

Fiduciary Activities Q&A – Public Meeting Minutes- April 12, 2007

Attendees:

Deb Carey, Securities and Exchange Commission

David Horn, Dept. of the Interior

Kristen Kociolek, Government Accountability Office

Margaret Williams, Dept. of the Interior, Office of Special Trust

Robert Winter, Dept. of the Interior, Office of Special Trust

Fred Winter, KPMG

Wendy Payne, FASAB

Eileen Parlow, FASAB

FASAB Executive Director Wendy Payne opened the discussion by asking if attendees had a copy of the draft Q&As (attached). She said that today's informal public meeting was the beginning of a process to provide implementation guidance for Statement of Federal Financial Accounting Standards (SFFAS) 31, *Accounting for Fiduciary Activities*. She said that

- The goal was to develop Q&As that were complete, clear and necessary.
- The next step would be to develop a draft for formal public comment.
- Today's meeting was to discuss the questions, and perhaps get some initial comments on the draft answers to the questions.

Ms. Payne asked if there were any questions that should be eliminated and whether the questions were clear. The meeting attendees indicated no objections to the inclusion or clarity of any of the draft questions. Ms. Payne noted that the questions had been vetted by interested parties including the Department of the Interior, so the lack of objections was not a surprise.

Ms. Payne then asked if there were any questions that should be added.

Ms. Carey of the Securities and Exchange Commission (SEC) said that there is one item that may or may not be within the scope of SFFAS 31. She said that sometimes as the result of an SEC enforcement action, the court will direct someone to pay funds into an outside escrow account that is not under the direct control of the federal government. She asked if such funds would be subject to the requirements of SFFAS 31.

Ms. Parlow said that this example seems similar to one of the draft questions, which addresses funds deposited into an outside escrow account. She said that the Department of the Interior had asked about a similar situation in which funds that were deposited into an escrow account and never came under the control of the federal government.

Ms. Payne asked who administers the escrow accounts. Ms. Carey replied that private banks administer the escrow accounts. Ms. Payne asked who directs the payments from the escrow accounts. Ms. Carey replied that for the cases she is asking about, the court directs the payments. (In cases where the SEC directs the payments, the money is

deposited in the U.S. Treasury rather than private banks.) However, the SEC generally reserves the right to approve or disapprove the distribution plan.

Ms. Payne said that FASAB staff could set up a future meeting with SEC representatives to discuss this issue. She asked if there were any other potential questions.

Ms. Payne then asked if there were any concerns about the draft answers to the Q&As. When there was no response, she said that any new issues that arise during the process and future comments on the Q&As could be addressed to Ms. Parlow.

Ms. Payne explained that the process for issuing Staff Implementation Guidance (SIG) is designed to provide speedy guidance. She said that once staff is satisfied that we have all the questions and the answers clear, we will go to the next step: a 15-day public exposure and made any resulting edits, and then go to the Board for negative assurance (no objections). SIG can theoretically be issued in 30 to 45 days. However, it may take additional time to resolve the SEC's question.

Ms. Parlow asked the Department of Interior representatives if they had any situations similar to what the SEC representative described. Mr. Winter asked if the public comments received would be made available. Ms. Payne replied that they would be, but because the content of the Q&As is believed to be non-controversial and the comment period is accordingly short, few comments would be expected.

Ms. Payne thanked the participants and adjourned the meeting.

Accounting for Fiduciary Activities – Questions and Answers

Q1. Do the requirements of Statement of Federal Financial Accounting Standards (SFFAS) 31 extend to all reports required by law or administrative action?

No. SFFAS 31, Paragraph 8, explains the scope of the standards as follows:

[8] This statement provides financial reporting standards for fiduciary activities in the general purpose financial statements for Federal entities. The standard does not affect reporting in the *Budget of the United States* or special-purpose reports.

Accordingly, SFFAS 31 does not apply to (a) reports such as stand-alone audited financial statements that are prepared under an “other comprehensive basis of accounting” (which may be considered “special purpose reports”) or (b) individual statements provided to beneficiaries.

