FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD
Minutes - February 22-23, 2012
Room 7C13
441 G Street NW
Washington, DC 20548

Wednesday, February 22, 2012

Administrative Matters

- ### Attendance

The following members were present throughout the meeting: Chairman Allen, Messrs. Dacey, Granof, McCall, Reger, Schumacher, Showalter, Steinberg, and Ms. Kearney. The executive director, Ms. Payne, and general counsel, Ms. Hamilton, were present throughout the meeting.

- ### Approval of Minutes

The minutes of the December meeting were approved electronically before the meeting.

Agenda Topics

- **Earmarked Funds**

Staff presented a ballot draft and ballots for SFFAS 43, *Funds from Dedicated Collections: Amending Statement of Federal Financial Accounting Standards 27, Identifying and Reporting Earmarked Funds*. The final ballot draft incorporated several minor edits to the Preballot Draft. There were no substantive changes.

All nine members of the Board provided signed ballots to approve the SFFAS.

Next steps:
The final SFFAS 43 will be transmitted to the FASAB principals (the Secretary of the Treasury, The Director of the Office of Management and Budget, and the Comptroller General) for a required 90-day review period.

- **Federal Reporting Entity**

Treasury and Federal Reserve Briefing on Pro Forma Illustration

Mr. Allen explained that staff member Ms. Loughan would be assisting with the session but as noted in the staff prepared transmittal memo, representatives from Treasury and the Federal Reserve were present to discuss the pro forma illustration and disclosures based on applying the draft ED requirements.

Mr. Allen noted that the following representatives would be providing a brief presentation:

Federal Reserve
Gregory L. Evans
Deputy Associate Director
Division of Reserve Bank Operations and Payment Systems

Treasury
Mark Reger[1]
Deputy Assistant Secretary
Accounting Policy

[1] FASAB Board member representing the Department of Treasury. Mr. Reger's office submitted the Illustration and his office is responsible for preparing the government-wide financial statements.

Carole Banks
Director
Accounting and Internal Control, Office of the Deputy Chief Financial Officer

Before beginning, Mr. Reger asked if FASAB staff wanted to add any introductory information. Ms. Loughan explained that she would leave the time for the experts, but noted that the session was being held because the Board members believed the interpretation of the proposed ED requirements and ultimately how they would affect the display and disclosures about an entity such as the Federal Reserve would be an important consideration during deliberations of the ED. In addition, certain advance questions were provided to the representatives for consideration.

Staff noted the draft pro forma disclosure was provided by Treasury staff and included as **Attachment 1** in the Board materials. As noted in the Attachment, the shaded items labeled “from the Federal Government Financial Statements” and "included" are information that was in the consolidated Financial Report of the US Government (CFR) or the US Department of the Treasury Agency Financial Report (AFR) for FY2011 and the items labeled "new" are items not previously in the CFR or AFR.

Mr. Reger explained the information presented in the draft illustration assumes that the Federal Reserve Banks are reported as non-core entities. However, to reach a firm determination regarding classification prior to finalizing the standards would be premature. For example, development of a definition of related party may be helpful in making the determination since the Federal Reserve was presented as a related party in previous years.

Mr. Reger explained an important fact to keep in mind, not only when considering the Federal Reserve but for other potential non-core entities, is the ability of the Treasury Department to obtain the required information for the disclosures. He noted in this particular exercise there was a spirit of cooperation to meet the Board’s request, but that might not be the case for all potential non-core entities when Treasury is preparing disclosures. Mr. Reger explained this is one of his main concerns; Treasury may run into instances where potential non-core entities may disagree with Treasury’s assessments and/or not be cooperative in providing the necessary information.

Mr. Evans explained the Federal Reserve has not taken an official position on whether the Federal Reserve Banks are non-core or what the appropriate disclosures are at this point. Instead, he explained the Federal Reserve staff provided technical assistance to craft the illustration given their deeper understanding of the Federal Reserve System’s structure and financial reporting processes that would be necessary to prepare the illustration. Mr. Evans explained that the Federal Reserve’s structure can often be confusing and misunderstood. Further, he understands that FASAB is writing standards for the preparer (Treasury) and the Federal Reserve does not follow FASAB standards. Therefore, his role was to assist Treasury in better understanding the Federal Reserve System.

Mr. Evans noted when he states ‘we’ or ‘us’ during his presentation that he is referring to the Federal Reserve Banks (FRBs) because that is his primary responsibility. He explained there are 12 Reserve Banks that present combined statements in accordance with the *Financial Accounting Manual for Federal Reserve Banks* (FAM), which is an accrual basis of accounting. He noted the FRBs are owned by member banks, not the Board of Governors. Mr. Evans explained the Board of Governors produces its own set of financial statements in accordance with FASB GAAP.

Mr. Evans clarified that the Illustration should be understood as exactly that, an illustration that was prepared based on the understanding that the intent of the non-core disclosures was to provide more information than was included under related party in previous years. However, Mr. Evans explained he liked the related party option because clearly there are aspects of the Federal Reserve relationship with the federal government that should be disclosed in the federal financial statements and that the related party footnote appeared to be the best place. He noted that in the current financial statements there are many disclosures about the Federal Reserve. He noted that the new proposal appears to be changing the focus of the disclosure to give it more stand-alone prominence—information about the FRBs would be presented as a whole rather than limited to activities with the federal government. However, Mr. Evans explained that providing this type of information might be difficult for the preparer.

Mr. Reger explained that often we discuss the Board of Governors versus the FRBs; he wanted to point out that the latest financial statements for the Board of Governors showed assets of approximately $218M and income of $15M. He explained this was very immaterial at the government-wide level. Mr. Evans explained it was his understanding that most FASAB Board members were interested in the FRBs illustration and not the Board of Governors because of materiality considerations.

Chairman Allen explained there are two important factors one considers—materiality but also conceptually the federal government’s relationship with parties can pose a benefit or potential risk and this may not relate to the materiality of the assets and liabilities. For example, the FRBs may not be able to influence anything that might be able to pose a risk or obligation to the federal government. However, the Board of Governors, though immaterial, may have the ability to significantly influence or pose a risk or obligation and therefore there may be a need for some type of consideration.

Mr. Reger postulated that it was the intent of Congress to specifically separate the management of the federal government from the day to day management of the Federal Reserve. Mr. Reger explained based on his limited research, it appears the intent was very clear that the federal government should not be operating the monetary system and instead there should be an independent system operating it in consultation with the federal government, but not under the control of the federal government.

Mr. Allen clarified he wasn’t trying to draw any conclusions; instead he was stating that materiality is one factor to consider, but impact to affect risk is also another factor that should be considered. Mr. Evans noted that it appears some of what Mr. Allen is referring to may be non-financial risks so he wasn't sure how that would show up in financial statements.

Mr. Evans explained the Federal Reserve is included as a Related Party in the current statements but that wasn't an option in the Draft ED. Therefore, without a related party option, non-core was the closest fit as they believed there needs to be some disclosure of the relationship. Mr. Evans explained that the Reserve Banks were clearly created by the federal government, though meant to be independent. Mr. Evans noted the FRBs use the term "federal instrumentality" as it is an entity that isn't totally federal but one can't conclude it is not federal either. He summarized that they started preparing the illustration with non-core as they didn't have related party as an option.

Mr. Evans explained they crafted the illustration based on what they believed the Draft ED was trying to require. He added they were very interested in feedback as they have informally heard divergent views; that it doesn't provide enough information and that it provides too much. He explained they attempted to use what was currently being disclosed plus what was in FRBs financial statements.

Mr. Reger explained that Treasury is starting with the presumption that every component would have to consider their related parties and determine if those relationships changed under the new proposed standard. He explained that is why Ms. Banks is present because she will be responsible for making those assessments and working with the organizations. For example, Ms. Banks would have to work with Mr. Evans to obtain the necessary information if the FRBs are determined to be non-core. Mr. Evans noted in the past, the related party disclosure was prepared by Treasury without any involvement of the Federal Reserve, so this will be a change in practice and difficult to implement for other non-core entities.

Mr. Evans explained there would have to be involvement or assistance with his office to prepare the non-core disclosures included in the illustration. He also noted what he perceived as problems or issues for including the FRBs information as it may relate to the government-wide:

- Because the FRBs do not prepare September 30 financial statements, Treasury would report December 31 information that is nine months old. Although the Draft ED provides for this timing difference, Mr. Evans wanted to point out that some may not believe nine month old information to be relevant and less relevant than the September 30 information reported today.
- Although FRBs use an accrual basis, they use a comprehensive basis of accounting other than GAAP. FRBs prepare in accordance with the *Financial Accounting Manual for Federal Reserve Banks.* The primary difference is the presentation of securities holdings at amortized cost rather than fair value presentation required by GAAP. Mr. Evans noted the FASB GAAP method is focused on investors and creditors where the method used FRBs is one deemed appropriate for central banks.
- Comparability with Treasury financial statements as the securities will be on a different basis.

- Mr. Evans explained he was concerned with the ability to audit the information that might be included in the government-wide disclosures. Although FRBs statements currently have clean opinions, including information will increase audit challenges, especially when one considers the judgments being made about what information is included.

Mr. Steinberg asked what the differences are between the OCBOA (*Financial Accounting Manual for Federal Reserve Banks*) and the Financial Accounting Standards Board GAAP. He noted that Mr. Evans explained the primary difference is the presentation of securities holdings at amortized cost rather than market or fair value presentation required by FASB GAAP. Mr. Steinberg explained that FASAB GAAP for investments in fixed income federal securities is also amortized cost. Mr. Dacey explained that our investments in non-federal securities or equity securities are all at fair value. For example, the TVA and PBGC are on a FASB basis and TARP investments in equity securities are all at fair value. Mr. Dacey explained loan and loan guarantees are at discounted present value which aren't technically considered market value but aren't amortized cost either. Mr. Dacey explained we don't hold debt securities. Mr. Allen commented there aren't a lot of the traditional investments at federal entities.

Mr. Evans explained that often standard-setters will use criteria that just doesn't fit a central bank because the FRBs are buying the securities to affect the reserves in the banking system. He added this is a different purpose than for income and earnings which are contrary to the FRBs intent. FRBs security assets are tools of monetary policy. Some would argue that neither fair value nor amortized cost is quite right when taken out of context. However, an important point is that the FRBs disclose fair value of its security holdings in their footnotes to be transparent as possible. He added there may be a few other smaller differences (such as settlement date) but that is the biggest difference and one that people care about.

Mr. Showalter explained he understood the points regarding how the decision regarding non-core was made. Mr. Reger explained they started with the premise the FRBs were non-core, so they considered what the disclosures would look like based on the Draft ED. Mr. Showalter explained that as standard-setters, the Board needs and would like additional information on the thought processes used in making the core versus non-core decisions in order to validate the criteria provided in the proposed standard..

Mr. Evans explained that although he isn't the preparer, when he went through the Draft ED and reviewed the core and non-core descriptions, he first concluded that he wasn't an appropriated entity. He next considered the accountability aspects and considered how the FRBs were structured. The FRBs are accountable to a Board of Directors and regulated by the Board of Governors. He explained this is an area that people often debate; they ask how close that is to oversight or direct control. He believes the way it is set up, it leads one to a conclusion of non-core. When considering core goods and services, he added this is a hard one to consider. As for risks and rewards, he believes this goes to the member banks but it is limited to a 6% dividend that is set by statute, with excess earnings being transferred to Treasury. Therefore, some may see the taxpayer as also bearing risk and reward.

Mr. Showalter asked if the risk and rewards to the taxpayer had expanded over the past few years. Mr. Evans noted the balance sheet had grown and there had been more earnings transferred. Mr. Showalter explained it wasn't an earnings question, but more one related to whether the risks to the federal government (either provided or assumed) had increased over the past few years based on the Federal Reserve's activities.

Mr. Evans explained he understood the question but he couldn't say they are creating risk or assuming risk on behalf of the federal government because the concept doesn't fit. He explained there are limits to the taxpayer's exposure to the risks. For example, the main financial risk to the federal government is that Federal Reserve earnings would be less. He added there is a perception that the Reserve Banks took on significant risk during the crisis that isn't accurate. The crisis related activities were loans and the Federal Reserve's lending authority is not unlimited, the statute requires loans to be collateralized. The FRBs may grant loans, but those loans must be backed by sufficient collateral. There are interest rate risks, no one can deny that. However, if one is focusing on the loans to special purpose vehicles like Fannie Mae, Bear-Stearns, and AIG, the assets that backed those up were believed to be sufficient at the time of the loans. Mr. Evans explained the assumptions in those cases appear reasonable given the asset performance to-date.

Mr. Dacey explained there are limitations on the risks the Federal Reserve can accept. For example, in some of the dealings with the AIG, the federal government accepted risk before the Federal Reserve because the Federal Reserve was to be paid back before the federal government.

Mr. Dacey explained the federal government has made deposits in the FRBs before and the level of deposits has varied over the years. The level was zero at the end of 2011. Mr. Evans explained the deposit activity being discussed relates to the Special Financing Account, which is reported separately from the Treasury's general account. Mr. Evans explained the FRBs is the Treasury's banker. The Special Financing Account's primary purpose relates to reserves in the banking system. As Treasury's deposits increase, the deposits absorb reserves in the banking system because the deposits are a liability on the FRBs balance sheet. He explained that Treasury's larger deposits to the Special Financing Account allowed for reserves provided by other activities to be absorbed. Mr. Evans noted that impression of a need for the deposit to finance the activities is a misunderstanding; instead the deposit was to fulfill a commitment by Treasury to help absorb the reserves. The deposit was not Treasury assisting the FRBs in funding operations.

