist in this effort. In addition, the International Accounting Standards Board (IASB) and Financial Accounting Standards Board (FASB) insurance contracts project led to substantial work in the area of expected cash flows and pricing uncertainties. We could expect to learn a great deal from their efforts.

The objective of this session is to **approve this project plan** for the project on risk assumed, **so that staff may take action on the next agreed-upon step.**

If you require additional information or wish to suggest another alternative not considered in the staff proposal, please contact staff as soon as possible. In most cases, staff would be able to respond to your request for information and prepare to discuss your suggestions with the board, as needed, in advance of the meeting. If you have any questions or comments prior to the meeting, please contact Julia Ranagan at 202-512-7377 or [ranaganj@fasab.gov](mailto:ranaganj@fasab.gov) and Ross Simms at 202-512-2512 or [simmsr@fasab.gov](mailto:simmsr@fasab.gov).

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**Tab D – Appendix  
Risk Assumed  
Reference Material  
(For More Information)**

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## BACKGROUND

In the 1990s, FASAB discussed two approaches for recognizing federal insurance liabilities: (1) recognize as a liability the unpaid expected present value (PV) cost of insured events that had occurred; or (2) recognize as a liability the unpaid expected PV cost of risks that had been assumed. Although board members believed that the second approach had merits from a conceptual standpoint, there was a concern regarding the measurability of risk assumed. Also, some members questioned the categorization of some assumed risks without a written contract. Consequently, the board decided to issue standards requiring entities to recognize the effect of events that had occurred and require the reporting of the estimated PV cost of the risk assumed for all programs, except social insurance, life insurance, and loan guarantee programs, as required supplementary information (RSSI).<sup>1</sup> Later, in 2003, the board decided to relocate risk assumed from RSSI to required supplementary information (RSI) and, again, members expressed concern about measurability when they chose RSI over basic information.

Today, many central governments are reexamining their fiscal risks in the wake of significant intervention efforts designed to stabilize financial markets and their economies. The U.S. implemented some major intervention programs as well; for example, when implementing policy initiatives to stabilize financial markets and the economy, the federal government explicitly assumed risks previously considered by some to have implied backing of the federal government. It provided financial support to government-sponsored enterprises (GSE) and private sector institutions and purchased or guaranteed troubled assets.

The types of risks assumed may be explicit, such as in the case of providing insurance and guarantees, while others may be implied. Risks may be implied in contractual agreements and in relationships with other entities like states who administer federal programs. Both explicit and implied risks may need to be identified and reported as part of efforts to demonstrate stewardship over resources, help determine the cost of programs, and plan risk mitigation strategies.

However, reporting on explicit and implicit risks presents financial reporting issues, including how to measure items and whether the items should be recognized in financial statements, disclosed, or reported as RSI. Additional FASAB guidance could help address these issues and better achieve the operating performance, stewardship, and systems and control objectives of financial reporting.

Given the level of interest and significant events requiring reporting guidance, board members believed a project on risk could be beneficial. During the technical agenda discussions in February 2011, all members indicated that risk assumed was a high priority (see the minutes from the technical agenda discussion at the April 2011 meeting beginning on page 24). Also, two members specifically suggested a broad approach to include commitments and/or inter-governmental dependency.

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<sup>1</sup> SFFAS 5, pars. 185 and 186.

This project is deemed a high priority project because:

1. The objectives of the project align well with the Operating Performance and Stewardship Objectives from Statement of Federal Financial Accounting Concepts (SFFAC) 1, *Objectives of Federal Financial Reporting*. Because cost information would be provided, information about the costs of activities would be enhanced. In addition, information relevant to assessing the government's ability to meet obligations as they come due would be provided.
2. Risk assumed amounts are likely to be significant from the governmentwide perspective.
3. The technical outlook of the project has improved since Statements of Federal Financial Accounting Standards (SFFAS) 5, *Accounting for Liabilities of the Federal Government*, and 25, *Reclassification of Stewardship Responsibilities and Eliminating the Current Services Assessment*, were issued. The economic and stabilization activities and recent regulatory changes have generated more data for academic research regarding valuing explicit and implied guarantees. Generally, we could expect to recruit a knowledgeable task force to assist in this effort. In addition, the International Accounting Standards Board (IASB) and Financial Accounting Standards Board (FASB) insurance contracts project led to substantial work in the area of expected cash flows and pricing uncertainties. We could expect to learn a great deal from their efforts.
4. The Government Accountability Office (GAO) has identified two insurance programs—the Pension Benefit Guarantee program and the National Flood Insurance program—as high risks.

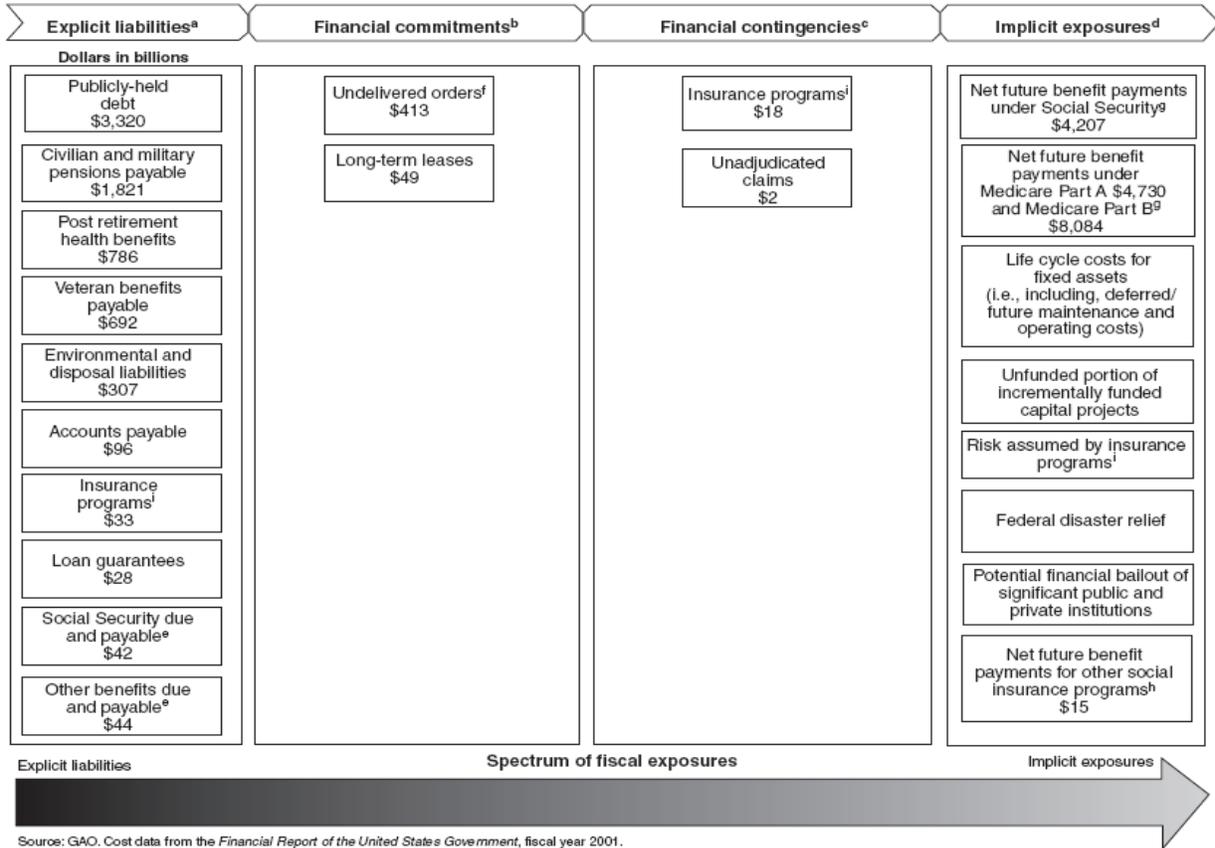
This project will subsume and close the Application of the Liability Definition project. The objective of the Application of the Liability Definition project was to reconsider the recognition, measurement and display of liability and expense, potential new elements/statements, and all related disclosures for commitments of the federal government that could potentially result in a net outflow of resources. In September 2007, the board decided to postpone the project until additional progress could be made in developing conceptual guidance. A summary of the project is provided beginning on page 12 of this Appendix.