With respect to individual statements to beneficiaries, some have suggested that the SFFAS 31 disclosures should be based on information prepared at the beneficiary ownership level and aggregated for the component entity. Component entities using this approach would develop and report accrual basis information for the individual beneficiary. The Board does not intend that this approach be required. Rather, the Board intends the accrual of fiduciary activities to be implemented in a cost-effective manner. Therefore, a single aggregate accrual that supports information presented in the schedule of net assets and fiduciary activity in a note to the financial statements should be considered. This approach would support the disclosures required by SFFAS 31 in a cost-effective manner.

Q2. May component entities aggregate fiduciary activities for disclosure purposes?

Yes. Further, discretion is permitted in selecting activities to be presented individually.

Paragraphs 20 and 21 of SFFAS 31 provide:

[20] For component entities with several distinct fiduciary activities, summary financial information required in paragraph 18 should be provided for each fiduciary activity presented individually. Information for fiduciary activities not presented individually (see paragraph 21) may be aggregated.

[21] Selecting fiduciary activities to be presented individually requires judgment. The preparer should consider both quantitative and qualitative criteria. Acceptable criteria include but are not limited to: quantitative factors such as the percentage of the reporting entity's fiduciary net assets or inflows; and qualitative factors such as whether a fiduciary activity is of immediate concern to beneficiaries, whether it is politically sensitive or controversial, whether it is accumulating large balances, or whether the information provided in the fiduciary note disclosure would be the primary source of financial information for the public.

Paragraph 20 of SFFAS 31 identifies the summary financial information that should be provided for each fiduciary activity presented individually and explains that this financial information should be presented as aggregated for all activities not presented individually. Paragraph 21 of SFFAS 31 recognizes that judgment should be exercised in deciding if any fiduciary activities should be presented individually. For example, subject to the considerations in paragraphs 20 and 21, an entity might present summary financial information for:

- all fiduciary activities in aggregate,
- fiduciary activities aggregated by type of activity such as leasing or investing activity,
- classes¹ of beneficiaries separately as individual fiduciary activities, or
- fiduciary activities conducted by individual program offices.

The entity may present simply "total fiduciary funds" as a single column. Alternatively, the entity may present the information by program office to facilitate performance measurement. Yet another option is to present information by class of beneficiary.

Q3. In some cases several bureaus within an agency or department perform activities that result in fiduciary balances that are distributed by another bureau of the agency. Should each bureau include fiduciary activities disclosures in its stand alone audited financial statements?

If the activity meets the definition of fiduciary activity it should be reported as such.

Collections for non-Federal individuals or entities that are directly invested on behalf of the non-Federal parties or directly deposited into a non-Federal account such as a commercial

¹ Beneficiaries may belong to a class if they are (1) served by the same system or program office, (2) share certain traits or characteristics (e.g., local governments), or (3) both.

Handout - April 12, 2007 Public Meeting: Draft Q&As

bank account or a deposit fund, generally meet the definition of fiduciary and should be reported in a fiduciary note disclosure by the bureau.

In contrast, collections that are transferred to another Federal agency, component or bureau generally meet the definition of custodial activity rather than fiduciary activities. For example, the Internal Revenue Service, which is a bureau of the Department of the Treasury, collects taxes on behalf of the Federal government and reports the collections in a Statement of Custodial Activity.

Paragraphs 61 and 101 of SFFAC 2 provide the following guidance for custodial activities:

[61] The collection of the major sources of funds for the appropriations, e.g., taxes, royalty payments, and fines, is the responsibility of just a few reporting entities, especially the Internal Revenue Service, the Customs Service, and the Minerals Management Service. These entities are functioning in a custodial capacity and are required to turn the taxes or other monies they collect over to the Treasury or other organizations. The results of these entities' custodial activities could be reported in a flow statement that provides an understanding of from whom the taxes or other monies were collected and to whom they were distributed. This would be called a statement of custodial activities.

[101] A separate statement of custodial activities would be appropriate for those entities whose primary mission is collecting taxes or other revenues, particularly sovereign revenues that are intended to finance the entire Government's operations, or at least the programs of other entities, rather than their own activities. The revenues should be characterized by those agencies as custodial revenues. The statement should display the sources and amounts of the collections of custodial revenues, any increases or decreases in amounts collectable but not collected, the disposition of the collections through transfers to other entities, the amounts retained by the collecting entity, and any increase or decrease in the amounts to be transferred.