Mr. Allen asked if there is a sense of shared risk or burden when the FRBs work with Treasury or the federal government. He asked if Mr. Evans believed there was a relationship that needed to be disclosed. Mr. Evans explained it was quite clear the Federal Reserve and the federal government cooperated during the economic crisis and related activities. However, central banking independence is one of the most significant things we value and it is built into the structure and authorities of the FRBs. He added that the FRBs could not loan to the Treasury or loan beyond their statutory authority to be only in collateralized loans. He doesn't believe the activity was a joint venture concept, but there was cooperation. Mr. Evans explained there were certain special purpose vehicles the FRBs believed they exercised control over and consolidated.

Mr. Reger explained he attempted to relate this to a similar type of entity. He noted when you consider the Federal Reserve and their product is money or the monetary system, perhaps one could compare it to telecommunications. When we had one telecommunications provider the provided service to everyone and shared the costs so a basic phone was available at a reasonable cost to everyone. When that company was divided into multiple independent entities a mechanism was needed to assure basic phone service was still available to everyone at a reasonable cost. The Universal Service Fund was then created to collect to collect fees from some companies and shre them with others to assure a sharing of basic service costs.. The Universal Service Fund is a federal asset but the company administering the program and collecting and distributing the funds is an independent entity created by the federal government as are the underlying telecommunications firms. Mr. Reger explained that he believes there is clearly a related party with the Federal Reserve Board, just like the Universal Service Administration Company vs the Federal Reserve Banks and the Telecom Firms. Those relationships should be disclosed but just as we do not put the Telecommunications firms in our statements neither should we put the Federal Reserve Banks.

Mr. Evans noted that a Board member had asked for clarification of the FRBs roles as fiscal agent for Treasury. He noted when the FRBs were acting in the economic crisis they were not acting in the capacity as Treasury's fiscal agent. Mr. Evans explained a fiscal agent processes check collections, savings bonds, and runs the auction when Treasury sells debt. Mr. Reger noted that Treasury has lots of fiscal agents other than the FRBs. However, FRBs is the largest fiscal agent.

Ms. Banks explained she believed there were aspects of the draft illustration that would bring enhancements to the current disclosures regarding the FRBs. She added that when you look at the Treasury statements and the government-wide report there is a lot of information regarding the FRBs throughout the document. However, there is not a single place where the information is consolidated. She added a succinct note could provide a clear picture in one place about the FRBs and the relationship. She believes the associated risks and rewards are an enhancement to the disclosures and good information to provide. However, Ms. Banks explained providing the condensed financial information may be more of a burden than a benefit, for many of the reasons that Mr. Evans explained. She explained the reporting period differences, basis differences, and audit costs should all be considered and may be overwhelming, not just when one considers FRBs but also when one considers other potential non-core entities. Ms. Banks added that she believes the distinction between non-core and related party to be a tremendous burden. However, she does see the qualitative improvements in the disclosures when presented in one concise and succinct footnote.

Mr. Reger explained he shared Ms. Banks' view , but he added he was not sure what view Treasury's auditor would make of the new non-core designation and was uncertain how the data presentation requirements might be viewed .

Mr. Showalter explained that he realized there was a lot of information in previous year's financial reports, but you were expecting readers to pull it all together and he believes part of transparency is providing information in a way that tells the story. Mr. Reger explained this could be an issue with all potential non-core entities, as well as obtaining the necessary information.

Mr. Allen explained the Draft ED is written conceptually and not just for the Federal Reserve and one of the objectives for the non-core entities is disclosure of information regarding the future exposures to gains and losses. Mr. Allen noted in reviewing the illustration there didn't appear to be much information regarding this. He added that while he understands the issues raised by Ms. Banks, he thought there should be some sort of explanation as to how the information presented relates to risks and rewards and conclusions about the narrative that is presented. Such information is more important than numbers.

Ms. Banks explained the most important information appears to be what the relationship is with the entity and because of that, what are the associated risks involved.

Ms. Kearney explained she agreed it is helpful to consolidate the information and help the reader but she isn't certain if it is appropriate to draw conclusions for the reader. The statements should present the facts and allow the user to draw the conclusions. Mr. Allen agreed. He believes we must explain some of these unique relationships so the readers are informed. Ms. Kearney explained she agreed with transparency.

Mr. Dacey noted that including data for condensed financial information that would be 9 months old was a concern. Also, one must consider if such disclosures would mislead the reader because the FRBs assets are not available for use by the federal government and the FRBs liabilities are not liabilities of the federal government. Also, there are audit issues that should be considered.

Mr. Dacey explained if you include numbers in the disclosures then the auditor will have to take responsibility. In this case, both the Treasury auditor and the government-wide auditor would be taking responsibility. Mr. Dacey explained there would be substantial cost as a result. Therefore, he questioned the cost/benefit of disclosing the condensed financial information. Mr. Dacey agreed with better consolidation of the information now listed in several places. He also agreed that the associated risk is very important information that should be disclosed.

Mr. Evans explained the presentation of risks and exposures in the Reserve Banks' financial statements and disclosures. He explained that the risk that holdings won't produce the carrying value of earnings is essentially conveyed by the existence of the assets and the more detailed information about the assets in the financial statements. There is a lot of information in the FRBs footnotes regarding maturity schedules, classes of assets, and fair values. However, he questioned how one might gather information for preparation of a government-wide footnote from this information that is presented in the Federal Reserve Banks footnotes. He added that it is very difficult to imagine how the preparer of the government-wide footnotes will manage this.

Mr. McCall noted that in a statement by the former Chairman of the FASAB, he explained that Federal Reserve was accountable to Congress and therefore is not independent. The former chairman had also conveyed the government-wide statements would not provide a complete accountability or be transparent without including the Federal Reserve. Mr. McCall also explained he looked at the Federal Reserve's annual report and it discusses the Federal Reserve Act and the FRBs. He explained it stated the Board of Governors appoints the Chairman and Vice Chairman at each FRB. Mr. McCall noted the Federal Open Market Committee is composed of members of the Board of Governors and the President of the FRBs. He explained in reading the annual report it stated the Federal Open Market Committee authorized and directed the Federal Reserve Bank. Mr. Mc Call asked to what extent the "actions" of the Federal Open Market Committee (FOMC) affect the independence of the FRBs as it appears the FOMC authorizes and directs the purchase Treasury securities, debt securities, etc. to improve conditions in financial markets.

Mr. Evans explained monetary policy is directed by the FOMC and he noted that Mr. McCall described it accurately. He explained the FOMC members include the seven members of the Board of Governors and five of the twelve Federal Reserve Bank presidents. The president of the Federal Reserve

Bank of New York serves on a continuous basis because that is where the operations take place. The other four FRB presidents serve on a rotating basis. Practically speaking, all FRB Presidents sit on the FOMC, but only those five have a vote.

Mr. Evans explained this is where the direction for purchasing and selling of the assets and so forth comes from as set forth in the Federal Reserve Act (purchases and sales of financial assets). These assets are distributed among all 12 Federal Reserve Banks. Lending transactions, on the other hand, are individual Reserve Bank decisions but some of them have to be approved by the Board. For example, the NY FRB had loans with the AIG, this was strictly the NY FRB with the approval of the Board of Governors. The purchase of Mortgage Backed Securities on the other hand is a FOMC decision, so there is a share of those transactions with all 12 FRBs. Mr. Evans explained one could conclude that the finances of the Reserve Banks are overwhelmingly driven by direction in monetary policy given by the FOMC, but does that get one to federal control of the FRBs? Most would agree the Federal Reserve System and the FOMC as a whole was created by the Federal Reserve Act so therefore, there is a close relationship with the federal government but it is also clear that the FRBs were created to be separate. Mr. Evans explained it is an interesting structure and people need to navigate what that means and how much control there is. He added he can't make the structure something it isn't; one must navigate through the structure to make those determinations. It seems clear, however, that Reserve Bank independence was the intent behind the structure.

Mr. Granof noted there is independence in form and independence in reality. He added that in the eyes of many, the level of cooperation has increased dramatically. He believes there is a common perception that the Federal Reserve makes very few moves without consultation or cooperation with the Treasury. Mr. Granof explained he heard there were weekly meetings between Treasury and the Federal Reserve. Therefore, in reality would a reasonable person believe there is independence? Mr. Granof also noted that in 2000 there was a bill in Congress that related to civil rights and the court of appeals found the Board of Governors of the Federal Reserve System to be an executive agency in the meaning of certain aspects of Title 7 of the Civil Rights Act. He also noted the case mentioned the Board of Governors did not argue the fact. Mr. Granof asked when one puts all of this together, how independent is the Federal Reserve.

Mr. Evans noted that the example given by Mr. Granof refers to the Board of Governors and the Board of Governors have described themselves as a federal agency. However, the FRBs do not believe they are federal agencies and they view themselves as separate from the Board of Governors. He added there are many FRBs lawyers who would continue this discussion and draw that distinction.

Regarding Treasury and Federal Reserve cooperation, Mr. Evans noted that one doesn't have to be uncooperative to be independent, but he understood Mr. Granof's point. Although non-cooperation may provide evidence of independence, cooperation does not prove a lack of independence. Mr. Evans explained the Treasury and the Federal Reserve have frequent meetings and coordination as a natural by-product of monetary policy. The Treasury's financial transactions have a significant impact on banking reserves each day that need to be understood by those conducting open market operations. However, Mr. Evans reiterated his personal experience that there is a strong sense of independence between Federal Reserve and Treasury as well as the Federal Reserve Board and Reserve Banks.

Mr. Reger agreed that many people could debate independence and the implications. Ms. Banks agreed and explained independence is not easily defined in these situations. Further, she added that FRBs is a significant related party and that should be the most important aspect to consider.

Mr. Evans explained it is clear in the Federal Reserve Act that they can't extend credit to the Treasury.

Mr. Evans had explained some of the issues with including the condensed financial information—different year ends, different basis, comparability and audit costs. It was noted the Board should consider these further.

Mr. Steinberg asked if the Board could discuss the decision on how the Board plans to address the Federal Reserve and whether the Board would be providing staff direction on how to proceed. Mr. Allen noted that previously the Board had agreed the Draft ED (principles) could be applied and the Federal Reserve did not have to be specifically mentioned within the proposed standards. Further, the Board had agreed the basis for conclusions would describe that SFFAC 2 is being amended and the Draft ED establishes a framework of standards that can be applied to all entities without listing specific exclusions.

Mr. Allen explained the decisions don't prevent reconsideration, but he is reminding the Board of the previous decisions and it would be considered reconsideration. Mr. Allen noted that Board members wanted additional information about how the Federal Reserve might be disclosed and now after hearing that, if the Board wishes to reconsider previous decisions or if they want to address any particular entity individually, it would be appropriate to bring up at this time.

Mr. Steinberg explained that he believed the Federal Reserve representatives explained how unique they are so that should warrant reconsideration and perhaps consideration if they should be addressed separate from the other non-core entities. He noted that many of their responsibilities are those of the sovereign federal government.

Mr. Reger asked if the Federal Reserve is really that unique from other types of entities that one might consider other related parties. Mr. Steinberg noted the Board has not defined related party as of yet. Staff noted if an organization meets the inclusion principles, then the organization is either core or non-core—they don't go to the related party for consideration.

Mr. Granof noted that as standards-setters our decisions to date are tentative. Further, the Board had stated before that we would have a good understanding of how some of the significant entities would be treated under the Draft ED. He agrees the Federal Reserve is unique and perhaps it needs to be addressed specifically. Mr. Granof explained there are standards that address specific types of assets, so this may be a situation that requires us to address a specific entity. Doing so, it doesn't mean the standards aren't principles based. He explained the Board may need to determine how it wants the Federal Reserve to be reported and write the standards to ensure the appropriate disclosures are included .

Mr. Allen agreed and that was one way to approach it. He added we could identify the uniqueness of the relationship and address that within the criteria without addressing a specific entity. Mr. Allen explained the Board could revisit this issue in conjunction with the government-wide ED discussion.

Mr. Allen thanked Mr. Evans and Ms. Banks for their time and explained the Board members have a better understanding of the relationship.

CONCLUSION: The Board agreed the presentation was very helpful. The Board agreed they would discuss any comments further with the government-wide reporting entity topic.

GOVERNMENT-WIDE REPORTING ENTITY

Mr. Allen explained the next agenda session is Tab C, Government-wide federal reporting entity and staff member Ms. Loughan would be leading this session. Ms. Loughan explained the objectives for the meeting are to approve changes in and to identify any remaining member concerns with the government-wide portion of the Exposure Draft (ED). However, Ms. Loughan noted before the break, the Board was discussing the Federal Reserve draft illustration and if additional work or changes in the draft standards would result based on the presentation.

Mr. Allen explained the Board would wrap up that discussion as part of this agenda item as it is related to Federal Reporting Entity. He explained prior to the break the Board heard a presentation from the Federal Reserve and Treasury representatives and asked questions about the pro forma disclosures. It was agreed the Board would discuss whether any changes in the approach thus far should be considered based on the morning session.

Mr. Allen explained that previously the Board agreed the draft principles could be applied. Therefore, the Federal Reserve did not have to be specifically mentioned within the proposed standards. He noted that after hearing the information about the Federal Reserve and how it might be disclosed, if any member wishes to reconsider the previous decision, it would be appropriate to propose dong so at this time.

Mr. Steinberg stated that he thinks the board should consider how unique the Federal Reserve is based on the discussion. He supports reconsideration and perhaps consideration of standards separate from the other non-core entities. Mr. Steinberg stated the disclosures should include information about mission and organization of the Federal Reserve System, relationship between the Federal Reserve System and the Federal government, relevant activity, future exposures. He noted that many of their responsibilities are those of the sovereign federal government and he believes it to be very important to disclose the mission and relationship with the federal government. Mr. Steinberg believes this would be achieving the transparency that the board has been driving towards.

Mr. Allen asked Mr. Steinberg how he would drive that standard—would he drive it from the standpoint of the Federal Reserve and the Federal Reserve Banks or would he drive it from the relationships and the exposure from unique relationships. Mr. Allen continued that the board drafted the ED to provide principles and questioned if the board can address Mr. Steinberg’s issue consistent with the draft principles or if he is asking for reconsideration of the draft to specifically guide some agencies. He said it is a question the board will need to address to satisfy Messrs. Steinberg and Granof.