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## EXISTING RESEARCH

In 2003, GAO issued a report on fiscal exposures. The report, *Fiscal Exposures: Improving the Budgetary Focus on Long-Term Costs and Uncertainties*, discusses the range of federal responsibilities that obligate the government to future spending or create an expectation of future spending. GAO uses the term fiscal exposure (risk) to “provide a framework to consider these long-term costs and uncertainties,” and GAO believes it is useful to think of the variety of fiscal exposures in terms of “a spectrum extending from explicit liabilities to implicit promises embedded in current policy or public expectations.” Many of the fiscal exposures presented along the spectrum of fiscal exposures are currently reported in basic financial statements. For example, explicit liabilities are recognized on the balance sheet; undelivered orders and contingencies are reported in the disclosures; and the entities with social insurance programs present a statement of social insurance. The GAO spectrum of fiscal exposures is presented on the next page (see Figure 1).

Also, see the Summary of Application of the Liability Definition Project beginning on page 12 of this Appendix for a summary of the research conducted by FASAB staff regarding commitments of the federal government that could potentially result in a net outflow of resources.



**Figure 1 – FOR REFERENCE PURPOSES ONLY—Source: GAO D-03-213; available online at <http://www.gao.gov/new.items/d03213.pdf>; accessed July 19, 2011**

<sup>a</sup>A liability represents a probable and measurable future outflow of resources arising from past transactions and events. A liability is recorded on the face of the balance sheet only when an item is identifiable, its occurrence is probable, and its cost can be reasonably estimated.

<sup>b</sup> Commitments refer to contractual obligations that require the future use of resources. For example, although a liability generally is not recognized on the balance sheet when a contract is signed because the contracted goods or services have not been delivered, this transaction may be recognized as a commitment in the notes. In contrast, budgetary accounting would record obligations at the time the government enters into a contract and allows for deobligation if the contract is not fulfilled. Budgetary accounting records obligations when an order is placed, contract awarded, service rendered, or similar transaction takes place that will require payment.

<sup>c</sup> A contingency is an existing condition, situation, or set of circumstances involving uncertainty as to possible gains or losses. The uncertainty will ultimately be resolved when one or more future events occur or fail to occur. Contingencies are disclosed in the notes of the financial statements if any of the conditions for liability recognition are not met and there is at least a reasonable possibility that a loss may have been incurred. Contingencies that are classified as remote are not required to be disclosed.

<sup>d</sup>In this report, the term implicit exposures refers to exposures that stem not from a legal obligation of the federal government but rather from implied commitments embedded in the government's current policies or in the public's expectations about the role of government.

<sup>e</sup>Due and payable amounts are the benefits owed to program recipients as of the fiscal year end that have not yet been paid.

<sup>f</sup>Undelivered orders represent the value of goods and services ordered that have not yet been received.

<sup>g</sup>The term net future benefit payments is used in this report to represent the net present value of negative cashflow. Net present value of the negative cashflow is the current amount of funds needed to cover projected shortfalls, excluding trust fund balances, over a 75-year period. This estimate of cashflows is for an open system, meaning that it includes births during the period and individuals below the age of 15 as of January 1 of the valuation year. The valuation date for the amount included in the figure was January 1, 2001. The trust fund balances at the beginning of the valuation period that were eliminated for this consolidation were: \$1,049 billion for Social Security, \$177 billion for Medicare Part A, and \$44 billion for Medicare Part B. This is a different measure from the actuarial balance in the Trustees' Report.

<sup>h</sup>Includes Railroad Retirement and Black Lung (Part C). See footnote g. Trust fund balances at the beginning of the valuation period that were eliminated for consolidation were: \$19 billion for Railroad Retirement and a negative balance of \$7.2 billion for Black Lung.

<sup>i</sup>Federal insurance programs are listed three times in figure 2. Under federal accounting standards, a liability is recognized based on insured events that have been identified by the end of the accounting period. The standard requires recognition of expected unpaid net claims inherent in insured events that have already occurred, including (1) reported claims, (2) claims incurred but not yet reported and (3) any changes in contingent liabilities that meet criteria for recognition. A contingency is an existing condition, situation, or set of circumstances involving uncertainty as to a possible loss. Contingencies that do not meet the conditions for liability recognition are disclosed in the notes to the financial statements. Contingencies that are classified as remote are not required to be disclosed. The risk assumed by federal insurance programs represents the cost of claims inherent in the government's commitment. Estimation of the cost of the risk assumed by the federal government can be thought of as analogous to premium rate setting in that it would look at the long-term expected costs of the insurance commitment at the time the insurance commitment is extended. The risk assumed by the government is essentially that portion of the full risk-based premium not charged to the insured.

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## EXCERPTS FROM EXISTING CONCEPTS, STANDARDS, OTHER GUIDANCE, AND LEGISLATION

### Concepts

Conceptual guidance to be considered during the project includes Statement of Federal Financial Accounting Concepts (SFFAC) SFFAC 1, *Objectives of Federal Financial Reporting*. SFFAC 1 discusses the objectives of financial reporting and the risk assumed project will focus on the operating performance and stewardship objectives. Focusing on risk information needed to help achieve the operating performance and stewardship objectives will help contribute to another reporting objective, the systems and control objective. The concepts note that financial report users expect information on the government's costs,<sup>2</sup> exposures and risks, and on whether internal controls have been established to mitigate those risks.<sup>3</sup> To address the stewardship objective, in particular, SFFAC 1, states,

Information relevant to this objective may include disclosures of financial risks that are likely or reasonably possible from sources such as government-sponsored enterprises, deposit insurance, and disaster relief programs.<sup>4</sup>

Also, management's discussion and analysis (MD&A) might address, "the reasonably possible future impact of known trends, risks, demands, commitments, events, or uncertainties that may affect future operations."<sup>5</sup>

Additionally, in SFFAC 1, the board explains that information about systems and control is needed...

Because the government spends such large amounts of monies, taxpayers and other citizens are naturally concerned that the resources they supply are being protected from fraud, waste, and abuse and that the errors are minimal. They want to know that controls are in place and operating effectively and that problems are being quickly identified and corrected. They are particularly concerned that identified high risks are addressed and that adequate funds are devoted to eliminating the risk.<sup>6</sup>

Other conceptual guidance may help to determine what items of information should be considered basic information and what items of information should be recognized. SFFAC 2, Entity and Display, discusses factors that the board may consider in determining whether an item of information should be considered basic information or required supplementary information (RSI). The following provides an example:

For example, members may consider the relevance of the information to fair presentation. If the information has a high relevance to fair presentation, it may be a candidate for basic information communicated by financial statements and notes to the financial statements. The financial statements

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<sup>2</sup> SFFAC 1, par. 122.

<sup>3</sup> SFFAC 1, par. 100 and 103.

<sup>4</sup> SFFAC 1, par. 141.

<sup>5</sup> SFFAC 1, par. 181.

<sup>6</sup> SFFAC 1, par. 263.

and notes could not be considered fairly presented if the information is missing or materially misstated.<sup>7</sup>

In addition, SFFAC 5, *Definitions of Elements and Basic Recognition Criteria for Accrual-Basis Financial Statements*, defines the five elements of accrual basis financial statements (asset, liability, net position, revenue, and expense) and the two basic criteria for recognizing an item in the body of a financial statement:

- (1) the item meets the definition of an element; and
- (2) the item must be measurable.<sup>8</sup>

Other conceptual guidance that will be considered includes SFFAC 3, *Management's Discussion and Analysis*. It states that among other items, the MD&A should address systems and internal controls, and

...the future effects of existing, currently- known demands, risks, uncertainties, events, conditions and trends. MD&A may also address the possible future effects of anticipated [note omitted] future demands, events, conditions, trends, etc. that management believes would be important to the reader of the report.

