

FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD
June 27, 2012
Room 7C13
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Wednesday, June 27, 2012

Administrative Matters

- **Attendance**

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

- **Approval of Minutes**

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

Agenda Topics

- **Asset Impairment**

Mr. Allen introduced the project by referring members to TAB A and asking Mr. Savini to begin the discussion. Mr. Savini noted that in addition to the two questions noted in the transmittal memorandum and apart from soliciting member questions, staff prepared a list of five additional questions reflecting the major issues raised by respondents.

First, members were asked if they thought that a public hearing should be scheduled or if staff should work with any particular respondent to further explore their opinions or concerns.

Mr. Allen noted that public hearings are normally held when there are significant or controversial matters and he asked the board if there was any member who would like to make such a case. He noted that he did not anticipate a public hearing at the time of the exposure draft but that would not preclude scheduling one if the board were so inclined. Noting that no member responded to his request for a public hearing, Mr. Allen concluded that the board does not believe that a public hearing should be held. He then proceeded to the second question that addressed working with particular respondents.

Mr. Showalter noted that we received two different views from NASA and that it may be beneficial to understand why the conflicting views exist. In response to a member question, Mr. Showalter explained that because the task force that drafted the document was made up of real property personnel, he felt it strange that the NASA real property staff would then take exception to it while the CFO community did not.

Mr. Savini stated that the real property people were not the only representatives on the task force and that two real property responses reflect the different philosophy which exists in that discipline concerning asset management. Unlike accountants or public administrators, in the facilities world the "asset is king" (meaning the asset must be preserved or restored). It is important to note that their view was not shared by the majority of respondents.

The two respondents represent a facilities or real-property point of view wherein the concept of impairment is deemed to be strange. They do not see the relevance of recognizing impairment on an asset that they know they must maintain. Furthermore, the NASA respondent sits on the task force and does not want to see additional requirements imposed on agencies when in his opinion, we should be using the federal real property reporting (Federal Real Property Profile or FRPP) data to impair assets. Please note that in working off-line with this gentleman, staff explained that the FRPP indicators do not directly lend themselves to the purposes of this proposed standard as it extends to assets beyond buildings and facilities.

As a result of the discussion, Mr. Showalter agreed not to pursue further explanation of this difference.

Mr. Schumacher then asked about (1) a respondent's concern that their auditors would require specific reviews in this area and (2) the KPMG response that they could not determine the extent of additional audit procedures until controls are assessed. He asked if we had made it clear enough in the ED that we were not requiring any special or specific reviews.

Mr Savini responded by stating that the ED was not clear enough in this regard. Some of the respondents offered suggestions such as avoiding words or terms like, "processes or procedures" and to use more consistent wording. Staff stated that the

revised draft ED in Attachment 3 is an initial attempt at addressing some of these concerns and believes that it addresses the issue raised.

Mr. Dacey stated if management has done nothing concerning impairment identification such as having no processes or procedures in place, then an audit scope issue is raised. In essence, if an entity has no policy in this regard, what is the board's position? He views this less of an issue as he believes the ED clarified that the Board did not want additional procedures taken as a result of the ED. The issue seems to be what happens if management has no process in place to identify impairments when if they had such processes, impairments would have been identified. This seems to be a potential audit issue.

Mr. Schumacher replied by stating that he does not believe there is much that the board could do to avoid that problem.

Acknowledging Mr. Schumacher, Mr. Dacey said the board should not incentivize management to not look for impairments. He understood the standard to require that processes be in place to identify impairments, but that such processes do not necessarily have to be separate processes.

Mr. Allen noted that unlike local governments, federal agencies have different levels of management and when the standard expects management to be aware of an impairment event, what specific management echelon do we mean? For example, when he read the DoD response he could not envision any impairment situation that would be material enough to distort the cost of service and for DoD to report. The two thoughts he shared were (1) who is management and (2) how do we keep the eyes high enough so we don't get enmeshed with detail that really does not have any effect on cost of service.

Directing his question to Mr. Dacey, Mr. Showalter noted that the standard presupposes that management has controls in place. So, does that mean if they do not have controls in place that they would be directed to then have procedures in place to identify impairments? We do not want to go down that route.

In reply, Mr. Dacey stated that entities should be doing this as part of their condition assessment for deferred maintenance or as part of other asset management processes, and if so, they would not have to do a separate study.

Elaborating further, Mr. Showalter asked what if an agency does nothing. Would this mean that an agency would have to search for impairments?

Mr. Allen stated this is not the intent of the proposed standard.