Mr. Granof responded that he agrees one hundred percent with what Mr. Steinberg said but the problem is that the scenario Mr. Steinberg describes does not neatly fit into any of the three categories the ED addresses: core, non-core, and related parties. Mr. Granof said that does not necessarily mean that the board has to throw out what it has done.

Mr. Allen noted that the structure laid out in the ED is to look first at the budget and then consider ownership and control. If an entity meets any of those three criteria, it is included in the federal government reports as either core or non-core. What the board has not yet developed are scenarios where an entity does not meet any of those three criteria and yet it is involved in a relationship with the federal government that is worth disclosing; those will probably be addressed by guidance for related parties.

Mr. Steinberg mentioned there is also the principle of “misleading to exclude” that is considered.

Mr. Granof responded that he thinks another criterion should be whether the entity performs functions that are deemed integral to the government. He provided an example from NCGA where certain sheriffs’ departments in Florida were legally independent and there was a question about whether they should be part of the county in which they operated. The decision there was yes they should because they perform functions which any reasonable government performs. Mr. Granof added that he thinks the Federal Reserve is increasingly performing those types of functions.

Mr. Dacey responded that part of the issue is what standards will be developed regarding related parties. At times, it appears there will not be any related parties; while at other times, it appears there will be related parties. The board has deferred making that decision until the component entity phase and is including a placeholder. He went on to say that, in looking at the disclosure requirements for non-core, he is not sure the board would develop different requirements for related parties—what is the relationship, what are the transactions with this entity, and what future exposure exists. He said he is not advocating a particular solution; but when he thinks about related parties that are not non-core, the same general information would seem to be needed.

Mr. Showalter stated that he supports Mr. Steinberg’s comments. He said he had asked Mr. Evans a question about his thought process earlier because he wanted to know how Mr. Evans interpreted the guidance so he could determine if the board had captured its intent in the draft standards. He thinks the Federal Reserve ultimately needs to be included somewhere in the financial report in such a way that it enhances transparency. Mr. Showalter noted that he liked Ms. Banks’ comment about pulling it all together because that really resonated with him. He said he is not really concerned about related parties because, if you look at an historical view of related parties, it is not a major entity. Usually, an entity has a relationship that creates a related party; it is not an integral part of the entity as Mr. Granof talked about, it is more of a side arrangement. The Federal Reserve is an integral part of the federal government; it is clearly not a related party in his opinion. Mr. Showalter said the Federal Reserve is either core or non-core and he would want to make sure the criteria laid out in the draft standard would result in the Federal Reserve being included in one of those two categories.

Mr. Allen noted that Messrs. Evans and Reger had commented that, since there is no category of related parties, their only option was to evaluate the Federal Reserve under the criteria provided for core and non-core entities.

Mr. Showalter said he interpreted Mr. Evan's comment to mean that, if there was a category for related parties, Mr. Evans would have categorized the Federal Reserve as a related party. Mr. Showalter said he would not want to write the standard to allow that to happen.

Mr. Allen said that remains an open question for the board—does it need to have a category for related parties or will all the important relationships be captured by the three established criteria (in the budget, ownership, and control).

Mr. Allen said that gets back to Mr. Granof's comment—if we do not capture all of the important relationships via those three criteria, then maybe we need a fourth criteria.

Mr. Granof pointed out that there are other ways to get to meaningful presentation. Right now, the standard requires all core entities to be consolidated. Perhaps the Federal Reserve, since it is critically important, should be core but does not necessarily need to be consolidated. Mr. Granof said the board needs to decide what level of disclosure is needed for fair presentation.

Mr. Allen said he wants to make sure that any requirements that are proposed by the board be conceptually based and not derived from exceptions on a case-by-case analysis.

Ms. Kearney asked why the board would want to categorize an entity as core if it would not want the entity to be consolidated. She asked what Mr. Granof thinks is missing from the non-core disclosures that would be needed for the Federal Reserve.

Mr. Granof said he does not have an answer at this time but believes the Federal Reserve is unique and may need to be treated as such. The board may need to work it into the existing framework or, as some have suggested, have another category for it.

Mr. Dacey said he believes the board should keep core and non-core distinct. He noted that the board was provided with an example of what the disclosures for the Federal Reserve as non-core might look like, much of which is already included in the consolidated financial report of the U.S. Government (CFR), but not all in one place. He said he thinks it is a great idea to synthesize the information. He went on to say that he is not sure what the final consolidated financial statements will look like, but having this type of disclosure about the Federal Reserve is virtually certain. The reason these disclosures are in the CFR now is because the auditing standards state that the report needed to disclose significant relationships.

Mr. Dacey said that, at some point, the board needs to discuss related parties and conclude once and for all whether they need to be addressed or not. Right now, there is general agreement on the nature of disclosure that is appropriate.

Mr. Showalter said that when the board does discuss related parties, it needs to ensure that the guidance on related parties does not allow entities that more appropriately classified as core or non-core to be classified as related parties.

Mr. Granof said that the standard does not include the types of disclosures that the board wants. Mr. Dacey responded that he thinks the standard does provide sufficient guidance on what should be disclosed. Under the principle of “misleading to exclude,” the report would have to say something about the federal government’s relationship with the Federal Reserve.

Mr. Granof responded that the board was presented with the Federal Reserve’s pro forma disclosures and that is not the sort of disclosure that was provided. Mr. Reger said the pro forma disclosures were for discussion purposes only.

Mr. Dacey said he thinks the disclosures will be more fully developed; there were some very good ideas presented during the discussion that would help clarify the disclosures for future reporting purposes. Mr. Granof noted that those ideas and recommendations should be in the standard. Mr. Dacey replied that the proposed requirements are in the standard; it requires that the disclosures discuss the nature of the relationship. The standards provide helpful guidance but ultimately judgment by the preparer is needed to develop the disclosures.

Ms. Kearney said she agrees that the standard as currently proposed is sufficiently written to achieve the results that the board wants. She does not think that the standards should be rewritten to be overly prescriptive in order to achieve particular results for a specific entity. Ms. Kearny noted that there is a check and balance from the auditor that will draw out areas needing improvement.

Mr. Reger said he acknowledges Mr. Granof’s concern that the pro forma disclosures for the Federal Reserve may not be what he expected, but recognizes that the disclosures will be enhanced based on the feedback from the board at the meeting as well as naturally through due process.

Mr. Granof said it is easy for the board to orally express what it expects but these expectations have to live on for a few more decades. He does not know what the preparers will be doing three decades from now but he knows they are not going to be looking at the minutes from this board meeting.

Mr. Reger replied that hopefully the auditor and the preparer of the statements will read our record and make a determination what the intent was as we put it together.

Ms. Kearney responded that another option is to use the Basis for Conclusion (BfC) of the document to express the board’s intent.

Mr. Granof responded that it is dangerous to set a standard in the BfC. Ms. Kearney replied that the board would not be setting a standard in the BfC; it would only be providing a description of the board’s intent.

Mr. Steinberg stated that the draft standard does include requirements for disclosures that include three of the items he mentioned earlier: relationship, relevant activity, and future exposures. Two of the other items he mentioned are mission and organization.

He stated that the social insurance standard requires the disclosures on social insurance to be put together in one place. Since there is a precedent, he thinks the board can draft a standard that says if the impact of this non-core entity is significant enough, then disclosures about the relationship, relevant activity, and future exposures, as well as the mission and organization, should be presented in one place.

Mr. Showalter asked Mr. Reger if he believes the pro forma disclosures presented for the Federal Reserve would have met the standard as currently drafted. Mr. Allen asked Mr. Showalter to first express what he thought was missing from the disclosures that were provided. Mr. Showalter responded that he thought the disclosures lacked a discussion about the risks, rewards, and benefits. Mr. Allen said it had been acknowledged that the discussion about the risks, rewards, and benefits was missing. Mr. Showalter said that was why he was asking; he wanted to know if coming into the meeting, did Mr. Reger think the disclosures met the intent of the standard. Mr. Reger responded that they were trying to put something together from what was available without pushing the envelope, intending that the board would then have a healthy discussion about what the disclosure should look like because they had it in the abstract. Mr. Reger said the disclosures were not prepared with input from Ms. Banks or the auditor. They took the information that was available from the Federal Reserve at the time and put it together. Mr. Showalter said Mr. Reger's response made him feel better about the standard since he did not imply that the intent of the standard was not clear.

Mr. Dacey said the preparer and auditor are participating in this discussion and can develop a robust disclosure about the Federal Reserve based on the discussion. While, he cannot promise to be here in twenty years, he expects a base will have been established and, if the then preparer and auditor begin to go awry in later years, the board can bring them back into proper balance.

Mr. Allen then asked for members' responses in the following two areas:

> (1) Do members think the criteria, as they are written now, will capture all of the entities that should be considered either core or non-core? In other words, looking at the standard as it is written now, do the members believe that entities that should be captured as either core or non-core will be?
>
> (2) Do members think we should make any changes to the standard to ensure that the disclosures are robust enough to meet the intent of the board?

Mr. Steinberg said he suggested that a description of the mission and organization be added as a disclosure requirement and he suggested that the disclosures be consolidated into one place within the financial report.

Mr. Schumacher said he agrees with Mr. Steinberg that the board should expand on the disclosure requirements. . He pointed to par. 58d, which states "The more complex relationships would involve more detailed disclosures to ensure the relationship is understood by the readers," noting that it puts the onus on the preparer to discuss more complex relationships, like the Federal Reserve, in more detail. Mr. Schumacher thought it might be helpful to be a little bit more robust in the standard to make sure the guidance will capture all disclosures the board believes are needed.

Mr. Schumacher said that today's presentation was very informative in terms of how the Federal Reserve functions, but he thinks the disclosure that was prepared needs to be more robust and capture the things the board discussed at the meeting. He added that he thinks what the board has in the current standard is good; he does not think the board needs to make major changes or put in exceptions as long as it makes sure the disclosures are there and they are presented in one place.

Ms. Kearney said she does not know if it is the board's role as a standards-setter to require that the disclosures be all in one place. She offered OMB Circular A-136 as another vehicle through which the board could achieve this objective without memorializing something in a standard. She is concerned that the board is reacting to a situation that currently exists, but has already been acknowledged by the preparer and will be fixed. She said she would therefore be less in favor of making that a requirement in a standard. However, she does believe that including information on mission and organization for significant non-core entities may be beneficial to add to the standard.

Mr. Showalter said he is concerned that the issue of related parties is still open because there is no back stop that would prevent an entity from sliding down to related parties. He said he is okay with the way core and non-core are defined, but cautioned that the board needs to be careful when it gets to the discussion of related parties that an entity that the board would perceive to be non-core is not permitted to categorize itself as related party based on its perception.

Mr. Dacey said he would be concerned about a requirement to have everything in one place. For example, there is a discussion of the Federal Reserve's role in the Term Asset-Backed Securities Loan Facility (TALF) but there is a full paragraph on TALF that is integral to the discussion of the Troubled Asset Relief Program (TARP). He would not want to suddenly remove the TALF discussion from the TARP discussion and move it over to the Federal Reserve note, but he thinks it would be fair to expect the Federal Reserve note to point readers to the TARP note and describe the relationship. He said putting the information all in one place does not always consist of just picking out paragraphs and moving them to one location; sometimes linkage is required.

Mr. Allen summarized that staff had received quite a lot of input from members on how to enhance disclosures. Instead of working on particular wording at the table, Mr. Allen asked members to provide additional input on thoughts or wording directly to Ms. Loughan.

Mr. Steinberg commented that, having read the consolidated financial report of the U.S. Government and the financial reports of the Treasury Department and the Office of Financial Stability, there is a lot of duplication within some of the footnote disclosures. He thought some good crafting could streamline the footnotes and avoid excessive duplication within the reports.

Mr. Steinberg responded to Ms. Kearney that A-136 addresses component entity financial statements and the standard under discussion is talking about the government-wide statements. Ms. Kearney responded that they have a government-wide section in A-136 that could potentially be expanded.

Mr. Allen asked Ms. Loughan when she wanted to address related parties. She responded that the Board agreed it would be addressed in conjunction or revisited with the component reporting entity phase of the project.

Mr. Allen said he believed the last issue to be addressed in Tab C was entities that use a different basis of accounting than generally accepted accounting principles (GAAP), par. 61 in the draft ED. Staff had proposed a question of whether the board wanted to specifically address accounting for disclosures regarding non-core entities that prepare reports on a comprehensive basis of accounting other than GAAP.

Ms. Loughan referenced a handout (AU 623.04) that contained a definition from auditing literature of Other Comprehensive Basis of Accounting (OCBOA). Mr. Showalter said he agreed this should be referenced if members choose to allow this so others are aware that there is a specific definition of OCBOA and it is not just whatever you want it to be.

Mr. Allen then said he does not want to address OCBOA in the standard; he prefers that the standard just refer to GAAP. He said he would prefer to let professional judgment drive the accounting treatment for those non-core entities that apply OCBOA.

Mr. Showalter said he agrees with Mr. Allen’s viewpoint; he just wanted to make sure that if the board defines OCBOA, it is clear in how it defines it.

Mr. Reger said his concern is the difference—we say just disclose the basis of accounting that you are using and how it might be different. If the “how it might be different” is permitted to be a generic discussion, that is fine. However, if they are required to actually sit down and be precise about the differences and what that might mean to the readers of the statements, that is a little more difficult.

Mr. Showalter said he is fine with the way the Federal Reserve described the difference in their disclosure if that was what Mr. Reger had in mind. Mr. Reger said that is what they had in mind.

Mr. Allen said he does not even want to go down the path of saying, if it is not GAAP, and then explain the difference. He wants to leave that up to the professional judgment of the auditor and preparer.

Mr. Dacey said he agrees with Mr. Allen; right now the standard is silent on OCBOA and he believes the standard should remain silent.