SFFAC 3 also discusses that the MD&A should explain the use of estimates and should discuss risks, uncertainties, events, conditions, and trends that affect amounts presented in the financial statements and supplementary information.<sup>9</sup> With respect to current demands, risks, uncertainties, events, conditions and trends, the conceptual guidance states

...The discussion of these current factors should go beyond a mere description of existing conditions, such as demographic characteristics, claims, deferred maintenance, commitments [footnote omitted] undertaken, and major unfunded liabilities, to include a discussion of the possible future effect of those factors.<sup>10</sup>

Moreover, "if there is a reasonable prospect of a major effect on the reporting entity due to the anticipated condition, then MD&A should include this information to the extent feasible."<sup>11</sup>

### Standards

Standards that will be considered include Statement of Federal Financial Accounting Standards (SFFAS) 5, *Accounting for Liabilities of the Federal Government*. SFFAS 5 provides accounting standards for federal insurance and guarantee programs (except social insurance and loan guarantee programs). It describes the nature of federal government insurance and guarantee programs by noting that such programs:

- Assume risks that the private sector are unwilling or unable to assume;
- Subsidize insurance payments to achieve social objectives;

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<sup>7</sup> SFFAC 2, par. 73E.

<sup>8</sup> SFFAC 5, par. 5.

<sup>9</sup> SFFAC 3, par. 30 and 31.

<sup>10</sup> SFFAC 3, par. 32.

<sup>11</sup> SFFAC 3, pars. 33-34.

- Provide protection against various types of risks, e.g., life insurance, medical insurance, and insurance against property damage;
- Often do not involve an explicit contract; and
- Are not intended to earn a profit; therefore, they are not subject to market forces.<sup>12</sup>

Accordingly, the standard distinguishes the types of risks that the federal government assumes from those of a commercial entity. It notes that not all risks assumed need to be written in a contractual agreement. Some risks may be inherent in the relationship between the government and other parties and both types of risk merit consideration when determining the likelihood of future costs and risk mitigation strategies.<sup>13</sup>

The accounting requirements for liabilities of insurance and guarantee programs state,

All federal insurance and guarantee programs (except social insurance and loan guarantee programs [footnote omitted] should recognize a liability for unpaid claims incurred, resulting from insured events that have occurred as of the reporting date. The standard requires recognition of the liability that is known with certainty plus an accrual for a contingent liability recognized when an existing condition, situation, or set of circumstances involving uncertainty as to possible loss exists and the uncertainty will ultimately be resolved when one or more probable future events occur or fail to occur; a future outflow or other sacrifice of resources is probable; and the future outflow or sacrifice of resources is measurable. Insurance and guarantee programs should recognize as an expense all claims incurred during the period, including, when appropriate, those not yet reported and contingencies that meet the criteria for recognition. Life insurance programs should recognize a liability for future policy benefits (a liability to current policyholders that relates to insured events, such as death or disability) in addition to the liability for unpaid claims incurred.<sup>14</sup>

Also, the standard requires other information that is not considered basic. SFFAS 5 requires risk assumed information and states,

Risk assumed information is important for all federal insurance and guarantee programs (except social insurance, life insurance and loan guarantee programs) and will be considered in the context of the Stewardship reporting. Risk assumed is generally measured by the present value of unpaid expected losses net of associated premiums, based on the risk inherent in the insurance or guarantee coverage in force.<sup>15</sup>

Additionally, for insurance and guarantee programs administered by government corporations, SFFAS 5 states,

When financial information pursuant to FASB's standards on federal insurance and guarantee programs conducted by government corporations is incorporated in

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<sup>12</sup> SFFAS 5, pars. 97-102.

<sup>13</sup> The Government Accountability Office's Standards for Internal Control in the Federal Government also states that management should identify risks by considering, "all significant interactions between the entity and other parties as well as internal factors."

<sup>14</sup> SFFAS 5, par. 104.

<sup>15</sup> SFFAS 5, par. 105.

general purpose financial reports of a larger federal reporting entity, the entity should report as RSI what amounts and periodic change in those amounts would be reported under the “risk assumed” approach referred to in this section (see par. 105). In other words, in addition to the liability for unpaid claims from insured events that have already occurred (including any contingent liability that meets criteria for recognition), such reporting entities should also report as RSI risk assumed information.<sup>16</sup>

Moreover, the standard includes illustrations to assist preparers in understanding how the standard should be applied.

With the issuance of SFFAS 25, *Reclassification of Stewardship Responsibilities and Eliminating the Current Services Assessment*, the board decided to reclassify risk assumed from required supplementary stewardship information (RSSI) to RSI. In doing so, board members considered several factors including the belief that “the amounts are not sufficiently reliable and measurement methods are still experimental.”<sup>17</sup> Additional factors a board member may have considered in reclassifying risk assumed information are presented in Table 1: Factors Considered in Reclassifying RSSI.

**Table 1: Factors Considered in Reclassifying RSSI**

SFFAS 25, par.	Factor
43	... Because SFFAS 5 does not include detailed criteria for defining and measuring Risk Assumed, preparers have considerable discretion in calculating it.  ... there may not be sufficient agreement on criteria that permit comparable and consistent reporting to permit classifying Risk Assumed as an integral part of the basic financial statements.
44	... The basic financial statements (including notes that are regarded as an integral part of the financial statements) and RSI are both important enough to be required items in financial reports.
45	... Since auditing is likely to increase precision (either through inducing more precise measures by the preparer or by reducing the variance in the measures by audit procedures), the less tolerance for imprecision that users have concerning an information item, the more likely that the board would want to make the item a required note disclosure instead of RSI.
46	... Precision about measures of past events seems inherently more possible than precision about estimates of future events. To the extent that there is a fundamental minimum amount of imprecision in certain information items, the cost of increasing audit effort might not be justified. For some board members, this consideration was among the factors (along with others such as cost/benefit) that imply “Risk Assumed” information should properly be classified as RSI at this

<sup>16</sup> SFFAS 5, par. 106.

<sup>17</sup> SFFAS 25, par. 20.

	time.
47	...some people may define the domain of accounting and/or financial reporting (or categories within that domain) in terms of the nature of information involved (e.g., as limited to “historical” financial information or to certain defined “elements” of financial reporting, or to certain concepts such as “financial position”). FASB has emphasized the role of “elements of financial reporting” in defining the financial statements and notes. FASB and GASB also emphasize the concept of net assets or financial position in defining financial statements and notes.
48	Other people may define financial reporting, and its component categories, in terms of the comparative advantage unique to reporting based on the information system for processing financial transactions. SFAC 5, Recognition and Measurement in Financial Statements of Business Enterprises, says that the “financial statements . . . articulate with each other and derive from the same underlying data (par. 5). Some believe this idea is rooted in the basic “bookkeeping” paradigm of accounting (see SFFAC 1, Objectives of Federal Financial Reporting, paragraphs 166-168). Such a definition might be expected to lead to accounting standards that would define the basic financial statements in a narrow or traditional way, with other kinds of information (e.g., performance indicators or management’s assertions about internal control) being reported as RSI.

Legislation

Legislation that will be considered during the project includes the following:

- Federal Managers Financial Integrity Act of 1982
- Chief Financial Officer’s (CFO) Act of 1990
- Government Performance and Results Act of 1993
- Government Management Reform Act (GMRA) of 1994
- Federal Financial Management Improvement Act of 1996

FASAB's Strategic Directions, Appendix IV, accessible at <http://www.fasab.gov/about/mission-objectives/>, provides a discussion and analysis of the above legislation.

