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# Statement of Federal Financial Accounting Standards 20: Elimination of Certain Disclosures Related to Tax Revenue Transactions by the Internal Revenue Service, Customs, and Others, Amending SFFAS 7, Accounting for Revenue and Other Financing Sources

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## Status

<b>Issued</b>	September 29, 2001
<b>Effective Date</b>	For periods ending after September 30, 2000
<b>Interpretations and Technical Releases</b>	None.
<b>Affects</b>	SFFAS 7
<b>Affected by</b>	None.

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## Summary

Statement of Federal Financial Accounting Standards (SFFAS) 7, *Accounting for Revenue and Other Financing Sources*, became effective in fiscal year 1998 and included detailed provisions that apply to entities collecting taxes on behalf of the Federal Government. The two entities collecting the vast majority of federal taxes are the Internal Revenue Service (IRS) and the U.S. Customs Service (Customs).

The Board is issuing this standard to rescind paragraph 65.2 of SFFAS 7. Absent very detailed explanations, the provisions of paragraph 65.2 could result in information being given to readers of the financial statements that they might misinterpret. The Board believes that paragraph 65.2 would not accomplish what it purports to accomplish, and would impose costs unnecessarily on both the preparer and auditor without a significant benefit. The Board's reasoning is explained more fully in Appendix A, Basis for Conclusions.

This amendment is effective for periods beginning after September 30, 2000.

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## Introduction

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### Purpose

1. This standard rescinds paragraph 65.2 of Statement of Federal Financial Accounting Standards (SFFAS) 7 and makes other conforming changes.

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### Background

2. SFFAS 7 became effective in fiscal year 1998 and included, along with other provisions, detailed provisions that apply to entities collecting taxes on behalf of the Federal Government. Paragraph 65.2 of that standard required disclosure of “revenue-related transactions affecting the beginning and end-of-period balances of accounts receivables, accounts payable for refunds, and the allowance for uncollectible amounts.”
3. Subsequent to the issuance of the standard questions arose as to the usefulness of the information as well as to the practicality of producing it. After discussing the issues and options, the Board issued, in November 1998, an exposure draft of a standard rescinding paragraph 65.2. Ultimately, the Board agreed that more study was needed, and in January 1999 it deferred the effective date of paragraph 65.2 until October 1, 2000 (SFFAS 13, *Deferral of Paragraph 65.2 – Material Revenue-Related Transactions Disclosures*).
4. In November 2000, the Board issued a second exposure draft, *Elimination of Disclosures Related to Tax Revenue Transactions by the Internal Revenue Service, Customs, and Others, Amending SFFAS 7*. Based on comments received and further consideration, the Board is now rescinding paragraph 65.2.

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### Effective Date

5. This amendment is effective for periods beginning after September 30, 2000.

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## Accounting Standard

6. Paragraph 65.2 of SFFAS 7 is repealed and rescinded.

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7. Other conforming changes:

- a. The last sentence of paragraph 107 of SFFAS 7 is changed to delete “65.2 and” from the parenthesis.
- b. The last sentence of footnote 41, paragraph 187.1 of SFFAS 7 is changed to delete “in its disclosures required by para. 65.2”.

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## Appendix A: Basis For Conclusions