Mr. Allen asked if the other members were okay with that. There were no objections.

Mr. Allen then asked Ms. Loughan what issue she wanted to address next. Ms. Loughan asked if any of the members had any objections to the changes that were made to the draft ED in Tab C.

Mr. Allen said he has concerns about three of the indicators in par. 28 (b, d, and g: access the organization's assets or direct the ongoing use of those assets, approve the budgets or business plans for the organization, and finance the deficits of and provide financial support to or settle liabilities). He believes those are persuasive indicators of control that belong in par. 27 and proposed that they be moved there.

Staff provided examples of relationships with Federally Funded Research and Development Centers and non-profits that would meet some of the indicators in par. 28 but would not be appropriately considered core or non-core entities. Therefore, those indicators could not be considered persuasive.

Staff also explained the difference in wording with the language that introduced par. 27 and par. 28. Par. 27 states "authority to" whereas par. 28 says "has the ability to" which would mean something very different and the federal government is not required to do something but has the option or ability to take action if they want to. Mr. Dacey agreed, but said he would have to think about the specific wording more. However, he agreed for the most part because of the reasons staff brought up and how one could interpret that access to assets. It is an imprecise term; some people's access might just mean help dictate the use of as opposed to take.

Mr. Allen suggested deleting the phrase "access the organization's assets" from 28b. None of the board members objected.

There was no support for changing 28d or 28g. Mr. Allen acknowledged that he has brought this issue up before and no changes were made. He said he felt the strongest about 28b so if they removed access to the organization's assets from 28b, he would be alright with leaving the other two in 28 since they can be read in the permissive way of "has the ability to" and is not something they regularly do or are required to do.

Mr. Dacey said he has some editorial comments that he will forward on to staff.

Mr. Allen requested that staff members forward any additional editorial comments or changes to staff.

CONCLUSION: The following decisions were made in the government-wide federal reporting entity session:

- **The Board did not recommend any specific changes to the inclusion principles based on the presentation regarding the Federal Reserve pro forma disclosures. There were suggestions regarding the disclosures and examples of information that staff will consider in determining if the disclosure requirements could be enhanced.**

- **The Board agreed the standard should remain silent on OCBOA and if there are differences with non-core it will be up to the professional judgment of the auditor and preparer to determine if they are significant.**

- **The Board agreed to deleting the phrase "access the organization's assets" from par. 28b.**

- **The Board agreed further discussion of related parties will be addressed in conjunction with the component reporting entity phase within the next few meetings.**

- **Board members will forward staff editorial comments on the Draft ED.**

~LUNCH BREAK~

COMPONENT REPORTING ENTITY

Ms. Loughan directed members' attention to Tab D – Component Reporting Entity and described two approaches to identifying organizations that should be included in the financial reports of component reporting entities (Option A – Administratively assigned approach and Option B – Revised inclusion principles approach).

Ms. Loughan explained Option A-- Administratively assigned approach - provides that the government-wide reporting entity's GPFFR includes all organizations for which the Congress and the President are accountable based on principles established in this Statement. The government-wide reporting entity is the only federal reporting entity that is an independent economic entity. Disaggregation of the government-wide reporting entity into component reporting entities supports accountability and should result in each component reporting entity including in its GPFFR all core and non-core entities administratively assigned to it. In addition, each non-core entity should be reported in the GPFFR of the core entity with which it has the most comprehensive relationship. In contrast, Option B-- Revised inclusion principles approach - provides principles for defining what organizations should be included in the component entity reports and attributes established for core and non-core entities (that would generally be the same as the government-wide, but have been restated so that they can be applied by the component entity.)

Staff explained Option A (Administratively Assigned Approach) may provide a more realistic view of how component reporting entities become accountable for organizations and how component entity boundaries are likely to be determined. Administrative assignments to component entities are typically made in policy documents such as budget documents, laws, regulations, or strategic plans. Ultimately, component reporting entities would identify and include in their GPFFR all core and non-core entities for which they are accountable so that both the component reporting entity and government-wide GPFFR would be complete.

Staff explained with additional guidance—perhaps a coordinated effort from the central agencies—there could be processes in place to ensure the component reporting entities are performing the necessary procedures to capture the material organizations from their perspectives and also for consideration at the government-wide level. Because option A does not create a second set of inclusion principles – which may imply greater differences than intended – staff believes it is a more effective approach to developing the necessary procedures.

Ms. Loughan asked if members had any comments on the two approaches and if they agreed with staff's recommendation of Option A – Administratively assigned approach.

Mr. Schumacher said one of the questions he had regarding the administratively assigned approach has to do with the statement that each non-core entity should be included in the general purpose federal financial report (GPFFR) of the core entity with which it has the most comprehensive relationship—is that always clear, are there circumstances where it could be split 50/50, who makes that determination, and how clear of a line is there.

Mr. Dacey added that he also has concerns about that specific requirement because certain non-core entities have transactions with multiple core entities (e.g., American International Group, Inc. (AIG), assuming it is a non-core entity, has transactions with the Federal Deposit Insurance Corporation (FDIC), Treasury, and TARP). AIG has significant relationships with several entities so he could perceive situations where non-core entities could be appropriately reported in multiple core entity GPFFRs. He suggested there might need to be a threshold test that could be used to determine whether a relationship with a non-core entity is significant enough to be reported in a core entity's GPFFR.

Ms. Payne asked Mr. Dacey to clarify that he is not concerned that multiple core entities may report their significant relationships with one non-core entity; in fact, one might argue that for fair presentation, if there is a significant relationship with a non-core entity, a core entity's GPFFR might be misleading if it did not report that relationship. Mr. Dacey confirmed that to be his viewpoint.

Ms. Payne then asked Mr. Dacey if he thought the standard should explicitly state that it is permissible for a non-core entity to be reported by multiple core entities. Mr. Dacey responded that the standard could explicitly state that but he would hope that would be the end result based on the criteria for accountability that is included in the standard.

Mr. Allen asked Mr. Reger if it presents a consolidation problem for him if relationships with a non-core entity are reported in multiple core entity GPFFRs. Mr. Reger responded that it does present a challenge when consolidating to figure out how to put each of the different relationships that are disclosed into one consolidated footnote. He said the best scenario for him would be for non-core entities to be discussed in the

GPFFR of the core entity it has the strongest relationship with, but he understands where a core entity's financial statements might be misleading if it does not discuss its significant relationship with a non-core entity.

Mr. Dacey said he cannot think of too many non-core entities that might cross the threshold test but AIG comes to mind as one that specifically would. Mr. Reger added that some FFRDCs might also.

Mr. Allen asked if that issue would be a problem common to both Option A and B. Mr. Reger responded affirmatively. Mr. Allen clarified that Mr. Schumacher was not speaking against Option A. Mr. Schumacher agreed, stating that he raised the issue because it was explicitly stated in Option A.

Mr. Reger said he is a little concerned about the universe of entities since each component entity would be responsible for identifying which non-core entities to make disclosures about, probably based on their existing disclosures. Mr. Allen clarified that concern is not germane to Option A or B either; it exists with both.

Mr. Allen asked members if there were any questions or support for either Option A or B.

Mr. Dacey responded that he prefers Option A, noting that in the end, a core entity is a core entity regardless and a non-core entity is non-core with respect to the federal government, and having criteria to assign the non-core entities to a particular core reporting entity would then follow from there.

Mr. Showalter said he would agree with Option A. He asked how Mr. Reger would be able to ensure that his universe is complete; is it a requirement that all information flow up through component entity financial statements or are there instances where entities and relationships need to be included in the government-wide GPFFR that are not included in any of the component entity GPFFRs.

Mr. Dacey said he envisions that there would be a reconsideration, both government-wide and at the component reporting entity, to identify the new boundaries under the new standard. That exercise will provide greater knowledge and experience.

Mr. Dacey added that GAO focuses on the 35 significant entities because they represent 99 percent of the statements. To find something material that is not currently included in the government-wide financial report would be a huge find because they have not seen it yet. He said the exercise of going through with a new standard will require effort and hopefully result in a conclusion that everything is materially captured in the current GPFFRs.

Mr. Reger said Treasury has been seriously discussing whether it would be necessary to advertise the new standard in newspapers and encourage those entities with a significant relationship with the federal government to contact their respective agencies to ensure they are appropriately included. Such advertisement would help provide evidence to the auditor that Treasury was taking every effort to be inclusive in their search for the complete population of entities to include. Mr. Reger said there is a real fear that an entity goes unrecognized until some later point, but he thinks it is highly unlikely that they do not know about an organization that would be a significant factor in the consolidation.

Ms. Kearney said when FASAB first started developing the federal entity standard they were merely taking what was currently in the concepts and giving it more authoritative standing by placing it in the standards. She said she never expected agencies to have to launch a significant effort to determine if the GPFFRs included everything that they should. To her, that would be a lot of time and money for not a lot of value. She said it seems to her that the GPFFRs already include the majority of the entities, especially since 99 percent of the government-wide statements are made up of only 35 significant entities. Ms. Kearney said if the board's intent is to have the agencies go out and re-canvas everything that would cause her concern because it would be such a huge effort.

Mr. Allen said he saw the administrative decision in Option A being one made by OMB to determine if there are any significant relationships that are not currently being captured in agency GPFFRs.

Mr. Dacey said there needs to be clear guidance, both at the government-wide level and the agency level. There needs to be communication to make sure they are in the same place so a component entity is not saying something is core that the government-wide is saying is non-core, and vice versa. Mr. Dacey said he does not think it would necessarily be a huge effort but there would need to be significant coordination.

Ms. Kearney asked if the component entity consolidates something as core, would it not just automatically flow up from the component entity and be consolidated as core at the government-wide level.

Mr. Reger agreed but said that they have to look at organizations to determine if they are, by this new definition, core where they may not have been part of a core before.

Mr. Dacey added that when GAO audits the consolidated financial statements, they have to be comfortable that whatever is included as core and non-core meets the definitions in the new standard. He thinks there would need to be a one-time sharing of information to ensure they are coordinated and applying it consistently.

Ms. Kearney replied that the agencies are receiving their own audit opinion, in which their auditors have opined that the statements are in conformance with GAAP.

Mr. Dacey noted that GAO would need to ask for information from the components and their auditors in some format to ensure that it agrees with the analysis and how they reached their conclusions regarding core and non-core.

Ms. Kearney said, other than picking up a few non-core entities not previously considered, she does not see the standard creating a huge change in practice for agencies. She said she does not anticipate the standard resulting in the identification of a new core entity that is not already being captured in the GPFFR.

Mr. Reger said it may not but they are going to have to have a process in place to decide that and validate to their auditor that they did go through the process.

Ms. Kearney agreed, stating that process should already be in place now.

Mr. Allen asked again if members had any specific comments on Option A or B. He summarized that he had heard general support for Option A with the modification that non-core entities will not be limited to being reported by just one core entity.

Ms. Kearney said she read the benefit of Option A being to identify which core entity has the most comprehensive relationship with each non-core entity. Since that requirement is being modified, does staff think there is still a benefit to selecting Option A over Option B.

Ms. Loughan responded that staff believes Option A is more representative of how things realistically operate in the current environment. She added that staff also believes trying to adapt some of the government-wide principles (e.g., control) to the components would be difficult for the components to apply in practice.

Mr. Dacey said he views a substantive difference between the two options. In Option A, a core entity to the federal government is a core entity and then we have to figure out where it gets reported, whether it is part of a core or reported directly into the consolidated. If it is non-core to the federal government, it is non-core and we have to figure out which entity reports it. In Option B, we would be making separate determinations in what he views as a less coordinated fashion.

Mr. Steinberg asked if Option A is truly up to OMB to make an assignment of what each component entity should report.

Ms. Loughan responded that Option A includes draft factors and proposed language. Ms. Payne added that staff envisioned that the agencies would follow the guidance laid out in the standard to determine what they should report and, if there were issues, the central agencies would then have the chance to opine.

Mr. Steinberg asked for clarification of how Options A and B differ. He stated that the way he reads it, Option B is based upon criteria that were developed for the government-wide statements and Option A is administratively assigned but the starting point appears to be the same criteria.

Ms. Payne responded that the challenge with Option B is that it gives the appearance that there is a distinct set of principles at the component level that the component can apply from its own perspective. In other words the component can look at the inclusion principles and the core and non-core distinction from the view of the head of a component reporting entity. She said she thinks that is somewhat misleading because the principles are very difficult to apply from the view of a department head because control is usually at the government-wide level. She said that is the main difference; it would give components the false impression that they are starting with their own principles when they are really operating as part of a government-wide effort and they need to make sure they report properly from a government-wide perspective.

Mr. Steinberg asked if Option A is closer to what we have under the existing concept. Ms. Payne said she would agree with that because the existing concepts do not set up two separate sets of principles.

Mr. Allen asked for a formal vote on the options from members.

Member	Option A	Option B	Comments
Allen	X		
Dacey	X		Conceptually supports A but has suggestions for changing some of the requirements.
Granof	X		
Kearney	X		
McCall	X		
Reger	X		
Schumacher	X		
Showalter	X		
Steinberg	X		

Members unanimously supported developing Option A for component reporting entities.

Ms. Payne said that staff has some issues within Option A that they plan to tee up for the next meeting but they have the time if any of the members want to flag issues they would specifically like to discuss at the next meeting.

Mr. Allen said he really likes the flowchart but it does take time and effort to read and understand it; he questioned if they could make it simpler.

Mr. Steinberg said he would like to address instances where OMB has provided waivers to entities from being consolidated into component entities (e.g., the Pension Benefit Guaranty Corporation). He would like to determine if they can develop a principle that would provide for such instances. Ms. Loughan responded that staff had developed the paragraph on “Misleading to Include” (par. 8 on page 6 of Tab D) to address those types of situations.