In addition, to develop an understanding of the types of risks the government has assumed, the project may consider legislation enacted in response to the nation’s financial crisis. As discussed in the *Financial Report of the United States Government*, such legislation includes:

- **Housing and Economic Recovery Act of 2008.** *Established a new regulatory agency, the Federal Housing Finance Agency (FHFA), to regulate the housing Government-Sponsored Enterprises (GSEs), Fannie Mae, Freddie Mac, and the Federal Home Loan Banks. FHFA placed Fannie Mae and Freddie Mac under conservatorship in September 2008 in order to*

*preserve GSE assets and restore those GSEs to a sound and solvent financial condition.*

- **The Emergency Economic Stabilization Act (EESA) of 2008.** *Provided authority and facilities that the Secretary of the Treasury could use to restore liquidity and stability to the financial system of the United States, and ensured that such authority and facilities have been used in a manner that protected home values, college funds, retirement accounts, and life savings; preserved home ownership; promoted jobs and economic growth; maximized overall returns to the taxpayers of the United States; and provided public accountability for the exercise of such authority.*

Also, the EESA authorized the establishment of the Office of Financial Stability (Treasury-OFS) within the Office of Domestic Finance of the Treasury Department to implement the Troubled Asset Relief Program (TARP). TARP, in conjunction with other Federal Government actions, helped to unfreeze capital and credit markets, bringing down the cost of borrowing for businesses, individuals, and state and local governments, restoring confidence in the financial system, and restarting economic growth.<sup>18</sup>

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<sup>18</sup> See [http://www.fms.treas.gov/finrep/mda/fr\\_mgmt\\_discussion\\_3.html](http://www.fms.treas.gov/finrep/mda/fr_mgmt_discussion_3.html), accessed July 28, 2011.

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## SUMMARY OF THE APPLICATION OF THE LIABILITY DEFINITION PROJECT

### ***Original Project Objective:***

The primary objective of this project was to reconsider the recognition, measurement and display of liability and expense, potential new elements/statements, and all related disclosures for commitments of the federal government that could potentially result in a net outflow of resources. This project is considered a companion research project to the liability element and social insurance projects to help determine the government-wide impact of proposals currently under review by the board.

### ***Current Status:***

Further work on this project was postponed after the September 2007 meeting pending further progress on the conceptual framework. At this time, staff believes the original objective of this project can be subsumed by the Risk Assumed project and will close this project and move it into Archived Projects.

### ***History of Board Deliberations:***

#### Deliberations prior to August 2004

This project was formally introduced at the April 2004 meeting. It had naturally evolved from the Social Insurance Liability Project due to the need to concurrently review other commitments undertaken by the federal government that may be more accurately portrayed with additional liability recognition, disclosure, and/or display requirements beyond due and payable.

At the April 29, 2004 meeting, the board discussed the staff's preliminary plan for the project under the title "Long-Term Commitments." The board expressed a preference to characterize the project primarily as research at that point and directed staff to prepare a list of the major programs to be reviewed (i.e., Medicaid, Food Stamps, etc) before approving a formal project plan.

At the July 1, 2004 meeting, the board requested relevant background information on other federal programs in order to compare and contrast how the liability recognition criteria being studied as part of the social insurance project may be applied to other government programs. It was agreed that this information would be provided at the August meeting.

#### August 25-26, 2004

At the August 25, 2004 meeting, fact sheets prepared for Medicaid, Food Stamps, Temporary Assistance for Needy Families, and Supplemental Security Income were provided for the board's information in conjunction with the Social Insurance Liability Project presentation. Staff planned to gather additional information on various

government programs in order to assist the board in making a determination of proper liability recognition for various government events.

October 20-21, 2004

An updated project plan (see excerpt below) was provided to the board members at the October meeting. Members discussed the usefulness of concurrent research on potential liabilities, disclosures, and new elements related to other government programs and agreed that staff should pick two or three programs to review. Staff will come back to the board in March with alternative obligating events and display options for the selected programs.

**Research into the Application of the Liability Definition  
Project Plan  
September 23, 2004**

**IV. Project Approach**

This project would cover a broad range of activities. Staff proposes that the first step in the project would be to gather additional information on the various kinds of programs of the government that result in significant obligations of some type. Staff would compile fact sheets on the various programs, develop a set of characteristics to be reviewed in line with what has been done in the Social Insurance liability project, and assign each program a broad category based on like characteristics. See appendix 3 for the fact sheets compiled to date and discussed at the August 26<sup>th</sup> meeting in support of the Social Insurance Liability Project. Staff would not review all government programs, but rather a selection of programs that would be varied enough to effectively support the development of a principal-based standard.

Staff proposes that the following three phases be considered:<sup>11</sup>

Phase One – Benefits Provided to Individuals

This phase would address entitlement programs other than SI (Category I). Programs to be considered are veterans' benefits, Medicaid, Food Stamps, TANF, and SSI.

Phase Two – Government Sponsored Enterprises

This phase would explore the implied assumption of risk associated with Government Sponsored Enterprises, e.g., Fannie Mae and Freddie Mac (Category III) and any recognition or disclosure warranted for these activities.

Phase Three – Agreements that include broad assumption of risk

This phase would address treaties, contracts, and grants (Category II) that often include broad assumption of risk by the federal government.

Staff listed these phases in a logical sequence based on prior work of the Board, work currently underway in conjunction with the Social Insurance Liability Project, and input from the Board at the April 29<sup>th</sup> meeting. However, staff recognizes that this is not the only possible approach and would reorder these phases, as the Board deems necessary.

For each of the above three phases, this project would present for the Board's review:

- (1) The current FASAB liability definition and its application to the category under review;
- (2) Relevant applications of definitions established by other standard-setters;<sup>12</sup>
- (3) Alternative obligating events (e.g., past events which create present obligations);
- (4) Alternative measures for each major category of obligations;
- (5) Alternative displays for the balance sheet, statement of net cost, and/or other statements;
- (6) Alternative disclosures; and
- (7) Associated issues.

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<sup>11</sup> This is a draft proposal of phases based on information gathered during the Social Insurance and liabilities projects and may be revised as a result of research completed during the information gathering stage of this project. Staff would present the Board with the results of the information gathering stage and proposed categories before proceeding with additional phases.

<sup>12</sup> For example, the International Federation of Accountants, Public Sector Committee, Invitation to Comment, "Accounting for Social Policies of Governments," January 2004 proposes three options for different recognition points as related to social obligations. This methodology would be reviewed as part of staff work on this project.

March 2-3, 2005

At the March 3, 2005, meeting, staff presented a discussion of alternative obligating events for the Supplemental Security Income (SSI) program. SSI is administered by the Social Security Administration and has some striking similarities to the Social Security program being reviewed concurrently by staff on the Social Insurance Liabilities Project. Staff recommended that the determination of eligibility be selected as the obligating event for SSI. Board members found the analysis to be very helpful but reserved a decision on the obligating event for SSI until a more finalized definition of liabilities is agreed upon in the Concepts project. The analyses are considered helpful to the board in their efforts to develop a liability definition that is appropriate across a wide range of government programs. The board requested that staff pick one or two other programs to review and come back to the board at a subsequent meeting to discuss alternative obligating events and display options for the selected program(s).

May 4-5, 2005

At the May 4, 2005 meeting, staff presented a discussion of alternative obligating events for two farm support programs administered by the Farm Service Agency – the Milk Income Loss Contract program and the Feed Grains Direct and Counter-Cyclical Payment program. Staff presented an analysis of several potential obligating events and recommended that the submission of the contract and documentation of supporting evidence be selected as the obligating event for both programs. Board members did not make a formal decision on the obligating event at this meeting, but tentatively agreed that the government's determination of eligibility could be considered a measurement issue rather than a necessary step in determining whether or not a liability exists. Some members also discussed whether the point that the program is created could be considered a valid alternative obligating event. Staff plans to provide the board with an analysis of the views presented at this meeting as well as a presentation on the Corporation for National and Community Service's Service Award Liability at the next board meeting.

June 22-23, 2005

At the June 22, 2005 meeting, staff presented an analysis of the Corporation for National and Community Service's (the Corporation) Service Award Liability. Staff selected this program as an example of a government program that recognizes a liability before the due and payable point even though it is a nonexchange transaction and not all conditions have been met for the member to have a legal claim to the award. The Corporation currently recognizes a liability for each member after he or she has completed 15 percent of his or her term of service.