8. This appendix summarizes some of the considerations deemed significant by the Board in reaching the conclusions in this Statement. It includes the reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others.
9. The Board issued an exposure draft in November 1998 proposing to rescind paragraph 65.2. Comments were received during a minimal comment period that ended December 12, 1998. In January 1999, the Board deferred the effective date of paragraph 65.2, SFFAS 7, until October 1, 2000.<sup>1</sup>
10. In December 1998, the Board agreed that further study was needed regarding the relevance of the information discussed in paragraph 65.2. Additionally, the Board was concerned about the relatively short exposure period (approximately 30 days) for the ED. The Board decided to defer the effective date for implementing paragraph 65.2 and revisit the issue of eliminating the requirement at a later date.
11. Following the decision to defer the disclosure requirement, the Board did not take up research on the issue immediately. In December 1999, the Board reviewed its agenda and weighed whether it should devote scarce resources to this issue or simply allow the provisions of paragraph 65.2 to take effect for fiscal year 2001 financial statements. To assist in making this decision, the Board sent a letter to the Internal Revenue Service (IRS) asking what additional information might be available to aid the Board in considering the issue.
12. The IRS responded with additional information based on its two additional reporting years' experience with SFFAS 7 requirements. In addition, the IRS provided a briefing to the Board regarding its collections process and systems modernization. The IRS renewed the request that the Board rescind the provisions of paragraph 65.2. Its auditor, the General Accounting Office, supported this rescission.
13. In November 2000, the Board issued a second exposure draft, *Elimination of Disclosures Related to Tax Revenue Transactions by the Internal Revenue Service, Customs, and Others, Amending SFFAS 7*, that proposed to eliminate paragraph 65.2. Because of the interest in the relevance of this information, the Board mailed copies to potential users, for

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<sup>1</sup> SFFAS 13, *Deferral of Paragraph 65.2 – Material Revenue-Related Transactions Disclosures, Amending SFFAS 7 Accounting for Revenue and Other Financing Transactions*, January 1999.

example, Congresspersons and staff directors of key committees. The Board received comment letters on the exposure draft from the following sources:

	Federal (internal)	Nonfederal (external)
Users, academics, others		2
Auditors	2	1
Preparers and financial managers	4	

## Responses to the Exposure Draft

14. The respondents were closely divided with the majority supporting the proposed elimination of paragraph 65.2. It is important to note that the Board did not rely on the number in favor or opposed to a given position. Information about the majority view is provided only as a means of summarizing the comments. The Board considered the arguments in each response and weighed the merits of the points raised. The Board summarizes the respondents' arguments below.

### Respondents Supporting the ED

15. Several respondents stated that paragraph 65.2 disclosures would not be useful, and could be misleading, to general purpose readers. A respondent stated that any attempt to reconcile the elements required by paragraph 65.2 could be misleading due to timing differences between assessments and collections and the definitions of revenue receipts and taxes receivable.
16. Some respondents said that the IRS currently provides sufficient detailed information about federal tax revenues, unpaid assessments, and refunds in its annual financial report through footnote disclosures, supplementary information and in its management's discussion and analysis (MD&A). Other respondents said that the disclosure requirements of paragraph 65.2 far exceed what should be required in general purpose financial statements. Another respondent concurring with the elimination of paragraph 65.2 stated that FASAB clearly documented its case in the ED's basis for conclusions.

### Respondents Opposing the ED

17. Other respondents had a different view. One respondent stated that the disclosure in SFFAS 7 was intended to overcome some of the practical limitations of the tax collection system and make the tax revenue recognition closer to what would be reported with fuller

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accrual accounting. He submitted that the information required in paragraph 65.2 is relevant and useful in assessing the efficiency and effectiveness of the tax system, not merely the administrative practices, and can be explained satisfactorily so as not to be misleading.

18. Several respondents stated that insufficient evidence has been offered regarding the lack of relevance and understandability of the information to warrant eliminating the paragraph 65.2 disclosures, and doing so would weaken SFFAS 7. These respondents recommended extending the deferral period for the standard, further research, and a hearing, as necessary, prior to the issuance of a final standard. One respondent stated that the ED did not convincingly explain why the information called for in paragraph 65.2 is so complex that it could not be clearly explained. The respondent stated that SFFAC 1, par. 158, provides that general purpose financial reports should not exclude essential information merely because it is difficult to understand or because some report users choose not to use it.

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## The Board's Discussion

19. In conjunction with re-deliberating the issues presented in the exposure draft and carefully considering the respondents' comments, the Board notes that SFFAS 7 represents a major accomplishment in establishing federal accounting standards. SFFAS 7 presents standards for classifying, recognizing, and measuring resource inflows as well as concepts for financial reporting and makes other significant contributions. Many provisions of that statement are now fundamental to federal accounting. However, the Board believes that paragraph 65.2 of SFFAS 7 is flawed because the information required therein might be misinterpreted, would not accomplish what it purports to accomplish, and would be difficult to produce.