Mr. Steinberg said that OMB had laid out criteria under which they would consider a waiver and asked if the board should include criteria in the standard or just leave the decision open to OMB. Ms. Payne responded that was one of the issues that got flagged for discussion at the next meeting so staff provide two options so members can discuss in more detail then.

Mr. Reger asked what other issues have been flagged for discussion. Ms. Payne responded that some of it will be clarity of wording. She noted that staff has plans to meet with some CPA firm representatives next week and hope to do some outreach to the preparer side as well. One issue she saw that they discussed earlier was the potential for non-core entities to be in more than one disclosure. She noted that the “Misleading to Include” paragraph is written the way it is written because it applies only “so long as” the entity is preparing its own GPFFR that would be consolidated at the government-wide level. She said that staff will develop that discussion along with the option to include factors as proposed by Mr. Steinberg.

Ms. Payne stated that, other than those few issues, she thinks most of the items for discussion at the next meeting will involve clarity of wording. She recognized the time that Ms. Loughan has spent developing the draft wording and stated that Option A is pretty well fleshed out and it is a matter of getting into the details at this point.

Mr. Dacey noted that par. 2 in Tab D talks about administrative assignments, which is consistent with what the board discussed at the last meeting. However, he struggled with pars. 3 and 4 and how they then relate back to par. 2. For example, if OMB says that PBGC does not need to be consolidated with the Department of Labor, does that mean you stop after par. 2 and do not go down to pars. 3 and 4. He stated that he struggled with the inter-relationship between pars. 2-4. He asked staff to consider whether this is a decision tree or step approach and how one should consider the paragraphs in relation to each other.

Mr. Dacey also asked staff to consider the significance of materiality for disclosure of non-core entities—should it apply only at the government-wide level or should it apply at the component level. There are certainly a lot of disclosures about non-core entities that would disappear at the consolidated level due to immateriality. Staff explained component entity disclosure requirements have not yet been developed for the component reporting entity, but did not envision having different materiality considerations at the component entity reporting level than would normally be there.

Mr. Allen said he would look forward to the discussion of these issues as well as related parties in the upcoming meetings.

Mr. Allen thanked staff for their work in the federal reporting entity area.

Conclusion: The Board members unanimously agreed with the staff recommendation to further develop Option A (Administratively assigned approach) for component reporting entities.

- **Federal Reporting Model**

Overview

During the reporting model project discussion, the Board deliberated the next steps for the project and considered the results of discussions with the preparer and auditor communities and discussions with internal and external users. Staff conducted the discussions to identify changes the participants believed are needed in light of the current environment. Consequently, the Board determined that the reporting model project should be segmented into multiple projects and, while members discussed initiating several possible projects, the Board primarily focused on performance reporting, the statement of net cost, and budgetary information.

The Board believed that the next set of projects should be well-defined and should offer FASAB the opportunity to play a direct role in resolving issues through accounting standards. After discussing the priority of the next projects during its strategic planning session, the Board determined that the issues needed to be more developed so that they could better assess the success of the projects upon completion. Staff will develop the issues for the Board to consider during the April 2012 meeting. Additional details of the Board reporting model discussion follows.

Discussion

Mr. Simms introduced the reporting model discussion by noting that staff conducted two roundtable discussions with the CFO community, a roundtable discussion with individuals from the audit community, and conducted interviews to help develop perspectives from internal and external users. In addition, Mr. Simms noted that based on the feedback received, the Board's conceptual guidance for displaying financial information could be updated and enhanced. The reporting model project began as an effort to describe the financial statements used to present the elements critical to meeting the reporting objectives and explain what statements are fundamental to meeting those objectives.

Mr. Simms also suggested that the Board segment the project into at least two areas – performance reporting and electronic reporting. While the Board acknowledged the importance of performance reporting and considers it a high priority, the Board has not provided standards on this topic. Additionally, users are increasingly obtaining their information electronically and the Board's Reporting Model Task Force recommended that the reporting model move toward electronic, Internet-based approach. Staff also referred members to examples of agency statements of net cost. The examples showed the wide range of displays being used to present cost information at the agency level.

Mr. Reger noted that the discussion on electronic reporting will not only need to involve the consolidated report, but multiple agencies. The consolidated financial statements are compiled because the federal government does not have a central accounting system that maintains individual transactions. One would need to go to the agency's statements to get a break-down of a particular line item. Ms. Kearney noted that there is nothing preventing electronic reporting today. The requirement to provide printed reports was removed from Office of Management and Budget Circular A-136. Thus, she was not sure what problem the Board would be resolving. The boundaries of audited versus unaudited information appear to be an audit concern. Also, Mr. McCall noted that he could understand the relevance of performance reporting, but had difficulty understanding how electronic reporting relates to generally accepted accounting principles (GAAP).

Mr. Steinberg noted that people are moving toward electronic information on the internet and when they conduct drill-downs they may be accessing information that is not a part of GAAP. The Board could provide a framework for what could be considered fair presentation of financial position and results.

Ms. Payne noted that the Association of Government Accountants is conducting a study on electronic reporting. They are considering a survey instrument that involves asking questions such as do you envision a need for standards; what topics could be covered by those standards; who is best suited to provide standards; are best practices needed; and who would be best suited for providing those best practices. In the next 20 years, solely paper-based reports would not be how standards-setters approach their work.

Mr. Steinberg noted that he agreed with the staff suggestion to begin projects on revisiting the conceptual framework, performance information, and electronic reporting. Also, Mr. Steinberg attended the December 8, 2011, CFO roundtable and noted that the participants discussed future-oriented information, budget comparisons, cost information, and internal controls and, while the existing conceptual framework touches upon each of these topics to some degree, the framework could be revisited and expanded to address the CFO community's concerns.

Mr. Granof noted that the Board has limited resources and should spend its time on projects that are well-targeted and are going to produce results in the foreseeable future. Mr. Granof was concerned that focusing on the conceptual framework will not lead the Board to changes in standards in the foreseeable future and, at this point, the issues need to be better defined. He noted the same concern with respect to electronic reporting. However, regarding the statements of net cost, Mr. Granof noted that the Board could have a manageable, well-targeted project, and could complete the project in a reasonable amount of time. Mr. Showalter agreed with Mr. Granof and noted that having a set of statements that are understandable is important for external users.

Mr. Dacey noted that he had similar concerns about the conceptual framework and electronic reporting. Also, he noted that users sought risk information, such as the potential impact of risks on operations and forward-looking information, and wanted to ensure that the Board's risk assumed project considered their concerns. Regarding the issue of presenting cost by program in the statement of net cost, the Board established a flexible approach with respect to responsibility segments. The standards allow agencies to aggregate the data for the responsibility segments that are most meaningful to them; therefore, there will be differences among agencies and it may not be the best outcome to prescribe what the agencies should present.

Mr. Dacey noted that some guidance could be provided on what agencies should consider when determining responsibility segments and how they should be aligned with their strategic plan. Regarding performance information, other standards-setters, such as the Governmental Accounting Standards Board (GASB) and International Public Sector Accounting Standards Board (IPSASB), provide guidance on performance reporting and that guidance could be used as a reference if the Board believes that a project is needed.

Mr. Allen believed that the reporting model project should be segmented into defined projects and, to determine the defined projects, he considered the Reporting Model Task Force recommendations. Those recommendations helped him settle on the following priorities:

1. Developing a functional statement of net cost. Mr. Allen noted that, based on his involvement with public hearings conducted by the GASB, people care about the cost of a program or function and they reorganize financial statements accordingly.

2. Net position of the government. Many of the news articles that the Board reviews show different individuals explaining the net position of the federal government. However, in light of the need for clarity and user understanding, it seems that a standards-setter should have a role in saying what the financial position of the federal government is.

3. Need for improving Budgetary Reporting. This area relates to the statement of spending.

Mr. Allen also noted that the Board may not be in a position to be the driver in performance reporting and electronic reporting. The Board could play a supporting role, but the Office of Management and Budget would be the driver. Mr. Showalter noted that most of Mr. Allen's priorities deal with the basic financial statements and, based on the feedback, the Board should take a serious look at the financial statements. The project could possibly anticipate a statement of spending and provide better guidance on other identified issues.

Ms. Kearney noted that the Board could look at how the federal government is currently reporting items of information and determine what makes sense to include, what does not make sense to include, and what is missing that should be added. For example, we could determine what we are trying to get out of net position that would be more meaningful. Currently, the net position of the federal government does not capture its ability to tax but includes assets that the government will not sell, like the pentagon. The Board has an opportunity to determine what items of information are significant by designating an item as either basic or required supplementary information (RSI).

Ms. Kearney noted that three agencies participated in piloting a statement of spending in 2011 and they plan to have additional agencies present the statement for 2012. The major CFO Act agencies will present the statement as other accompanying information. This approach would help identify implementation challenges prior to moving to a basic financial statement.

Mr. Steinberg noted that when the Board developed the statement of net cost, the intent was to present the cost of strategic goals. This would allow users to see how much it costs an agency to achieve its strategic goals and to compare net costs to outputs and outcomes. Later, Statement of Federal Financial Accounting Standards 4, Managerial Cost Accounting Standards and Concepts used the term "responsibility segments," which was loosely defined. As a result, agencies chose different things as their responsibility segment. Some chose strategic goals while others chose major funds or appropriations. To show what government services are costing, the flow statement should be organized by strategic goals and programs are a subset of strategic goals.

Mr. Allen noted that the Board's citizens survey indicated that some citizens wanted to know the cost of the war in Afghanistan and it seems that people care about functions rather than the agency that conducts the function.   So, the challenge is whether we should stay with a departmentally based presentation or do we identify key functional areas that cross several departments.

Mr. Dacey noted that the program level would be extremely opaque if a functional presentation was used at the government-wide level.   Also, the consolidated report shows net cost by agency because, at that time, the user study indicated that users did not understand the budget functions.   Mr. Steinberg noted that to determine the cost of the war one would need to gather cost data from several agencies. Different agencies have different roles with respect to the war.

Members expressed concern whether the statement of spending could be revised to address every user's needs. Mr. Simms noted that different users appear to expect different levels of aggregation and citizens in particular indicated that they would like to know how an item affects them. For example, during focus group discussions, citizens wanted to know how much funding went to entities in their local area.

Mr. Steinberg noted that the recent passing of the Government Performance and Results Modernization Act indicates that an interest in cost by strategic goals continues today. Also, if the Board would like to pursue a project on budgetary reporting, the Board should do what the states have been doing for over 40 years - present a comparison of budget authority to actual expenditures.

Regarding performance reporting, Mr. McCall noted that the focus should be on presenting the challenges in providing services in the future. This would engage citizens because they want to know whether they are going to continue to receive those services in the future.

Mr. Schumacher noted that he was not in favor of revisiting the conceptual framework. Also, he was not sure what influence the Board would have at this time with respect to electronic reporting. However, the projects he would consider a priority include: performance reporting; providing more meaningful information in the statement of net cost; and budgetary reporting. It would be helpful to have budget to actual comparisons.

Mr. McCall noted that performance reporting and budgetary reporting could be priorities. Also, a budget to actual comparison is an essential statement. In addition, Mr. Granof noted that he would support presenting budget to actual comparisons.

Mr. Allen noted that the Board is now at the point where it needs to clearly define the issue it wants to address so that a project or projects can be developed and prioritized. Clearly defining the issues will help the Board assess whether the projects were successful upon completion.

Mr. Simms noted that members appeared to be interested in performance reporting, the statement of net cost, and budgetary information.

Mr. Allen noted that members will need to take these areas under consideration when they prioritize projects during its strategic planning discussion. See the Strategic Planning session for details of that discussion.

> **Conclusion:** For the April 2012 meeting, staff will develop and present issues that the Board could consider for the project's next steps.

- **Fiscal Sustainability Reporting and the CFR**

Ms. Parlow opened the agenda session by noting a correction for a citation in the briefing materials memorandum. She said that the date of the previous Board meeting discussion was February 2011. At that meeting, Mr. Steinberg had noted the importance of the cost of delay, and Mr. Allen had expressed the expectation that the reporting on "Cost of Delay" would more closely resemble the illustration in Statement of Federal Financial Accounting Standards (SFFAS) 36, *Reporting Comprehensive Long-Term Fiscal Projections for the U.S. Government.*[2] Mr. Allen had noted that the fiscal year (FY) 2010 comprehensive Financial Report of the U.S. Government (CFR) reported the cost of delay as a net figure, expressed as a percentage of GDP, instead of

[2] SFFAS 36, Appendix B, Illustration 6: Impact of Delaying Action

following the illustration, which reported the cost of delay in terms of change that would be needed in projected revenues or spending.

Ms. Kearney said that the Office of Management and Budget (OMB) requested this agenda session. She said that in accordance with SFFAS 36, for the past two years, this reporting has been presented as Required Supplementary Information (RSI), and that presentation as RSI has allowed a period of experimentation to find the best way to present the information. She said that the current year will be the last year of experimentation, because SFFAS 36 provides that this reporting will be basic audited information starting in FY 2013. She said that the OMB would like some indication from the Board that the reporting is moving along the right lines and meeting expectation, and whether the Board would like to offer any suggestions for improvement.

Mr. Allen said that when he does public presentations of fiscal sustainability reporting, he uses the cost of delay illustration in SFFAS 36 rather than the actual reporting in the CFR.

He said that the illustration of the “Cost of Delay” as illustrated in SFFAS 36 was in his opinion, the most important and the most understandable part of SFFAS 36. He said that this information does not resonate unless you put it in the format illustrated in the standard. He said that the format illustrated in SFFAS 36 shows that closing the fiscal gap requires certain actions, and this is what they are, at a level that you can understand – either raise revenues, or cut outlays, or a combination of both of those. He said that this format is a key slide in every presentation that he makes. He said that he had tried earlier in the year doing a presentation using a percentage of GDP and frankly got blank stares from the audience, so he discontinued using it. He said that when the information is presented simply as a percentage of GDP, it doesn’t resonate, and people don’t understand what he is talking about. He said that it needs to be presented as a percentage of revenue or outlays.