However, Mr. Showalter noted that this was the direction the standard was in fact headed towards.

Mr. Schumacher similarly noted that this was his understanding of the KPMG letter. They in essence were saying that they would have to evaluate to see if procedures were in place and if they were not, the auditor would have to initiate some action.

At this point, Mr. Allen reminded the board that the standard was written for those impairments that were significant enough to affect the cost of service.

Although Mr. Dacey concurred with Mr. Allen, he noted that this was the challenge. Because of the level of significance, agencies would hopefully have sufficient enough procedures already in place to identify such impairments. However, good points are being raised and his concern is that the Board does not incentivize management not to look for impairments or to not communicate upwards in the chain of command. How do you balance these two. When you set a standard that management should identify impairments, then the issue becomes whether management should have reasonably been able to identify impairments. This then gets back to controls and processes. The Board may need to emphasize this matter more in the basis for conclusions. Specifically, the Board can express its thoughts and it how we came up with the notion that management would not have to apply additional procedures. Management might have to do more work to document materiality so that auditors would accept that the financial statements are presented fairly. This is not an uncommon exercise.

Mr. Reger stated that despite our intent not to create burden, management will have to document processes. For example, some of the respondents ask how impairment compares to depreciation. In these cases, management will have to document its processes. He said he doesn't think Mr. Dacey is saying anything different than an agency that might not have a system in place would at the minimum, document how it has read the standard and intends to apply it. So, regardless of what we say in the standard, there will be some documentation put in place. Now, how robust this would be and how much work is entailed depends upon the circumstances and if there's an entity that has absolutely nothing in place, then it would seem like a good idea to have at least something in place.

Mr. Showalter stated that the board was trying to relieve burden and some of the respondents have said that this standard increases burden. This is the only reason why he is raising this matter.

Mr. Reger replied by noting that burden will be added to the extent that agencies will have to document how they are complying with the standard.

Mr. Allen then asked the question of Mr. Dacey. If an agency such as the Department of Defense takes the position that the standard does not apply to it because of immateriality would you accept that as the auditor?

Mr. Dacey replied by saying the answer would depend upon the situation. However, DOD would at least need to have something documented even at a very high level. He is not sure how the auditor would be able to determine whether something was material.

However, he could see other agencies apart from DOD where there could be potential for material impairments.

Mr. Allen agreed with Mr. Dacey noting that he does not want to exempt all agencies from the standard. However, he sees that in DOD's case that materiality is an issue.

Mr. Dong asked if materiality was based on overall operating costs or a value of that asset. For example, if an entire DOD building is destroyed and if it does not make a dent, there would be no impairment loss?

Mr. Allen replied that materiality is based on overall operating costs and their overall assets.

Mr. Dacey replied to Mr. Dong's question by noting that the problem arises at audited component entities; for example, if the Defense Logistics Agency has an impaired building and that building is the agency's only building and is material to its reporting. How does that then translate to DOD wide reporting? So, as component units issue statements that could have material amounts reported for the respective components, a challenge arises for the entity wide reporting. It is conceivable that an agency could make an argument that agencywide there are immaterial impairment losses; however it would necessitate some thought on the agency's part to justify the conclusion. It would be hard to make an absolute argument for large agencies that have several component entities and diffuse assets.

Mr. Allen emphasized his concern that the impairment standards not cause a significant amount of additional work.

Mr. Dacey acknowledged Mr. Allen's concern and stated that he would like to explore if the basis for conclusions could clarify the board's intent so that it would preclude someone going to that lower level. It is important to note that for some agencies, their entire property portfolio is immaterial.

Mr. Allen asked staff to draft language reflecting the board's intent in this regard. We should consider addressing this in a response to some of the respondent comments. For example, agencies who have already determined that they have immaterial amount of assets in this regard would not have to be concerned with the implementation of the standard. The board wants to expedite the standard and does not want to impose additional burden and for that reason we concluded that entities are not to do additional searches for impairments. The standard has a unique place within each entity and probably not at entity wide or large agency levels.

Mr. Allen then asked staff to address the remaining questions to the board.

Staff proceeded to review each of the following questions with the Board:

1. Question 5(b) asked respondents if there are G-PP&E categories, classes, or base units to which provisions of this proposed Statement should not apply. Do members wish to explore waiving the requirements for specific G-PP&E categories based on the responses?

2. Do members agree that the standards should apply to “construction work in process”?

3. Par. 8 (page 7) - Do members wish to revise the definition by removing “gradual” such that the definition reads: ‘Impairment is a sudden, significant and permanent decline in the service utility of G-PP&E, or expected service utility for construction work in process’?