Q4. In some cases, beneficiaries may direct third parties to make payments to a federal agency for credit to the beneficiaries' account. For example, the beneficiary may hold assets outside the trust and elect to liquidate the assets and have the proceeds deposited in the trust. At what point does this activity result in an asset that qualifies for disclosure as fiduciary activity?

The role of the federal entity must be understood in order to determine the extent of the fiduciary disclosure requirement in SFFAS 31. In some cases, there is no fiduciary or trust asset until an actual deposit is received. If, for example, the federal component entity has no collection responsibilities but merely receives funds directed to the entity by the beneficiary, there is no account receivable. Instead, the entity would become responsible for disclosing cash only after a deposit is made.

Q5. Is there any requirement to report fiduciary assets, liabilities or flows when the Federal entity does not perform any of the fiduciary activities listed in the definition, but does provide other services, such as advisory services that may lead

to a contract being executed outside of the Federal government, with no further Federal role?

No. Certain activities that support beneficiaries may not lead to the creation of fiduciary or trust assets.

Per SFFAS 31, par. 10, in a fiduciary activity a Federal entity collects or receives and subsequently manages, protects, accounts for, invests, and/or disposes of cash or other assets in which non-Federal individuals or entities (or “non-Federal parties”) have an ownership interest that the Federal Government must uphold.

For an activity to meet the definition of a fiduciary activity, the Federal entity has to:

- a) collect and receive fiduciary cash or other assets and
- b) subsequently perform one or more of the other activities identified in the definition (manage, protect, account for, invest, and/or dispose of the fiduciary cash or other assets).

Q6. In some cases, courts may direct third parties to make payments to an escrow account in a commercial bank to be distributed to harmed parties. The escrow accounts are not the property of the Federal government, and the interest income is subject to taxes. In some of these cases, a Federal agency may have some control over disbursements (e.g., by approving or disapproving a third-party distribution plan). Does this situation meet the definition of fiduciary activity in SFFAS 31?

No. In this example, the Federal agency has not received or collected the cash or other assets.

For an activity to meet the definition of a fiduciary activity, the Federal entity has to:

- a) collect and receive fiduciary cash or other assets and
- b) subsequently perform one or more of the activities identified in the definition (manage, protect, account for, invest, and/or dispose of the fiduciary cash or other assets).

Q7. Does SFFAS 31 require reporting the monetary value of fiduciary land held in trust

No. SFFAS 31 requires a general description of land that is held in fiduciary trust and reporting of the total quantity of land held in fiduciary trust, as follows:

- beginning quantity,
- quantity received,
- quantity disposed of,
- net increase/decrease, and
- ending total quantity.

The reporting requirements for land held in fiduciary trust are found in paragraph 18 of SFFAS 31: **(bold added)**

[18] A separate note to the financial statements should include the following information for individual fiduciary activities:

- (a) A description of the fiduciary relationship, e.g., the applicable legal authority, the objectives of the fiduciary activity, and a general description of the beneficial owners or class of owners.
- (b) A Schedule of Fiduciary Activity displaying, for all periods presented:
 - The beginning balance of net assets,
 - The inflows from the fiduciary activities by category (e.g., contributions, investment earnings) and outflows by category (e.g., benefit payments, refunds, administrative expenses),
 - The change in net assets, and
 - The ending balance of net assets.
- (c) A Schedule of Fiduciary Net Assets displaying the current and prior period ending balances of cash and any other assets by category (e.g., receivables, investments), and liabilities by category (e.g., accounts payable, refunds payable), and a variance analysis addressing significant changes from the prior period. **The disclosure for non-monetary fiduciary assets should include a description of the composition of the assets, the method(s) of valuation, and changes (if any) from prior period accounting methods.**
- d) **Component entities also may have non-valued fiduciary assets. Non-valued fiduciary assets are fiduciary assets for which required disclosure does not include dollar values. Non-valued fiduciary assets may include land held in trust. Component entities holding non-valued fiduciary assets should disclose them in a Schedule of Changes in Non-Valued Fiduciary Assets, which should include a description of non-valued fiduciary assets, beginning quantity, quantity received, quantity disposed of, net increase/decrease in non-valued fiduciary assets, and ending total quantity.**

Q8. How should the concept of materiality be applied to disclosures about fiduciary activities?