Mr. Granof said that he agreed 100% with Mr. Allen’s comments. He said that overall, the fiscal sustainability reporting is excellent, and he uses almost all of the tables in presentations that he gives. However, the one table that he does not use is Table 3 (Cost of Delay). He said that this table is not particularly clear.

Ms. Parlow said that the illustrative example of reporting on the cost of delay is section 6 of Appendix B of SFFAS 36. She noted that the illustrative example showed the changes that would be needed in revenues or expenses or a combination of both, to close the fiscal gap at different intervals of time, depending upon how long action is delayed. She said that the graph shows how much worse the situation becomes over time.

Mr. Granof said that the concept of “fiscal gap” is complex. Mr. Allen said that it is complex, but explainable. He said that he always takes a moment to explain that closing the fiscal gap means not to pay off the debt, but rather only to allow the government’s debt to grow at the same percentage as GDP grows. He said that he thinks that people can understand that.

Ms. Parlow agreed, and said that the same section of SFFAS 36 provides an example narrative to explain this concept in plain English: "In the projection, 'closing the fiscal gap' means to maintain the government's debt at the same size (in relation to the economy) as it was at the beginning of the projection period." She said that someone would not have to be an economist to understand that.

Mr. Granof agreed that you do not have to be an economist, but said that it takes a certain level of sophistication to know what "change in average primary surplus" means. He said that this is difficult to explain to a general audience. Ms. Parlow agreed, and noted that the term "change in average primary surplus" is used in the "cost of delay" reporting in the CFR, not in the example in SFFAS 36.

Mr. Allen asked Ms. Kearny if the presentation might be geared more towards economists, and wondered if different presentations could be field-tested for understandability.

Ms. Kearney agreed, said that one of the challenges is that the projections are created by economists, and that economists communicate in terms of percentages of GDP. She said that, to them, that is the most accurate portrayal of fiscal sustainability. She said that when we go to the more traditional terminology that we use in accounting, economists do not necessarily believe that this would be the most appropriate way that sustainability could be projected. She said that they tried to come up with terminology and language that do not require a degree in economics to understand, but at the same time the economists want to keep it pure and in line with what they're projecting. She said that she can take this back, and that it is great feedback, that they are a little too technical in this section, and is there is a way that we can make it easier to understand.

Mr. Granof said that the numbers in the cost of delay table – 1.8 %, 2.2%, 2.8% [of GDP] – those numbers are not dramatic. When we talk about a change of 2.8%, that doesn't sound like much. You don't get a feel for it. He said that when you look at the graph and see these huge bars, that means something to people.

Ms. Parlow said that there is a way to translate. She said that if you look at the projections of receipts and spending, everything is expressed as a percentage of GDP. So, you could actually translate that data to the type of graphic that is illustrated in SFFAS 36 – instead of netting, you could split out changes needed expressed in terms of receipts and spending.

Mr. Granof said that another issue is the focus on the primary deficit, non-interest spending and receipts. He said that those numbers are shown as getting closer together, so that it looks like you don't have a big problem - but meanwhile, interest is skyrocketing, and that's not shown until subsequent graphs. You have to go to subsequent pages to see that.

Ms. Kearney said that this was largely approached as telling a story. You start with chart 1, which gives one picture, and then chart 2 and – as Mr. Granof correctly notes - it's not all there yet, but in chart 3, it is. The way that they're framing it isn't as dramatic, but she is not sure that dramatic presentation was a goal. She said that their intent might be to tell a story, step by step.

Mr. Granof agreed, and said that in a presentation that he's giving, he does tell a story, and leads through the graphs, just as Ms. Kearney is talking about. Ms. Kearney asked if they could do a better job of telling the story. Mr. Granof said that they did a pretty good job.

Mr. Allen asked why the statement only shows non-interest spending. He asked what would happen if there were a surplus instead of a deficit , interest could easily be the biggest outlay of the whole budget, but you would come to a misleading conclusion that you have a cash surplus, even if the interest goes up sharply.

Mr. Reger said that a discussion of the interest calculation might obscure this discussion, too.

Mr. Dacey said that the values in the table are discounted present value. He said that if receipts exceeded spending, then effectively you'd be paying down the deficit and interest costs would be going down rather than going up. He said that interest is included implicitly because they are used to discount the cash flows to calculate the present value amounts that are presented on the statement.

He said that the display of projected non-interest spending is appropriate, because non-interest spending is where policy decisions need to be made. He said there is also a separate graphic on what happens to the debt, which shows the impact of interest. He said that it's important to have both – the projections of non-interest spending, and the debt chart – so you can see how they interact with each other.

Ms. Payne said that the narrative on page 154 of the FY 2011 CFR – the "fiscal gap" explanation - addresses Mr. Allen's question by explaining why the necessary adjustment in non-interest spending and/or receipts is larger than the primary deficit. She said that during the development of SFFAS 36, the Board considered having the fiscal gap on the statement but decided not to require that placement to give the preparer options on where to put it.

Mr. Dacey said that it might be helpful to note earlier in the reporting that even getting to zero [deficit for non-interest spending] is not going to solve the problem of the fiscal gap- that you actually need a percent or so surplus to keep the debt level constant [as a percentage of GDP].

Mr. Showalter said that he appreciates the charts, but that the wording is still pretty technical from the average reader's perspective. He said if OMB wants feedback on understandability, he found himself reading some paragraphs a couple of times, and saying to himself, "What did I just read?" He said that if they could communicate in something closer to plain English, that this would be very helpful to readers.

Ms. Parlow noted that on page 148 of the CFR, where the statement showed an improvement in projected non-interest spending less receipts of nearly $10 trillion from FY 2010 to FY 2011, that Mr. Allen had comments.

Mr. Allen said that the challenge that he has in using this in a presentation is that this conveys a very significant improvement. He said that, hypothetically, if Congress passed a law that in 2030 we would have a balanced budget with all debt paid off, would the fiscal sustainability reporting reflect that? He said that when the Board developed SFFAS 36, they struggled with that. He said that the Board had to consider how to define “current policy” and consider that Congress has made adjustments many times to policies. He asked what the appropriate time is to reflect legislation in the projections. He said that it seems to him that Congress just making a statement without putting policies and procedures in place is subject to significantly changing before the legislation is implemented. He said that the FY 2011 fiscal sustainability reporting does paint a very positive picture, that 2/3 of the sustainability problem has been solved. However there is little agreement as to how it will happen.

Ms. Kearney said that OMB did try to follow the standard, in that the law has been put into place and that would be the current policy unless you have historical precedent that this law will not be implemented. She said that SFFAS 36 has certain triggers as to when you would deviate from current law, but that absent those triggers, current law would be current policy. She said that each law would be considered separately as to whether or not that would change the projections, but that absent triggers, current law would be projected.

Mr. Allen said that there was a great deal of discussion on how to reflect the law. For example, we have a law on what the debt limit is. He said if you reflect that law, it would change the projections dramatically. But the decision was to ignore that law in calculating the projections.

Ms. Kearney asked if the feedback would be that OMB should enhance its disclosure on the assumptions used in the projections.

Mr. Allen said that perhaps there could even be scenarios showing projections absent the law being implemented. For example, there was some discussion of physician payments. He said that Congress had repeatedly overridden that law, but that the projections reflect those cuts being made, or other cuts equal to that. He said that the narrative even acknowledged that those cuts have been overridden consistently, but claimed that we’ll find other ways to make those cuts. He said that this is where he is struggling, that until they’ve identified ways to make those cuts, and implemented them in policy, should you recognize them? He said perhaps this could be address with a range of amounts, or with different scenarios.

Ms. Parlow said that the requirements most closely associated with what Mr. Allen is referring to are in paragraphs 27 -28 of SFFAS 36:

From SFFAS 36

1) Policy assumptions should reflect reasonable assumptions about the future course of receipts and spending assuming the continuation of current policy without change. The guiding principle for selecting policy assumptions is to base selections on assumptions consistent with the continuation of policies in place as of the valuation date.

2) Current law is the best place to start when identifying "current policy without change." However, a simple projection of "current law" would not always reflect current policy without change.

    a) Cases where a departure from current law may be appropriate include but are not limited to those in which current law

        i) expires almost immediately,

        ii) contains provisions that are internally inconsistent, or

        iii) has been changed in a consistent direction over time (i.e., there is a recurring history of change).

    b) The following examples demonstrate how a simple projection of current law may be inconsistent with the guiding principle:

        i) Legislation providing for discretionary spending provides funding that extends at most a few years into the future. A current-law policy assumption would show discretionary spending falling to zero within a few years. In this situation a simple projection of "current law" would not reflect the implicit "current policy without change."

        ii) Current law may contain inconsistent provisions in certain situations. For example, current law may contain provisions for scheduled social insurance benefit payments as well as provisions that restrict spending on certain social insurance programs, for example, Social Security and Part A of Medicare, to the amounts available in the Social Security or Medicare **trust fund accounts**, respectively, plus inflows of **earmarked revenues**. A current law policy assumption would not be feasible in this case since both requirements can not be met simultaneously. Thus, an interpretation of "current policy without change" will be necessary.

        iii) Current law may include provisions that have been changed in a consistent direction over a period of time. For example, the statutory limit on federal debt has been consistently raised. A current-law policy assumption would be that Treasury borrowing will never increase beyond the dollar amount of the current statutory limit. In such situations a simple projection of current law would not reflect the implicit "current policy without change."

Ms. Kearney said that the reporting was following the standard, but perhaps the Board is looking for a better explanation.

Mr. Allen said that he is not saying that reporting was not following the standard at all, but rather that there is a tension that takes place when passing a law without specifically identifying how that law is going to be achieved. For example, Congress may say, "We're going to reduce the deficit by this much; we don't know how, but we're going to do it." At what point do you make the adjustment for that? Do you wait until they come up with how they are going to do it, and then make the adjustment? The same problem happens at the state and local level. If there is a history of overriding that law, then you ignore the law. At what point do you recognize the benefit or the drawback of a new law or policy in the projections?

Mr. Granof asked about the discount rate or interest rate, whether it varies or is a constant.

Ms. Kearney introduced OMB senior economist Robert Anderson, who was attending as an observer. Mr. Anderson said that the rate varies, but not by very much. He said that the rate is based upon the rate chosen by the Social Security trustees and the actuaries who advise them.

Mr. Granof asked why they did not just choose a risk-free rate. Mr. Anderson said that the rate is their estimate of the rate that will be on government debt for the Social Security Trust Fund.

Mr. Dacey said that an explanation of the interest rate is on page 136 of the FY 2011 CFR.

Mr. Reger said that he was still struggling with the question of what the Board would like Treasury to do. He said that he understands the tension of which law do we ignore – for example, the debt limit versus the physicians payment reduction. He asked what was in the reporting that the Board believes should be done, or should be done better, next year.

He said that the discussion is fairly clear, but the reporting may not come to the same conclusion that you as an individual reader might like it to come to. But it does have to ride that really tough line of being a non-political discussion to be of any value.

Mr. Allen said that he thinks that the fiscal sustainability statement lives up to that purpose. When you look at long-term projections, you recognize that in this period, you did make a change – and we can see in this period, the long-term effect of that. The question that he has is at what point do you say – when you pass a law, when do you say that this is something that is going to happen, but we don't have any policies or procedures in place to determine how it's going to happen. Does this have the full effect of law?

Mr. Dacey said that obviously the Budget Control Act has some real reductions, which we are experiencing now. The Affordable Care Act was in 2010, and there is a specific statement that physicians' payments will go down. Mr. Allen said that reductions in physician payments have been overridden many times. Mr. Dacey said that at least last year, when Congress overrode it, they offset it with other reductions. He said that the reduction that is pending right now has an offset also. He said that it's complicated, but there is a requirement to reduce the payments, so it's not an aspirational goal.

Mr. Anderson said that Congress has overridden it, but has never removed the basic formula. When they overrode it, they could have said, "We're not having this formula any more; it's not working," but they never say that; they always keep the formula in place. So for us to say that the formula is not going to be followed would be very presumptuous.

Mr. Allen said that there were disclosures about the uncertainty, and that was helpful.

Mr. Anderson said that he wanted to point out that the fiscal sustainability reporting continues to draw attention to the unsustainable upward drift of the debt ratio. He said that the reporting could have made the point that you just did, that we've almost solved the problem, but didn't, partly because of some of the doubts that you've expressed. So the judgment of the analysts is shown by that aspect of the reporting. He said that there are still things to negotiate with GAO, which has come back a number of times on some of these very points.

Ms. Kearney said that the Board may not disagree with the assumptions, but may want a better understanding of the assumptions in the narrative, or is not sure they do agree. Mr. Allen said that a key determination for financial statements being fairly presented, is that economic events and transactions are reported in the correct fiscal period.

Ms. Payne said that the reporting did an exceptional job of reporting the alternate scenarios. Mr. Allen agreed.

Mr. Steinberg asked about the charts with non-interest spending versus spending including interest. He said that he would suggest that in order to get to the full impact quicker, he would have preferred to see interest spending added to the earlier charts (and that Treasury would need to find an additional color to use). Mr. Granof agreed, and said that the increase in interest spending over time would be very dramatic.

Ms. Parlow agreed, and said that the illustration in SFFAS 36 that reflects Mr. Steinberg's suggestion is in section 3 of Appendix B (see box below) That graph shows all spending, including interest, and it does show interest spending rising dramatically over time. She also said that the graph uses cross-hatching instead of colors, so that the graph is effective even in black-and-white.