### Information that Could Be Misinterpreted

20. Paragraph 65.2 requires disclosure of information about the beginning and ending balances of accounts receivable and related accounts, as well as material types of revenue transactions that relate to the collecting entity's custodial responsibilities. The minimum information required would include "assessments by the entity," "penalties," "interest," and "abatements." In the two exposure drafts on this issue (November 1998 and November 2000) the Board has discussed the complexity of the assessment and abatement process. The Board has discussed the various IRS-initiated tax collection actions, including compliance assessments; the enforcement work-in-process status of the assessment database; the possible timing difference between the period to which the tax relates, the eventual assessment of the tax and penalties and interest, and the final collection or abatement of the assessment; and other complicating factors. Many assessments, penalties, and interest are made for enforcement purposes, are often overstated due to incomplete information, and are subject to change based on receipt of additional information

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from the taxpayer. Thus, they do not always precede a receivable<sup>2</sup> in an accounting sense. The Board believes that the user could misinterpret assessment reporting because increases or decreases in assessments do not lead necessarily to increases or decreases in receivables or revenue. Further, developing meaningful categories of assessments that would permit a user to analyze whether enforcement assessments are likely to lead to revenues would not be cost-beneficial when one considers the remaining reporting required under SFFAS 7 as amended.

21. The Board also has discussed the complications of the abatement process. Abatement is a reduction or cancellation of an assessed tax. Abatements are made for myriad reasons and in some cases there is no correlation between the original assessment and the final reason for the abatement. For example, taxpayers can carry back losses to prior years and reduce prior year taxes that were correctly assessed by the IRS. Such reductions are classified as abatements but are not the same as abatements where the tax assessment itself was in error.
22. Moreover, taxpayers also file amended returns that can require abatement of the original amount they reported, including taxpayer requests to abate particular types of penalty assessments due to reasonable causes. For example, during 1998 a new law required the IRS to disallow certain dependents and credits claimed if the taxpayer did not include a social security number for a dependent child or a taxpayer identification number for a child-care provider. In each case the IRS posted an assessment, accrued penalties and interest pending provision of the information, and subsequently abated the assessment when the taxpayer provided the required verification. This change in law increased the total assessments, interest, penalties, and abatements to enforce a reporting requirement rather than to collect additional tax revenue. One could be misled since both assessments and abatements were “overstated” in the sense that it was anticipated at the time of assessment that, in the majority of cases, the assessment would be abated.
23. There are many different reasons for abatements with varying transactions potentially covering 10 years of assessments, each affecting the balances to be disclosed under paragraph 65.2. The Board believes that reporting on total assessments, including penalties and interest thereon, and abatements could be misinterpreted in the context of disclosures purporting to be transactions affecting the beginning and ending balances of accounts receivable and related accounts. Moreover, the Board believes that attempts to reconcile the elements required in paragraph 65.2 could be misinterpreted due to timing differences

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<sup>2</sup>Per SFFAS 7, paragraph 53, accounts receivable should be recognized when a collecting entity establishes a specifically identifiable, legally enforceable claim to cash or other assets through its established assessment process to the extent the amount is measurable.



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between assessments and collections and the definitions of revenue receipts and taxes receivable.

24. The Board concludes that the paragraph 65.2 information is not relevant for reconciling the beginning and ending balances of accounts receivable and related accounts, which paragraph 65.2 purports to do. Some of the required information is beyond the scope of those accounts since activity does not result in or relate to revenue or receivables, precedes the recognition of taxes receivable, or relates solely to tax administration or enforcement.
25. When considering whether to retain paragraph 65.2, the Board considered the materiality of taxes receivable. The IRS' taxes receivable are not large in relation to annual tax revenue. For FY2000, approximately \$20 billion in IRS receivables represent three days of collections.