Staff compared the Corporation's program to the other programs presented by staff at prior meetings (Supplemental Security Income, Milk Income Loss Contract, and Feed Grains Direct and Counter-Cyclical Payment) and suggested that the point at which the member applies for the program could be considered the obligating event based on the

same logic applied by staff to the other programs (the point at which a mutual understanding/"meeting of the minds" has been formed).

Board members did not make a formal decision on the obligating event at this meeting, but did agree that it seems appropriate for the Corporation to recognize some amount earlier than due and payable for this program. However, under current FASAB SFFAS 5, a liability would not be recognized until due and payable if the transaction is characterized as nonexchange.

In addition, several board members debated whether (1) the program was actually nonexchange and (2) the liability should, in fact, either be recognized in full after the member has completed service or on a prorated basis as he is performing service. The alternative recognition points proposed by members would still result in earlier recognition than due and payable, which for this program, is after a member has completed his full term of service and incurred eligible educational expenses.

#### August 17-18, 2005

At the August 17, 2005, meeting, staff summarized the project results to date and presented three options for continuing:

- Present educational sessions on IASB and FASB work on expected values and obligations;
- Begin developing an operational approach to different classes of liabilities; or,
- Divert staff resources to another project.

Staff noted that there are fundamental disagreements between the board members, particularly on whether the liability is the future sacrifice itself or the stand-ready obligation to make that sacrifice. As a result, continuing to review individual programs one by one would probably not result in the timely settlement of many of these differences.

After a brief discussion, the board members unanimously agreed that the project should continue but should focus on classes of liabilities from this point forward, rather than a review of individual programs. Staff will research potential classes of liabilities and present a list of options for the board to consider.

#### October 5-6, 2005

At the October 2005 meeting, staff presented the following three potential liability classification options:

1. Option 1 – Apply New Liability Definition to Current SFFAS 5 Liability Classes
2. Option 2 – Apply New Liability Definition to Liability Classes by Transaction Type
3. Option 3 – Apply New Liability Definition to Liability Classes by Relationship Type

Staff stated that after considering the advantages and disadvantages to selecting each option and the degree of flexibility, effectiveness, and feasibility that might potentially result from choosing each of the options, the staff recommendation is that the board members select option 2.

After a brief discussion, Mr. Mosso took a poll of the board members regarding their preferences for the three options. The board members overwhelmingly selected option 1 as their preference; however, several of the board members that selected option 1 noted that even though they were selecting option 1, they recognized that option 1 would still require some revision or enhancements to what is contained in SFFAS 5. Staff will provide members with a revised list of liability classes based on option 1 with the different transaction types in option 2 incorporated.

January 11-12, 2006

Staff presented the board with a revised project plan (see excerpt below) that includes the four classes of liabilities from SFFAS 5 (exchange transactions, nonexchange transactions, government-related events, and government-acknowledged events), maps transaction types to each of the four classes, and proposes the engagement of a task force. The plan also proposes the following five tasks:

- Task One – Test the four Classes and Sub-classes of Liabilities through the use of a task force.
- Task Two through Five – Develop principles for determining when an obligating event has occurred and related recognition criteria for each of the four liability classes, prepare standards for each sub-class, and issue an exposure draft.

Staff solicited input and approval from the board on the revised project plan.

The board was in overall agreement with the revised project plan. Several board members indicated that they preferred that tasks two through five be completed concurrently; they would favor issuing one complete exposure draft over one exposure draft for each class. Two board members indicated that they would like to see an enhanced discussion on how conditions relate to the determination of obligating event as the project progresses. Staff will begin completion of Task One by assembling a task force of individuals representative of the federal financial management community and each of the four classes of liabilities.

Application of the Liability Definition  
Revised Project Plan  
December 21, 2005

## II. Project Scope

This project would address all significant obligations of the federal government that could potentially result in a net outflow of resources other than those obligations already being addressed by staff for the Social Insurance Liability Project. The project would focus on (1) obligations arising from transactions between individuals and the government and (2) assumption of risk through unique federal activities such as treaties or government sponsored enterprises. Significant government obligations include Medicaid, Food Stamps, Supplemental Security Income (SSI), Temporary Assistance for Needy Families (TANF), Veterans benefits, treaties, contractual agreements, and Government Sponsored Enterprises.

## IV. Project Approach<sup>6</sup>

There is broad and general agreement among FASAB Board members that establishing liability classes<sup>7</sup> would result in a more consistent application of the liability definition without the need for step-by-step rules on how to apply the definition to each government program as it comes into being. It is important to note, however, that the use of liability classes should not result in separate definition, recognition and measurement criteria for each class. Rather, the use of liability classes and sub-classes should allow grouping and discussion of common events and relationships within a class that would be relevant to consistently applying liability definition, recognition, and measurement criteria.

At the October 6, 2005, board meeting, the members voted to maintain the four broad classes that FASAB used to establish principle recognition points in SFFAS 5, *Accounting for Liabilities of the Federal Government*. Staff has slightly revised the definition of each of the classes as indicated by the use of underlining below:<sup>8</sup>

1. **Exchange Transactions** – an exchange transaction arises when each party to the transaction directly sacrifices value and directly receives similar value in return. There is a reciprocal or two-way flow of resources or of promises to provide resources of similar value. In an exchange transaction, a liability is recognized when one party receives goods or services in return for a promise to provide money or other resources in the future (e.g., the federal government purchase of goods or services at market value<sup>9</sup> from a vendor);
2. **Nonexchange Transactions** – a nonexchange transaction arises when one party to a transaction receives value without directly giving or promising similar value in return or one party to a transaction gives or promises value without directly receiving similar value in return. There is no reciprocal or two-way flow of resources or of promises to provide resources of similar value (e.g., grants to state and local governments, subsidies, and other transfer programs for individuals);
3. **Government-related Events** – government-related events are nontransaction-based events that are of financial consequence to the federal government because they involve direct interaction between the federal government and its environment, either through the conduct of federal operations or because the events take place

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<sup>6</sup> The previously approved project approach is included at Appendix 1.

<sup>7</sup> A class is "a group, set, or kind sharing common attributes" (characteristics) as defined by Merriam-Webster Online at [www.webster.com](http://www.webster.com).

<sup>8</sup> The original definitions are included at Appendix 2.

<sup>9</sup> Market value is defined as the price as determined dynamically by buyers and sellers in an open market.

**Application of the Liability Definition  
Revised Project Plan  
December 21, 2005**

on federal property (e.g., accidental damage to nonfederal property caused by federal operations); and,

4. **Government-acknowledged Events** – government-acknowledged events are nontransaction-based events that are not the result of federal operations and do not directly involve the federal government but are of financial consequence to the federal government because it chooses to respond to the event (e.g., damage to nonfederal property caused by a natural disaster).

The underlined additions above were made (1) to apply the word “direct” more consistently (see discussion of Issue 1 in Appendix 3) and (2) for clarification purposes.

At the October 6, 2005, board meeting, several board members indicated that they would like to see how the transaction types in staff’s Option 2 could be “mapped” to the liability classes in Option 1. The following listing presents this mapping:

1. Exchange Transactions
  - a. Employee and Veteran Benefit Payments – Examples would be federal employee pension and other retirement benefits, military pension and other retirement benefits, other post-employment benefits, FECA, and Veterans disability compensation.<sup>10</sup>
  - b. Capital Leases – Leases that transfer substantially all the benefits and risks of ownership to the lessee.
  - c. Federal Debt – Includes Treasury debt to federal agencies, federal agency debt to the Treasury, and federal debt to the public.
  - d. Accounts Payable for Goods and Services – Includes goods and services purchased through any means, including contracts, purchase orders, blanket purchase agreements, credit cards, intragovernmental agreements, etc.
  - e. Other
2. Nonexchange Transactions
  - a. General Fund Benefit Payments – Benefit payments that are financed by general revenues. Examples would be Temporary Assistance to Needy Families, Medicaid, Food Stamps, and Supplemental Security Income.
  - b. Insurance and Guarantees – Examples would include Pension Benefit Guaranty Corporation, Federal Crop Insurance Corporation, Overseas Private Investment Corporation, Federal Deposit Insurance Corporation, Loan Guarantees, the Milk Income Loss Contract Program, the Feed Grains Direct and Counter-Cyclical Payment Program, and other stand-ready obligations.
  - c. Grants and Award Programs – Government grants and awards can be provided under many different scenarios. Some can be provided without any significant requirements (e.g., formula-type grants to states based on population), while others may require specific activities to occur before the funds are available (e.g., the Corporation for National and Community Service’s Service Award Program).
  - d. Social Insurance – Includes Social Security, Medicare, and Railroad Retirement (see discussion of Issue 2 in Appendix 3).