The Board's position on materiality is published in the Foreword to *Original Pronouncements, Volume 1*, available on the FASAB website at:
<http://www.fasab.gov/codifica.html>

Materiality

The Board intends that all standards' application be limited to items that are material. "Materiality" has not been strictly defined in the

accounting community; rather, it has been a matter of judgment on the part of preparers of financial statements and the auditors who attest to them. Presented below is the Board's position on the issue of materiality at this time.

The accounting and reporting provisions of the Board's accounting standards need not be applied to immaterial items. The determination of whether an item is immaterial requires the exercise of considerable judgment, based on consideration of specific facts and circumstances.

Additional guidance on materiality is provided in SFFAC 2, SFFAS 1, SFFAS 3, and the American Institute of Certified Public Accountants (AICPA) Code of Professional Conduct.

SFFAC 2

[78] Some of a reporting entity's components are likely to be required by law or policy to prepare and issue financial statements in accordance with accounting standards other than those recommended by FASAB and issued by OMB and GAO,² e.g., accounting standards issued by the Financial Accounting Standards Board or accounting standards established by a regulatory agency. Those components should continue to issue the required reports. The reporting entities of which the components are a part can issue consolidated, consolidating, or combining statements that include the components' financial information prepared in accordance with the other accounting standards. They need to be sensitive, however, to differences resulting from applying different accounting standards that could be material to the users of the reporting entity's financial statements. If these differences are material, the standards recommended by FASAB and issued by OMB and GAO should be applied. The components would need to provide any additional disclosures recommended by FASAB and included in the OMB-issued standards that would not be required by the other standards.

SFFAS 1

[12] Except as otherwise noted, the accounting and reporting provisions of the accounting standards recommended in this Statement need not be applied to items that are qualitatively and quantitatively immaterial.

[13] The determination of whether an item is material depends on the degree to which omitting or misstating information about the item makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or the misstatement.

SFFAS 3

[8] The accounting and reporting provisions of the Board's accounting standards need not be applied to immaterial items. The determination of whether an item is immaterial requires the exercise of considerable judgment, based on consideration of specific facts and circumstances.

² Note: After October 1999, FASAB issues standards absent an objection from the Office of Management and Budget (OMB) or the Government Accountability Office (GAO).

[9] FASB's Statement of Accounting Concepts No. 2, "Qualitative Characteristics of Accounting Information," discusses the concept of materiality. According to this statement, the determination of whether an item is material depends on the degree to which omitting or misstating information about this item makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or the misstatement. This concept includes both qualitative and quantitative considerations. An item that is not considered material from a quantitative standpoint may be considered material if it would influence or change the judgment of the financial statement user.

In addition, the AICPA Code of Professional Conduct, Rule 203 states (**bold added**):

Rule 203—Accounting Principles A member shall not (1) express an opinion or state affirmatively that the financial statements or other financial data of any entity are presented in conformity with generally accepted accounting principles or (2) state that he or she is not aware of any material modifications that should be made to such statements or data in order for them to be in conformity with generally accepted accounting principles, if such statements or data contain any departure from an accounting principle promulgated by bodies designated by Council to establish such principles **that has a material effect on the statements or data taken as a whole**. If, however, the statements or data contain such a departure and the member can demonstrate that due to unusual circumstances the financial statements or data would otherwise have been misleading, the member can comply with the rule by describing the departure, its approximate effects, if practicable, and the reasons why compliance with the principle would result in a misleading statement.

Materiality with respect to fiduciary disclosures should be based on professional judgment considering relevant qualitative and quantitative factors. Examples of quantitative factors include but are not limited to the relationship of fiduciary amounts to other appropriate information in the entity's principal financial statements including disclosures. For example, the quantitative materiality determination for each fiduciary item could be made based on the significance of those amounts to amounts recognized on the principal financial statements of the reporting entity, and/or on the significance of an individual item within the fiduciary amounts to all fiduciary amounts presented by the reporting entity.

In all cases, qualitative materiality aspects should be appropriately considered.

Q9. May estimating techniques be used when reporting fiduciary disclosures?

Yes, estimating techniques may be used when reporting fiduciary disclosures. For example, accrual estimates may be developed and reported on a summary level. When estimates are used for summary information for fiduciary activities, the fiduciary note should include disclosure of the use of estimates and explain that the actual results may vary from the estimates reported.