#### Other Information Required

26. The Board calls attention to other SFFAS 7 paragraphs and to other FASAB standards that require disclosures and supplemental information that the Board believes accomplish the objectives of SFFAS 7 as stated in paragraph 187.1 and elsewhere. Paragraph 65.1 requires disclosure of factors affecting collectability and timing of categories of accounts receivable and the amounts involved. Paragraph 65.3 requires disclosure of cumulative cash collections and refunds by tax year and tax type. Paragraph 67 requires supplemental information about the estimated realizable value of compliance assessments and pre-assessment work-in-process; about other claims for tax refunds that are not yet accrued but are likely to be accrued when administrative actions are completed; and, about the amount of assessments that the entity still has statutory authority to collect but that have been written off and thus excluded from accounts receivable. SFFAS 15, *Management's Discussion and Analysis*, requires discussion, among other things, of performance goals, objectives, results, systems, controls, and legal compliance.

#### Conclusion

27. The Board actively sought comments from potential users. In addition to the FASAB distribution list, the Board sent the ED to all those who had commented on the prior ED of November 1998 and to potential decision-makers, including especially House and Senate committees and sub-committees. Also, in setting February 16, 2001, as the cut-off date for comments, the Board provided an extended period for respondents to submit comments. Despite the Board's efforts to reach users the response to the ED did not demonstrate a demand from users to have the information. Only one respondent said the information was useful and necessary. Other respondents who oppose eliminating paragraph 65.2 at this time said that the Board did not offer enough evidence regarding relevance and understandability to warrant eliminating paragraph 65.2, not that they themselves found it

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useful or relevant and for what purposes. Due to the cost of the information, the availability of other information on this topic, the requests from the preparer and auditor communities, and lack of a response from users of the information, the Board does not believe the paragraph should be retained.

28. The Board believes that sufficient evidence has been produced to conclude that the information required by paragraph 65.2 could be misinterpreted by users of general purpose financial statements and that it does not accomplish what it purports to accomplish. The Board does not exclude essential information merely because it is difficult to understand or because some report users choose not to use it. In this instance, however, the complexity of the tax collection process in conjunction with the context of accounts receivable reconciliation renders paragraph 65.2 defective and, therefore, not relevant. The objective of SFFAS 7 is to tell users what is happening at the tax collection entities, and the Board believes the standard is achieving this objective without paragraph 65.2, and that paragraph 65.2 could in fact be misinterpreted. This amendment of SFFAS 7 is limited to the problem of disclosures in paragraph 65.2 being misinterpreted.

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### Vote for Approval

29. The amendment of SFFAS 7 prescribed in this statement is approved by a vote of seven members in favor and one member dissenting (only eight members voted due to a vacancy on the Board). The dissent is available for review at the FASAB offices.

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## Appendix B: Paragraph 65 of SFFAS 7

65. Entities that collect taxes and duties should disclose the following relating to future cash flows, revenue-related transactions, and custodial responsibilities:
- 65.1 Accounts **receivable**. Factors affecting collectibility and timing of categories of accounts receivable and the amounts involved.
- 65.2 Material **revenue-related transactions**. Revenue-related transactions affecting the beginning and end-of-period balances of accounts receivable, accounts payable for refunds, and the allowance for uncollectible amounts should be disclosed. All material types of revenue transactions which relate to the custodial responsibilities of the collecting entities should be disclosed. The disclosure should be comprehensive enough to include as a minimum: self-assessments by taxpayers (or importers); assessments by the entity; penalties; interest; cash collections applied to taxpayer accounts and unapplied collections; refunds, refund offsets, and drawbacks; abatements; accounts receivable written off during the reporting period as uncollectible; and provisions made to the allowance for uncollectible amounts.
- 65.3 Cumulative **cash collections and refunds by tax year and type of tax**. Cash collections and refunds by tax year and type of tax should include cash collections and cash refunds for the reporting period and for sufficient prior periods to illustrate (1) the historical timing of tax collections and refunds, and (2) any material trends in collection and refund patterns. Sufficient prior periods for each type of tax are the periods which end when the statutory period for collection ends. Collecting entities may shorten these periods if evidence for prior tax years indicates that a shorter period would reflect at least 99 percent of the collectible taxes.