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<sup>10</sup> Some believe that Veterans’ benefits arise from exchange transactions. However, SFFAS No. 5 provides an exception to full accrual accounting for health care benefits. This is a controversial exception in light of legislation intended to enhance veterans’ access to health care. The Board agreed to take up this issue in connection with this broad project on obligations.

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- e. Environmental and Disposal –Includes actions that are taken to comply with the Comprehensive Environmental Response Compensation and Liability Act of 1980 (CERCLA, or Superfund), and subsequent amendments; Safe Drinking Water Act; and Toxic Substances Control Act.
  - f. Other
3. Government-related Events
- a. Environmental and Disposal (e.g., hazardous waste resulting from government operations or the disposal of assets)
  - b. Damage to nonfederal property caused by federal operations (e.g., military aircraft crashes into private office building)
  - c. Damage to federal property resulting from federal operations or natural disasters (e.g., damage to the National Finance Center in New Orleans caused by Hurricane Katrina)
  - d. Treaties
  - e. Other
4. Government-acknowledged Events
- a. Environmental and Disposal (e.g., toxic waste damage to nonfederal property caused by nonfederal entities).
  - b. Damage to nonfederal property caused by natural disasters (e.g., damage to an apartment building in New Orleans caused by Hurricane Katrina)
  - c. Other

Staff Note: The classes and sub-classes above are based on the usual practice of the federal government but are not without exception. For example, in the unlikely event that the federal government was to enter into a capital lease that transferred substantial benefits to the federal government for significantly less than fair market value, the transaction would be more appropriately classified as a nonexchange transaction. In addition, there may be some insurance programs that are closer to exchange transactions if the value of the premiums received more closely matches the value of the risk assumed. However, many federal insurance programs were established to assume risks that private sector entities are unable or unwilling to assume (at least at prices that beneficiaries of the program can afford or want to pay) or to subsidize the provision of insurance to achieve social objectives. The four classes allow grouping and discussion of common events and relationships within a class that would be relevant to applying the liability definition. The “Other” sub-class is included as a placeholder for additional sub-classes that may arise as a result of the task force involvement discussed below.

March 29-30, 2006

Staff presented the board members with a copy of the packet that was sent to individuals in the federal financial management community, inviting them to participate in a task force on liability classification. The task force was approved by the board as part of the revised project plan presented at the January 2006 board meeting. The task

force invitation packet was sent to members of the Federal Financial Management Council and Financial Statement Audit Network, as well as several independent public accounting firms (IPA). Staff received a fairly good response rate, with representation from numerous agencies and three IPAs. The first meeting of the task force was held on Wednesday, April 12, 2006; the second meeting was scheduled for Thursday, May 11, 2006.

May 24-25, 2006

At the May 24 board meeting, staff presented a status report on the project, explained that the liability classification task force had held two meetings – the first on April 12 and the second on May 11 – and briefly summarized the results of the two meetings.

Staff recommended to the board that it take the input from the task force, update the class definitions and the subclasses, and then create a survey of five or six questions for wider distribution to the federal community for comment.

As there were no objections by the members to staff's recommendation, staff will circulate a survey to the federal community to solicit feedback on the enhancements to the class definitions drafted by staff and the completeness of the liability sub-classes based on the feedback from the task force.

July 26-27, 2006

Staff circulated a survey to the federal CFO and IG community to solicit feedback on the enhancements to the class definitions drafted by staff and the completeness of the liability sub-classes based on the feedback from the task force. Responses were requested by August 15, 2006. Staff planned to compile the responses and provide a summary to the board at the September meeting.

September 27-28, 2006

At the September 28, 2006, meeting, staff presented the results of the survey that was circulated to the federal CFO and IG community to solicit feedback on the enhancements to the liability class definitions and the listing of sub-classes drafted by staff. Based on a review of the responses to the survey and a discussion of the difficulty in defining only four classes for such a diverse group of transactions and events, the board directed staff to develop a framework for identification of obligating events at the sub-class level (e.g., grants, insurance, benefit programs, etc.) rather than at the class level. Once the obligating events are identified at the sub-class level, the board should be able to determine how or if additional grouping by major class might be accomplished.

Minutes from the September 28, 2006, meeting—the last meeting at which this project was discussed by the board—are included on the pages that follow.

- **Application of the Liability Definition**

Staff opened the session by providing a brief look at the status of the project, including completed phases and planned future phases. Since the project began in March 2004, staff has presented a project plan, fact sheets on selected federal programs, and an analysis of potential obligating events for select federal programs. In addition, staff has convened a task force and circulated a survey on liability classifications to obtain feedback from the wider federal financial management community.

Staff explained that the results of the survey were the subject of this meeting. If the Board continues to approve of the direction the project is headed, staff would begin to develop obligating events by class and a revised standard on liabilities to conform to the newly proposed liability definition.

Mr. Allen questioned whether it would be more appropriate for the project to be shelved until feedback is received on the Social Insurance Preliminary Views document. He pointed out that the Social Insurance document describes the obligating event in detail without ever referring to the liability classification structure.

Mr. Reid questioned what the alternatives would be if the project was held until the Board considers feedback on the Elements Concepts Exposure Draft and the Social Insurance Preliminary Views document. Ms. Comes responded that there are several other projects that have been designated as priority such as the Appropriate Source of GAAP, which staff has been working on in its spare time. In addition, Ms. Comes suggested that staff could rework the approach to this project and make it more conventional by addressing clearer sub-classes such as asset retirement obligations, social programs other than social insurance, grants, or insurance. She opined that the global approach to applying the liability definition might not facilitate change well in the community. She said she would prefer to see a more conventional approach.

Ms. Comes provided an example of why staff does not think the broad approach works very well, citing the standards in SFFAS 5 on government-related events. Those broad standards have not resulted in federal entities recognizing liabilities for such things as asset retirement obligations. Therefore, it seems that more specific standards are required.

Mr. Farrell agreed that maybe it would be more helpful in facilitating change to look at transactions from the sub-class level (e.g., grants, insurance, etc.).

Mr. Reid said it might be more prudent to hold this project until we work through some of the other priorities. Mr. Allen said he did not see the pressing nature of this project when the Board has other more pressing agenda items to address, such as Federal Entity.

Mr. Reid stated that we might want to revisit the project approach because, as it stands, he would not raise it to the level of importance of some of the other projects the Board has on its agenda.

Mr. Mosso asked if the Board would be willing to take a different approach. He suggested that staff come back with a discussion of obligating events by sub-class rather than by the four classes.

Mr. Patton said he is concerned that the Board will end up discussing all the nuances among the various programs.

Mr. Dacey said that there is general agreement on some of the broad concepts but that does not mean the Board cannot fill in some of the subparts of the framework more clearly.

Ms. Comes said it might be feasible to leave the general standards of SFFAS 5 and the guidance on the four classes in place and pull out sub-classes one by one and provide specific guidance on recognition and measurement by sub-class, not by program.

Mr. Mosso asked if there were any comments on staff's recommendations.

Mr. Allen said he was not clear on what the feedback was leading towards. Mr. Dacey said it is positive that we have feedback from the community upfront as to what the categories are.