<u>From SFFAS 36, Appendix B:</u>

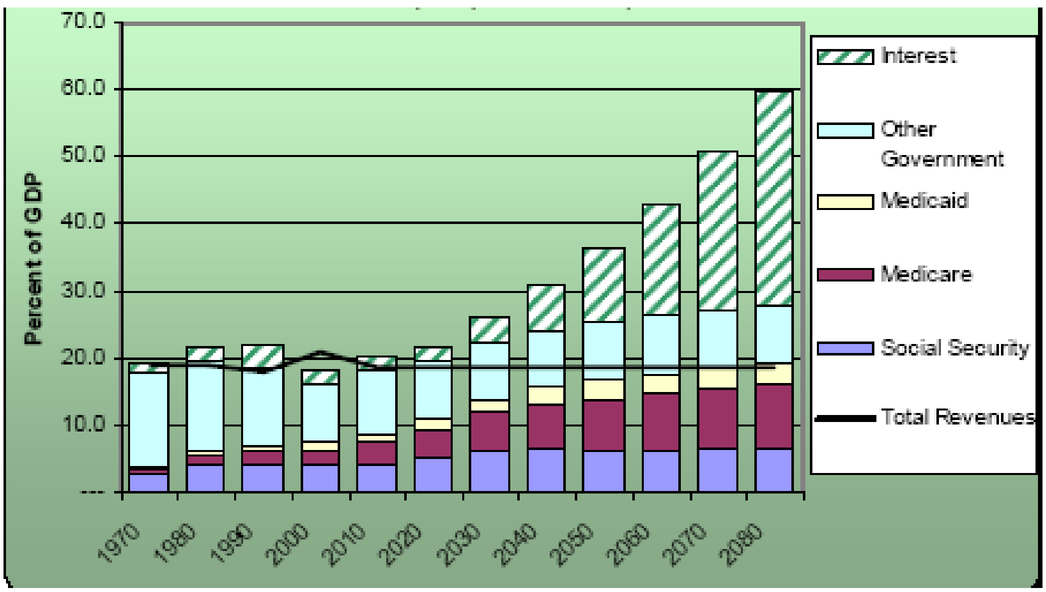
3. Relationship of Projected Receipts and Spending

The RSI section could include a graphic of the relationship between projected receipts and spending for a progression of years, for example beginning 20 years before the current year and extending to all future years projected in the basic financial statements. Below is an example.

Illustration 3: Projected U.S. Government Receipts and Spending

Projected U.S. Government Receipts and Spending

(As a percent of GDP)



Source: FY 2007 *Financial Report of the U.S. Government*, Chart H, page 18. Available at http://fms.treas.gov/fr/index.html (accessed May 7, 2009).

Ms. Kearney said that the illustrations do not represent the required way to make the presentations. She said that OMB did fulfill the requirements, but it did so in four different charts, because it wanted to tell a story and walk the reader through, versus an up-front picture. But she said that she does understand what the members are saying, that they would like to see the full impact earlier in the reporting, and then walk through the story. She said that she would take that feedback to OMB.

Mr. Reger said that Treasury is in the process of having a number of people review all of the charts, and finding out what is the impact of each chart and is there a better way to tell the story, so Treasury will take this back also. He said that because one of the directives is to further condense the Citizens' Guide to the CFR, this might provide an opportunity to help achieve that.

Mr. Allen referred to the section on Fiscal Projections in Context, on page 157 of the FY 2011 CFR. He said that this is probably a very sensitive part of the reporting. He suggested that the reporting could have been more informative on where the U.S. stands relative to other countries.

Ms. Kearney said that feedback on this section was very much appreciated. She said that it was a challenge because many countries do not report on fiscal projections. Mr. Reger said that even when countries do report, the data is not comparable, so comparisons may be more misleading than helpful. Mr. Dacey agreed. He said that a whole range of differences make it difficult to report on. He said that another issue is that of qualitative factors that make each country different. For example, Japan has a high debt-to-GDP ratio, but has other factors that make it more manageable, while other countries may have a debt-to-GDP ratio that may appear more favorable than ours, but that are having more trouble.

Mr. McCall said that he would like to see an explanation like this, as to why a direct comparison or ranking may not be possible or appropriate.

Mr. Granof said that the graphs show a spike in deficit spending from 2008 to 2010. He said that it would be helpful to have an explanation of that.

Ms. Kearney said that she would take that comment back to OMB.

Mr. Allen said that there was some discussion of that in the narrative in the FY 2011 CFR.

Mr. Steinberg asked about the assumptions about receipts on page 150 of the FY 2011 CFR. He said that one of the assumptions stated was the following:

> Individual income taxes are projected to return to their historical ratio to wages and salaries of about 17 percent over the next several years, and from that point on to increase gradually to almost 28% in 2086 to reflect the progressive nature of the Federal income tax, which implies that as real wages rise over time, the average taxpayer will move into higher tax brackets.

Mr. Steinberg said that although individuals do move into higher tax brackets as they get older and they earn more. Eventually they retire and their place is taken by younger people who are not going to make as much money. Accordingly, he found the assumption on receipts unusual, particularly because there is so much concern about tax levels in this country as a percentage of GDP. He said that he finds it unusual that we have a projection that taxes are going to go from 17% of GDP up to 28% of GDP.

Congress has always reduced the tax rate when it gets above a certain percentage, usually 20%.

Mr. Anderson said that, just as with any of the other projections, they could be wrong about that. However, what drives that assumption is that they assume, based on what the [Social Security] trustees give us, that the average person in the economy over the next 75 years will experience a real increase in income. So, the younger people replacing the older people will be paid more, in real terms, than the people they've been replacing, and that will continue. Now, it's not at a huge rate, perhaps 2% a year, but that's what's been happening historically. If that happens, and continues to happen, the average person will be in a higher tax bracket as time goes by, and unless they change tax law, the government will get more income taxes out of that.

Mr. Steinberg asked if the assumption was that people would make more money, irrespective of inflation. Mr. Anderson said yes, after inflation.

Mr. Allen said that he had similar questions on this assumption. Does this mean it is assumed that because of inflation citizens in lower tax brackets such as those qualifying for food stamps would eventually be in the 28% bracket?

Mr. Anderson said that there are broad macro-economic assumptions that [the OMB economists] share or basically copy from the trustees report that tell us what they think is going to happen to the average wage-earner's wage in the economy. If you are poor enough to be on food stamps, you may not be earning much or any wages, but the people who are earning an income and paying Social Security taxes – these are the trustees' forward-looking assumptions. All that OMB is doing in this case is work out the implications of that for the income tax, which the trustees do not think about because that's not part of Social Security. So, it is also true, as Mr. Steinberg points out, that there have been tax cuts periodically, which keep income taxes from rising steadily over time, but those are not easy to predict and it would be debatable whether you could consider that to be current policy.

Mr. Allen said that the other side of that equation is, as the Board was talking about a couple of years ago, that there was just a historic projection, that over a period of many years the ratio of total revenue to GDP has remained very constant over time.

Mr. Anderson said that he would differ a little bit from that, in that the ratio has fluctuated, but it hasn't fluctuated on a rising track.

Mr. Allen said that he understands how the preparers got this calculation, but the assumption is a departure from this historic trend.

Mr. Anderson said that in order to keep the ratio constant, there had to be periodic enactments of tax cuts. He said that a number of groups have done projections, with varying assumptions about receipts. He asked Mr. Dacey to confirm that when GAO prepares projections, the assumption is that revenue is a relatively constant share of GDP. Mr. Dacey said that is essentially correct. He said that the Congressional Budget

Office has made assumptions that differ over time. In recent times, they've prepared a couple of alternative projections, one of which is more in line with current law, which shows a large increase in taxes, because they don't try to impose any policy that differs from current law. The projections in the FY 2011 CFR do not assume that the Alternative Minimum Tax will ultimately affect increasingly lower income levels, but other assumptions do not include tax cuts to offset real bracket creep. He said that those are judgments, and somewhere in SFFAS 36 it mentions judgment, and you do have to apply it.

Mr. Allen said that there needs to be a fuller discussion of this in the report, because there was only a sentence or so to cover all that Mr. Anderson had just explained.

Mr. Anderson said that perhaps Treasury would begin to prepare the revenue projections. He said that Treasury's Office of Tax Analysis is very capable and they do detailed revenue projections for the budget, and that's what OMB puts right in the budget, but they currently do not prepare the projections for the financial report. He said that he believes that they would be able to make an even more informed judgment.

Mr. Reger said that OMB's assistance is invaluable in preparing the report.

Mr. Showalter said that what he is hearing is a need for more ranges, or perhaps more of an indication that the projections are not absolute numbers.

Mr. Steinberg said that on page 151 of the FY 2011 CFR, there is reference to the primary deficit and asked what the primary deficit is, and how it differs from a secondary or tertiary deficit. Mr. Anderson said that the terms secondary and tertiary are not commonly used, but that the unified deficit is all the spending, less all the taxes. The primary deficit includes all the spending except interest, less all the taxes. Mr. Dacey said that he term "primary deficit" is a term commonly used.

Mr. Steinberg said that he was not familiar with it, and suggested that it be defined in a footnote to the reporting.

Mr. Allen said that accounting standards involving assumptions always discuss the importance of disclosing those assumptions and often discuss the importance of consistently applying those assumptions.

Mr. Anderson said that the members had touched on, in this discussion, many of the sore points about the projections, and what the sensitive points are about the assumptions – the ones that, if there were going to be changes, those where change would be most likely.

In reply to Mr. Allen's question, the members indicated that they had no additional questions or comments to share with OMB.

- **Asset Impairment**

Mr. Allen introduced the project by referring members to TAB G and asking Mr. Savini to begin the discussion. Mr. Savini began the presentation by distributing a revised draft Exposure Draft (document entitled*, Accounting for Impairment of General Property, Plant, and Equipment Remaining in Use).*

The revised document included member comments and minor (cold-read) edits made subsequent to the mailing of the Tab G materials. Staff noted that there were no open technical matters and then provided an overview of the changes contained in the document. Staff then reviewed the additional TAB G changes as follows:

1. Page 7, Question 3. This change is made to conform to the previously agreed-to change in paragraph 12b regarding laws or regulations limiting or restricting G-PP&E usage.

2. Page 11, Step 1 Title. Striking "Potential" from the title so as not to confuse impairment with a (potential) impairment loss.

3. Page 12, Para. 13. Rephrase (i.e., changing from a passive to more active style) the sentence that states entities are not required to search for impairments.

4. Page 14, Para. 17. Substitute "appropriate" for "reasonable" so as to avoid circular-logic.

Staff then opened the floor for questions and noted that ballots would be collected at the conclusion of the session.

Mr. Steinberg inquired about the length of the comment period noting that 60-days could be sufficient. Mr. Savini recommended the 90-day comment period because the standard is the first of its kind and fairly technical in nature.

Noting no objections, both Ms. Payne and the Chairman called for ballots. As a result, staff collected 9 affirmative ballots and was asked to begin press release and related notification procedures.

Mr. Allen then concluded this portion of the meeting thanking staff and members.

- **Steering Committee Meeting**

Members noted that no updates regarding the FY 2013 budget were available. Ms. Payne indicated that the FY 2014 projections would be available at the next meeting.

Adjournment

The Board meeting adjourned for the day at 5:00 PM.

Thursday, February 23, 2012

Agenda Topics

- **Public Hearings**

Mr. Allen had thought about the desirability of holding a public hearing for the reporting model project. He noted that there are no rules requiring a public hearing. He asked Ms. Payne to explain the process involved in deciding to hold a public hearing.

Ms. Payne noted that whether to hold a public hearing was based on the complexity of the issues being addressed. She noted there were two windows to decide to hold a public hearing – first, when the exposure draft is issued and second, when responses are received. In either case, advance public notice of a meeting is required. Ms. Hamilton noted that the rules of procedure provide for a 60-day notice period but that could be reduced if the Board considers it appropriate. Cancellation also requires public notice in the Federal Register.

Mr. Steinberg noted that scheduling a hearing before an exposure draft is released could encourage people to participate. Mr. Allen noted that the meeting could be cancelled if comments and participation do not warrant holding it.

Mr. Dacey felt that a significant new proposal, such as federal entity, may warrant a public hearing. On the other hand, where a knowledgeable task force was engaged in developing a proposal in areas already covered by standards and issues are non-controversial a public hearing may not be warranted. Mr. Reger suggested that the publicity around a public hearing may help engage people; both in responding to the proposal but also in participating in the hearing.

Mr. Allen suggested that the hearing would be best held at the end of the comment period. Ms. Kearney noted that we always try to engage as many people as possible. A hearing would be consistent with that approach. Mr. Allen asked Ms. Payne to consider the timing and need for a public hearing as the reporting entity project progresses.

- **Strategic Planning**

Ms. Payne noted that the Board previously committed to an annual review of its strategic plan. In preparation for the discussion, the Board issued its three-year plan and informally invited input. Several responses were received. She asked if there were any question about the responses.

Mr. Allen noted that he was pleased with the level of feedback received and suggested that next year we consider whether to more formally request feedback.

Mr. Schumacher asked about the suggestion from one respondent that the Board reconsider the audit status of fiscal sustainability information. Mr. Dacey noted that he spoke with the respondent. The respondent indicated that he thought it was important to have fiscal sustainability information become basic information as soon as possible.

Mr. Allen noted that another respondent sought expansion of fiscal sustainability information to include intergovernmental dependency.

Ms. Payne noted that her summary also included some ideas that came from the roundtables on reporting model. She indicated that some participants raised particular line items on the balance sheet as problematic. That is, the cost of providing audited information for those line items outweighed the benefit in their view. She had not viewed concerns about individual line items as a reporting model issue; instead, the reporting model project focuses more broadly on the financial statements, understandability concerns, and concerns about alignment with the reporting objectives.

During roundtables, participants have sometimes identified historical cost depreciation of fixed assets and precise estimates of environmental liabilities as not cost-beneficial. Ms. Payne explained that historical cost depreciation is a controversial topic but one rarely finds strong majority support for another alternative. She also noted that she sought input from auditors about ways to adjust the cost associated with auditing these two items. No concrete ideas came from her discussions.

Mr. Allen also noted the comment about asset retirement obligations. He explained that the FASB standards are quite different from the FASAB standards. He expressed the view that the FASB approach was not aligned with the needs of a sovereign government.