Mr. Torregrosa inquired whether the nature of transactions as voluntary or involuntary, which are not mentioned in the definitions, was an important characteristic. Ms. Comes said that there is some reference in the literature that says exchange/nonexchange transactions need not be characterized as voluntary or involuntary. She said staff would provide the literature to Mr. Torregrosa.

Mr. Patton pointed out that the revised definition of exchange allowed for any exchange, no matter how small the dollar amount, to be an exchange, while the revised definition of nonexchange only included transactions where the flow was one-way and there was \$0 on the other side. He said that he did not believe the distinction was that clean and perhaps there should be another box for mixed exchange/nonexchange. If that were the case, these definitions for only \$0 and non-\$0 transactions would not work.

[Break]

Mr. Mosso returned from the break and asked if staff was ready to begin developing a discussion of obligating events by sub-class.

Mr. Reid said he sees a continuum of transactions where some are exchanges, some are nonexchanges, and some have attributes of both. He said he shares Mr. Allen's concerns and, given the broad scope of federal programs, he is not sure that the Board

would be able to develop something that is much more helpful than the four classes that exist today. Mr. Reid said that preparers and auditors would need to exercise a certain amount of judgment as to where a program falls on the continuum of transactions, and when we get done, that is still going to be the case.

Mr. Dacey said it might be helpful to develop a discussion of the obligating events at the sub-class level and then see if they can fit under an umbrella for the class. If not, they may not belong in a class, but it is too early to make that decision. In other words, determine if an obligating event can be described in a reasonably consistent way for each of the sub-classes. Then see if those sub-classes can be raised to a higher level as a principle for the class, or break apart the class, whichever is more appropriate.

Mr. Mosso asked if the approach outlined by Mr. Dacey seemed workable to staff. Ms. Comes responded affirmatively. Mr. Mosso asked if any of the members objected to that approach. Mr. Allen asked if the silence of the Board meant that they had agreed to the approach. Mr. Mosso said yes and suggested that staff time their activity once they have something a little more concrete to apply to the groupings.

**CONCLUSIONS:** Staff will begin developing obligating events by sub-class, as deemed appropriate by the developments in the related projects on Elements and Social Insurance.

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All briefing materials referenced above are available currently on the active project page at <http://www.fasab.gov/projects/active-projects/application-of-the-liability-definition/>.

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## MINUTES FROM TECHNICAL AGENDA DISCUSSION AT APRIL 2011 MEETING

Ms. Payne introduced the technical agenda discussion by reviewing existing projects. She believes that in the three to five year window, each of the identified future priority projects could attract resources. The question for the board would be the sequence of future projects and she provided her comments on the merits of each project. She then suggested that member ask any questions they have and then offer their priorities.

Mr. Dacey asked about risk assumed – he referred to page 5 of the briefing materials and asked for clarification regarding the scope. Items 1 and 2 on those pages were understandable. He asked about the other areas. Ms. Payne indicated that FASAB would be breaking new ground in some areas—such as implied guarantees and natural disasters. In addition, in some cases it would be difficult to set boundaries for reporting.

Mr. Dacey asked for more information on implied guarantees. Ms. Payne noted that there is currently a great deal of interest in implied guarantees in academic and public policy arenas. For example, recent regulatory reforms are being studied and some are reporting that large banks now enjoy a lower cost of capital than smaller banks. Some believe this is the result of an implied guarantee resulting from regulatory arrangements. She expressed some concern that a search for implied guarantees that could be reported would pose a slippery slope dilemma and greatly expand the project and financial reporting boundaries. For that reason, she estimated a longer time frame for the project, suggested a phased approach, and allocated more staff resources.

Mr. Dacey indicated he envisioned some narrative disclosure about relationships. He did not believe it could go much further than that. He asked about the notion that expected cash flows be used a basis for recognizing costs.

Ms. Payne responded that the IASB project on insurance contracts may offer lessons learned about valuation. She allowed that we could not draw direct analogies from the insurance industry but that some recognition of costs may result from applying new measurement methods.

Mr. Allen noted that many economists addressed the subsidy resulting from implied guarantees and that it was observable through market pricing of transactions. He wondered if you ought to make disclosures about such subsidies. Mr. Dacey affirmed that he viewed this as an area for disclosures but not necessarily changes to recognition requirements. He viewed the need as clearer disclosures of risk so that a reader could understand the nature of the risk assumed.

Mr. Allen added that it was a fair concern because such a project could be open ended and go on for many years. Ms. Payne indicated that the scope could be adjusted but she had not envisioned foreclosing the notion that an amount could be measured. If an amount could be measured then the question should at least be asked whether an amount should be recognized.

Mr. Dacey noted that the face value of contracts might be available and wondered if that was sufficient measurement. Ms. Payne noted that some might argue that amount overstated the risk assumed and that expected cost had evolved greatly.

Mr. Allen asked if there was a movement away from the traditional FAS 5 approach to contingencies. Mr. Dacey noted the differing views of FASB and IASB—they are approaching loan losses as an expected value measurement. They seem to have agreed to move to an expected loss approach to loans. Today they would not project expected losses; instead they would focus on known impairments. In the insurance industry, we have an expected losses approach today. The FDIC does a bank by bank analysis to determine those they expect to fail. For flood insurance, the liability is based on floods that have occurred. He thought it would be challenging to come up with an expected loss on the current book of business.

Mr. Allen indicated that we may not be able to settle on the scope today. He asked if there are other questions about the projects.

Mr. Steinberg indicated that he thought we should start with as broad a scope as possible and then narrow down. He noted that we have a statement of fiscal sustainability that he hopes covers all exposures and whether we can sustain them. He is much more worried about the liability side. He places risk assumed number one and this is behind some other projects in terms of the start date. Ms. Payne indicated that the timing of the start is based on when staff members would become available.

Mr. Jackson noted that risk assumed should be a priority. He is comfortable starting broad and narrowing down later.

Mr. Granof noted that some projects report only “one member” supports. Ms. Payne indicated that it was the strongest statement she was able to make after listening to the tape of the board’s discussion. Mr. Granof responded that he thought the electronic reporting project was elusive but very important. He liked the project write up.

Mr. Allen indicated that he thought a partnership would be needed to make progress. He saw a role for OMB and asked if a joint effort would be beneficial. Credibility would be brought by a partnership with GASB and IPSASB along with the administration. If it was a high enough priority – he would approach the other boards.

He asked members to comment on their priorities. Mr. Showalter asked if the request was to report a ranking. Mr. Allen indicated yes and Mr. Dacey asked members to also comment on what was a priority in the three to five year window. If there are projects at the bottom of the list that are not urgent, they may fall off the list.

Ms. Payne reported Mr. Schumacher’s priorities since he was unable to be at the meeting today. His priorities are risk assumed, leases (prefers to be right behind FASB on this), cleanup costs, investments in non-federal securities, and public-private partnerships. He also offered comments on four other projects. On reduced burden on preparers, he was unsure of the scope and it being a stand alone project but was generally supportive of the

idea that burdens be reduced when appropriate. On electronic reporting, he noted that a partnership – such as the one Mr. Allen described – would be essential for it to succeed. On performance reporting, he believed it was worthwhile but that it may not be a FASAB project. On internal use software, he would support it if other members supported it but he would rank it sixth.

Mr. Showalter ranked risk assumed first and supported a broad scope at the beginning of the project. He supported reducing burden on preparers as number two but would approach it through evaluation of the component entity reporting model. He believes we still need to look at the financial statements as published and how effectively they communicate. He places leases as number three. Investments in non-federal securities had not been on his list but now had a better understanding and placed it at four. Public-private partnerships is at five. He would like to collaborate on electronic reporting. He noted that cleanup costs could come out of risk assumed and he did not rank it separately.