Mr. Showalter said he was amazed by the comments from some that they don’t see value in PP&E accounting but they do want cost accounting; demonstrating the lack of understanding of the connection between the two. Ms. Payne noted that cost was precisely the driver of the current standards requiring historical cost depreciation. The view was that operating performance objectives are not met if one expenses PP&E on acquisition. Some criticize that approach by saying historical cost depreciation is not a good measure of cost; some prefer replacement or market value approaches. For example, some suggested imputing market rent for buildings but the effort would be too costly.

Mr. Dacey explained that the Department of Defense (DoD) has not challenged the current approach to general PP&E accounting other than military equipment. However, DoD does challenge the cost-benefit of historical cost depreciation for military equipment. Ms. Payne noted that, narrowing the discussion to military equipment, the debate centers on whether the information is relevant. That is, does anyone want to know the period cost of using military equipment? She believes it is clear that there is interest in the cost of military equipment as it is being acquired. It appears there is also some interest in how long the equipment will last.

Mr. Reger recalled that former OMB member, Debra Bond, had discussed the timing of DoD making its request to the Board. He noted that the discussion had been some time ago and an update on DoD and Department of Homeland Security progress and current thinking would be helpful.

Mr. Showalter suggested that alternative approaches actually may be more expensive than present standards. Mr. Allen noted the GASB experience regarding infrastructure including the engineers' perspectives on the issue. The option of demonstrating that the infrastructure was being maintained rather than being used up (depreciated) was provided. If infrastructure is maintained, depreciation is not required. He noted that accountants thought depreciation would be easier than the alternative. The engineers so strongly supported the alternative that GASB provided it. He agreed that sometimes alternatives to depreciation prove to be more expensive to implement.

Mr. Granof related the railroads' experience with betterment accounting.

Mr. Allen thought there could be better information but it is unlikely to require less effort.

Mr. McCall noted that he believes over 90% of Florida cities use historical cost depreciation rather than the alternative. Most noted that accountants tend to prefer that method because it is cheaper than alternative approaches. It is still possible to report what it costs to maintain the roads as well as the cost to restore unmaintained roads.

Mr. Steinberg noted that a past DoD proposal regarding military equipment included condition reporting. That option was considered sensitive information and ultimately DoD did not support disclosing condition information.

Ms. Payne noted that concerns were also expressed about the cost of supporting general PP&E valuation (for example, determining what costs should be capitalized as general PP&E is acquired) and estimation of environmental liabilities. She noted that she thought there would be general receptivity to ways to reduce the cost of preparing and auditing but that ideas that might reduce such costs have not been presented. She explained that the Accounting and Auditing Policy Committee is working on guidance regarding costs to be capitalized when an entity is constructing an item of PP&E. She noted a great deal of diversity of view regarding what may constitute full cost among participants.

Mr. Allen asked if Ms. Payne recommended waiting for a specific DoD proposal before pursuing a project on military equipment. Ms. Payne felt we would learn a great deal from DoD's efforts to reach audit readiness. However, she noted the timeline presented in the Congressional Panel's report on DoD's efforts. The report indicated DoD planned to defer coming to the Board but in the meantime systems that would not capitalize military equipment are under development. In that case, significant investments would already be made before the request was made. If the Board did not support the proposal to expense military equipment costly systems changes may be needed. This may place the Board in a difficult position.

Mr. Allen felt that was a concern. Mr. Dacey noted that DoD is exploring how to demonstrate existence and completeness of military equipment. The effort may lead to alternatives to the DoD's initial decision. He felt the Board could explore the general concept of whether the Board expensing military equipment was a viable option.

Ms. Kearney noted that no staff is available for a new project. She suggested that she work with Mr. Reger to contact DoD and explore the timing issue. Mr. Reger agreed that such outreach would be helpful. He did not see a need for a project at the moment but thought DoD should be asked whether Board assistance would be helpful. Reminding DoD of the Board's timeline for a major project, which requires public deliberation and outreach, would be helpful given the importance of timely presentation of any DoD proposal to the Board.

Mr. Steinberg suggested we not start ahead of an explicit request from DoD. He thought DoD may come up with ideas as they work through the systems issues.

Mr. Allen noted that the standards ought to be based on the reporting objectives for a sovereign government. He thought exploring whether the current standards properly support such objectives would be interesting. However, in the absence of a specific proposal, he did not believe we should revisit the standards until DoD makes its request.

Ms. Payne noted that there appeared to be no consensus to take up the topic before an update on the DoD effort is provided by Mr. Reger and Ms. Kearney. They committed to an update on the timing of any new DOD request at the April meeting.

Ms. Payne asked members if they thought the input on the three-year plan would lead to deferring any current projects. Members did not offer any candidates for deferral.

Ms. Payne noted that staff was seeking a better sense of the next steps the Board desires in the reporting model project. She reminded the Board that the earlier discussion centered on three areas – the conceptual framework, performance reporting, and electronic reporting. She asked Mr. Simms to review the candidates from the earlier discussion that seemed to have the most support. Mr. Simms offered that performance reporting held the most promise. An improved presentation of the statement of net cost as well as better performance information was desired by many members. He thought this more narrowly focused effort could be attained. For example, the management's discussion and analysis (MD&A) standards require performance information but do not offer much guidance on presentation of performance information. Other countries do present performance information in a standardized manner.

Mr. Simms noted that the citizen survey and other user needs work shows interest in performance information. He suggested that further review of performance information in the MD&A could identify areas for improvement through guidance.

Ms. Kearney noted that the Government Performance and Results Modernization Act required that all performance information be provided electronically. The Performance and Accountability Reports and Agency Financial Reports are printed documents which include performance information consistent with the Reports Streamlining Act. Reconciling these requirements may require some effort and the project could explore this.

Mr. Allen referred to the suggestion from the GWSCPA that we explore streamlining of the reports; a review of all disclosures and required information. He thought making reports more understandable would be a positive outcome of streamlining. He wondered if the project could explore ways to make the reports more understandable. MD&A, the statements, and the notes have an integral relationship. Looking at how to communicate through each part also should be an integrated effort.

Mr. Showalter agreed that many things could be considered under the umbrella of streamlining. He felt the basic statements were embedded in the conceptual framework and could be addressed through a project on the concepts. He expressed concern about adding the statement of spending; he felt it should be viewed as a part of the entire analysis of the required set of financial statements and its relationship to the entire set of financial statements should be explained. He also wondered if one should add something without considering what could be taken away. The addition of the statement could create confusion. He supported looking at a budgetary statement.

Mr. Allen agreed and thought that the suggestion from a respondent that we consider the general fund should also be addressed. He thought reporting on the general fund was important to understanding the whole. Looking at items in isolation is problematic.

Mr. Dacey noted he was troubled by the word “streamlining.” He preferred to look at enhancing the usefulness and understandability of the information. A common concern has been how to tie the audited information back to the programs and to what matters to program managers. He wasn’t sure how the Board could help people see the connection between the statements, transparency information, and performance information. He acknowledged that program managers were struggling to see how the audited financial statements relate to programs and help them. He noted that Labor has a system intended to serve all the information needs within the agency. The message he took from many of the CFO Act review meetings was that participants wanted help in making the connections to program managers. He was not sure how the Board could be helpful in that effort. The relationship between strategic plans and cost may be an area the Board could help to explore.

Mr. Allen noted that the linkage between sustainability reporting and historic financial information might be an area to explore. It could be better linked.

Mr. Dacey noted that explaining in MD&A the risk to programs and future delivery of services was an area that might be explored through the reporting model project. He thought that the forward looking general risk was different than risk assumed (where we look at what has already happened).

Mr. Allen indicated that the risk assumed project would fit into the reporting model; rather than being in a separate new statement.

Mr. Steinberg mentioned that forward looking information in MD&A was improving. He gave an examples of the Agriculture report mentioning the risks of international travel to crops and livestock and Social Security Administration explaining the need for funding after the crossover point (where revenues are less than benefits). Otherwise, he believes the agencies have not done a good job on forward looking information. He thought the structure of the standards and concepts caused problems for preparers. Mr. Dacey agreed.

Mr. Steinberg agreed with the three areas Mr. Simms had identified. He did not see a need to change the conceptual framework but thought we would evaluate whether standards are living up to the concepts. He suggested that a standard for a component-level reporting model might address these things [note the following summary was provided by Mr. Steinberg following the meeting and is included to ensure clarity regarding his intent]:

1. The costs in the Statement of Net Costs should be classified according to the strategic goals in the agency's strategic plans. The GPRA and the GPRA Modernization Act require the agencies to identify their strategic goals as a basis for establishing programs. The Statement of Net Cost, therefore, should present the costs incurred to pursue/achieve each strategic goal. Agencies that believe it is still necessary or desire to present the costs for their funds (GSA, SSA), sub-organizations (HHS), or appropriations (DOD), can and should do so with a cross-walked footnote.

2. The costs for each strategic goal should be built up from the costs of the programs, which will fulfill for readers the frequently-stated desire to see (electronically or manually) the costs of the programs. This also would further the adoption of cost accounting.

3. The component's GPFFR should present key performance results for each strategic goal, either in a Statement of Program Performance, which is cited in SFFAC 2; or in the MD&A, but pursuant to a more explicit specification of what should be presented than is contained in SFFAS 15.

4. As either a replacement for the Statement of Budgetary Resources, or as an additional statement, there should be a budget to actual statement, perhaps containing four columns: final appropriation, obligation, outlay, accrual-based expenditure. The lines could be objects, programs, or some other cost center. This statement would fulfill the desire for a Statement of Spending, plus provide the budget to actual comparison, which the focus groups and other-government reviews indicated is a useful.

Ms. Payne was asked if she wanted members to prioritize at this stage. She suggested that staff develop a plan for the next stage of the reporting model project based on the member input received at the meeting. The plan would be presented at the April meeting and, in the meantime, staff would explore some of the ideas raised.

Mr. Allen reminded staff that several members raised the streamlining project suggested by the Greater Washington Society of CPAs. Mr. Dacey also suggested that reporting on intergovernmental dependencies also could be explored as a risk area addressed in MD&A.

Mr. Showalter raised budgetary reporting and the need to explore it further; noting that any effort should view the statements holistically.

Ms. Payne suggested that it might be helpful for the Board to have an educational session on budgetary reporting. Perhaps a short session regarding the key terms used in budgetary reporting and how the reports are structured would provide a better understanding of budgetary reporting.

Ms. Kearney asked how budgetary reporting fit with FASAB's mission; she thought budgetary standards could not be developed by FASAB. Ms. Payne indicated that she referred back to prior work as a frame of reference. While SFFAS 7 does not define terms or set recognition and measurement standards, it does require presentation of budgetary information as it is defined and measured by others such as OMB or Congress.

Mr. Steinberg recalled that it was OMB that requested a basic statement to present budgetary information and subject it to audit. Ms. Payne added that some from OMB had suggested, during earlier roundtables, that more detailed budget data by audited because the high level of aggregation means detailed information may not be as accurate as they desire.

Mr. Showalter clarified that he was earlier referring to the statements reconciling operating cost to the deficit and the deficit to change in cash. Mr. Granof asked if the government-wide reporting model task force made any recommendations on these statements. Ms. Payne noted they recommended that the first – cost to deficit – remain while the second – deficit to change in cash – could be moved to notes or RSI.

Mr. Reger recalled that Messrs. Showalter and Steinberg suggested that the component entity reports be structured to help program managers as well as to build the consolidated financial report. He asked if that information could be presented to support needs of program managers as well as support a consolidated financial report that is helpful to external users such as citizens and rating agency analysts.

Mr. Allen said it was no surprise to him that program managers do not use the financial statements. He felt the only use was that the audit improves the quality of day-to-day information. Program managers need more detailed information on a real time basis. The improved systems provide the benefit to internal users.

Mr. Reger asked if there was a way to sum the information up and combine it with other agencies' information so that a consolidated report can be produced. He asked if there was a way to encourage it.

Ms. Payne indicated that staff would provide a more detailed plan for consideration at the next meeting.

Mr. Allen asked members to consider if there were things we have on the three-year plan that should come off and whether some things not on the list should be added. He acknowledged that the active projects consume present resources. Ms. Payne thought we could revisit that in April. In particular, as the broader plan for the reporting model project is presented the members might consider whether they wish to reallocate resources from existing projects to support aspects of the reporting model plan. Staff will have updates on the new projects on investments and public-private partnerships at that time.

Mr. Allen suggested considering the internal use software project – he would simply expense it. Ms. Payne indicated that "quick hit" projects could be undertaken. She noted that SFFAS 35 on estimating historical cost was done in that manner. If there is consensus to expense internal use software, it could certainly be developed and exposed quickly.

Mr. Steinberg asked if preparers raised concerns about it. Ms. Payne noted that some had suggested changes. Her research showed that the current standards are not producing information anyone would use. The investment decisions and monitoring focus on all the costs of the projects rather than on the costs incurred after feasibility is proven as required under current standards. Further, she gave examples of two agencies that requested that the standards be changed to permit expensing.

Mr. Allen indicated that he saw merit in sun-setting something that isn't useful. With the speed of change in software, he thought capitalization was unnecessary. In response to a question about the timing of making such a proposal, Ms. Payne indicated that the Board usually looks at an exposure draft at least three times. Mr. Dacey asked if the useful life is really that uncertain; he did not find it to be.

Members generally did not support an effort to revisit the internal use software capitalization requirements.

Ms. Payne noted the need to have a better understanding of the issues emerging in the statement of spending pilots.

Ms. Kearney committed to report on progress at the April meeting.

> **Conclusions:** Staff will provide more detailed options for the reporting model project for discussion in April.

Mr. Reger and Ms. Kearney will provide feedback regarding the timing of a potential DoD military equipment proposal.

Ms. Kearney will provide an update on the statement of spending.

Adjournment

The meeting adjourned at 10:30 AM.