Mr. Dacey ranked risk assumed first and leases (following FASB's lead) second. He would not put reducing burden on his list but would consider it in each project. Electronic reporting is elusive and he noted that GASB has been occasionally working on it without much progress. He wondered if AGA should work on it as a best practices effort. Performance reporting would not be on his list. On investments in non-federal securities, he wonders how the board would change the FASB preparers' reporting in the separate project on that issue. If the board changed the notion that federal entities can report under FASB standards, he might consider it. For public-private partnerships, he believes the GAAP hierarchy would apply. He asked if we really have much activity at the federal level. Ms. Payne noted service concession arrangements at the parks, VA regional health care facilities, and DoD military housing. She also noted that the automatic application of the GAAP hierarchy prevents the board from making decisions about the timing and level of detail appropriate for US entities.

Mr. Dacey thought perhaps we would adopt the standards established by others. He was open but did not see a strong need. On internal use software, he thought the issues could be dealt with by the AAPC or others.

Ms. Bond started by looking at existing projects. She thought that the reporting model project changed somewhat based on yesterday's conversation. She thought the statement of spending should be top priority but would begin as a FASAB project in 2013. She also thought the component entity portion of the project would be broader. The CFO Council and the Council on Government Integrity and Efficiency study of the 20 years of CFO Act experience and accompanying recommendations should be a top priority. She would like to see resources remain available to work on that. She supported Mr. Showalter's comments on reducing burden on preparers. She thought that work on the statement of spending and the results of the study would demonstrate a concern for reducing burden and she would support that effort.

Ms. Bond ranked risk assumed next but shared Mr. Dacey's concerns about the scope. She felt it was drafted too broadly and would be unwieldy. More work could be done

years out after some initial progress. She would address leases next. The other projects she would not address. Cleanup costs is something she would not address at least until 2013. Electronic reporting is not a FASAB project – she agrees with others' comments. While she is personally interested in performance reporting, she would not rank this as a FASAB project. The others she does not see as priorities in the near term.

Mr. Allen noted that he linked the evaluation of the component entity reports, the 20 year study of the CFO Act, and reducing burden; he ranked this as a priority for current projects. Risk assumed would be his first. Electronic reporting would be second if there were partnerships. Ultimately, he thought there should be certain minimum standards for electronic reporting. He acknowledged that this was on the fringes of our authority.

After these, leases would be next because the time may be right to build on the FASB guidance. He would then rank investments in non-federal securities. He prefers that the standards cover all topics rather than relying on the hierarchy. Internal use software would be next—he would simply expense it depending on the recommendations of the AAPC task force. Public-private partnerships would be next. Cleanup costs could be done quickly and might come sooner for him.

Mr. Reger thought reducing burden should be an under-lying priority in all projects. His number one is risk assumed. He thought integrating the statement of spending and saying how it relates to cost is second. His third was leases. The public-private partnerships should be addressed because it can be a long-term problem and he ranked it fourth since they can create liabilities. Electronic reporting would be important if we could partner with others. He did not rank any others as priorities right now but might come back to them in the future.

Mr. Steinberg ranked risk assumed first. He put electronic reporting second. He said the project description showed how important this is and the issues we may encounter. He believes it will move ahead at a rapid pace and this is an opportunity to get out front on something the preparers care about. He also thought we would not have differences with GASB on this and could partner. He ranked cleanup costs next because he does not learn anything from reading the statements of agencies with large liabilities. He did not see the problems in other areas but would put them on the agenda to be addressed as time permits. He also thought the statement of spending is a concepts project and we previously deferred concepts work.

Mr. Jackson noted that the statement of spending will require us to describe the basis of accounting. He thought we would be compelled to address it in GAAP to make it a basic statement. He ranked risk assumed as a top priority. He would not put anything else on the list. With respect to cleanup costs, he sees some fatal flaws in the cleanup costs – for example, the landfill example is not appropriate. However, the burden on preparers arising from cleanup costs could be quite significant. He appreciated the need to fix the standard but would be cautious. He would reduce burden by considering cause and effect for each standard and not as a separate project. He thought consideration of materiality at the component entity level would help reduce burden. He thought leases

should be addressed when FASB completes its work. He would simply expense software but did not rank it as a priority. His absolute ranking was risk assumed and nothing else.

Mr. Granof agreed that risk assumed was first. He was troubled by where to rank electronic reporting and ranked it two so we would not forget about it. There is a lot to be done but partnerships would be important. Leases he ranked three. Investments in non-federal securities he ranked four. Owning twenty or thirty percent of an entity is significant. He believed that there will be more ownership of non-federal securities and that it will be a prominent issue. He ranked public-private partnerships fifth and we could deal with this efficiently. He ranked cleanup costs and internal use software as five and six. Performance reporting is critical and the federal government is ahead of state and locals. But, he would not rank it high as a FASAB project.

Mr. Reger asked Ms. Bond if the review of the CFO Act would produce recommendations. Ms. Bond indicated that she could not say what the recommendations would be. She thought that it would be prudent to be aware of what's going on in the community. There is potential for the board to see some priorities among the recommendations. She raised it so that the board would be aware of the effort and not be surprised. She thought the board should be prepared to be nimble.

Mr. Allen indicated that it would be part of the reporting model project and we have resources available. Mr. Reger said the timing would be an issue – there is some question of when the report will come out. Mr. Allen said the prioritization has some flexibility. We can revisit after the report comes out. Mr. Jackson noted that a great deal could be done through the AAPC and staff guidance to reduce burden. Often we simply need to provide some leadership to effectively implement a standard rather than changing it.

Mr. Dacey agreed. Sometimes issues are simply related to implementation approaches. Mr. Jackson noted that perhaps other standard setters don't offer much implementation guidance but we have the advantage of being in a smaller arena.

Mr. Allen suggested we summarize the results and let members offer feedback. Some members may wish to change their rankings. Ms. Payne summarized the top ranked projects for the three to five year window as follows:

- 1 – Risk Assumed
- 2 – Leases
- 3 – Investments in non-federal securities
- 4 – Public-private partnerships

She noted that number five was electronic reporting but had a large "if" – if we found partners – and number six was internal use software.

Ms. Bond noted that reducing burden was mentioned many times. Ms. Payne noted that it was almost always in the context of other projects and being mindful of reducing burdens. Ms. Bond noted that those projects without majority support would not seem to

be areas we would come back to. Generally, members questioned how to deal with projects ranked highly by some members but not ranked at all by more than four members. Mr. Reger noted that providing a sense of where to put resources may be all we accomplish today but a score for each possible project was not useful.

Ms. Payne indicated that all members and staff have indicated sensitivity to reducing burden. In addition, events and circumstances that arise during the three to five year window can influence where resources are assigned.

Mr. Allen indicated that a ranking below the top four was not useful.



**STAFF SUMMARY OF RISK ASSUMED RANKING**

<b>Member</b>	<b>Risk Assumed Ranking</b>	<b>Related Comments, if any</b>
Allen	1	
Bond	3	Concerned about scope of project; felt it was drafted too broadly and would be unwieldy. More work could be done years out after some initial progress.
Dacey	1	Views implied guarantees as an area where additional disclosures may be warranted but not necessarily changes to recognition requirements
Granof	1	
Jackson	1	Would not put anything else on the list; comfortable starting broad and narrowing down later
Reger	1	
Schumacher	1	
Showalter	1	Supports a broad scope at the beginning of the project
Steinberg	1	Should start with as broad a scope as possible and then narrow down

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## **ABBREVIATIONS**

CBO	Congressional Budget Office
CFO	Chief Financial Officer
EESA	Emergency Economic Stabilization Act
FASAB	Federal Accounting Standards Advisory Board
FASB	Financial Accounting Standards Board
FHFA	Federal Housing Finance Agency
GAAP	Generally Accepted Accounting Principles
GAO	Government Accountability Office
GSE	Government-sponsored Enterprise
IASB	International Accounting Standards Board
OFS	Office of Financial Stability
RSI	Required Supplementary Information
RSSI	Required Supplementary Stewardship Information
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards
TARP	Troubled Asset Relief Program

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## KEY TERMS

**Risk assumed** is generally measured by the present value of unpaid expected losses net of associated premiums, based on the risk inherent in the insurance or guarantee coverage in force [excerpt from SFFAS 5, par. 105].