4. Par. 12 (page 8) - Do members believe the nature of the indicators of potential impairment could be clarified by adding:

The indicators identified below are not conclusive evidence that a measurable or reportable impairment exists. Entities should carefully consider the surrounding circumstances to determine if a test of potential impairment may be unnecessary given the circumstances.

5. Par. A22-4 (page 26) – Do members support including a discussion of the distinction between depreciation and impairment in the basis for conclusions?

Board discussion follows:

1. Question 5(b) asked respondents if there are G-PP&E categories, classes, or base units to which provisions of this proposed Statement should not apply. Do members wish to explore waiving the requirements for specific G-PP&E categories based on the responses?

Staff briefly reviewed the DOD and SEC respondent letters wherein both entities asked for exemptions.

Mr. Allen replied that pursuant to the prior discussion, both of these cases can be responded to by noting that the issues raised are not the focus of the standard. For example in the case of military weapons systems how would we say this is an unanticipated event? These are assets that are being used up and they are anticipated to be used in combat. Therefore, they do not fit into the category of impairment. In regards to the SEC case, we would argue that more than likely, these are immaterial assets. Mr. Allen recommends addressing these in the basis for conclusions.

Mr. Dacey noted that in the near future DOD may be requesting a different valuation basis for military equipment and as a result, he struggled with whether or not to issue a blanket exemption. He agrees with their argument concerning individual pieces that would be insignificant. However, how far should the Board carry “unanticipated”? Do we mean that we did not anticipate an asset only achieving a two year service life when

initially we estimated five years? Or do we mean that we did not anticipate a premature impairment.

Mr. Allen replied by noting that in the defense environment we do not schedule wars.

Mr. Dacey agreed but expressed concern regarding “unanticipated” . This touches on the discussion of depreciation versus impairment and whether or not to account for unanticipated or anticipated events either through depreciation or impairment. This concept will be addressed in question five where staff asks members if the Board should include a discussion regarding the distinguishing characteristics between depreciation and impairment.

Mr. Granof noted that if an asset is destroyed in combat operations it will be removed from service and is not an impairment issue. However, if there is a military weapons system that becomes technologically obsolete that would be considered impairment.

Staff replied by noting that if at the time you procured the asset you expected to generate a certain number of widgets per se, and if the asset can continue to generate that same number, one might reasonably conclude that the asset is not impaired because what we bargained for in output is what we are getting in output.

Mr. Allen replied to Mr. Granof noting that in a defense environment how can one argue that you can ever assign years of anticipated life? You cannot because you are in a constantly changing environment. One would probably assign very short life to assets subject to technological advancement.

Mr. Granof then gave an example of naval vessels that no longer are needed because of the change in mission strategy. In such cases, he would argue that the assets are impaired.

Ms. Payne replied to Mr. Granof by noting that he was describing a total impairment and that the proposed standard addresses partial impairments. Ms. Payne further noted that in the case of a partially impaired asset, DOD would need to determine whether or not to fix the asset or keep using it in its partially impaired state. Typically, one would expect that DOD would probably fix the asset and keep it in service. In essence there will be a very small number of assets that will go through the flowchart and result in a partial impairment.

Mr. Dacey then noted that in the case of military equipment, unless we change the use to training or something else, he’s not sure that you would be putting the asset into situations where you would be using it for other than defense-related purposes, if it can continue to function as expected.

Ms. Payne noted that the AAPC would be an appropriate forum to handle such technical questions that could come up in the future.

Mr. Showalter stated that due to the pending nature of DOD's request regarding military equipment, he would not advise making any determination at this time on this impairment standard. Concerning military equipment, the military typically doesn't impair its equipment making this a moot point. He would not make an exception for military equipment.

Mr. Allen concurred with Mr. Showalter. However, in the basis for conclusions we could respond to this point.

Mr. Granof noted that when he was in the Coast Guard, operating vessels were taken from active service and put into a training status.

Mr. Reger then noted that as preparers read the standard from a cost implementation point of view we should make clear that they should not incur a significant amount of effort in implementation. Staff should consider a broader discussion with the DOD respondents so that we can craft something in the basis for conclusions that addresses their particular issue.

2. Do members agree that the standards should apply to “construction work in process”?

Staff reviewed the basis for a respondent's suggestion to re-title the proposed standard. SFFAS 6 addresses G-PP&E from the point of view that it is in service however, due to the very nature of construction in process, since it is technically not yet in service it is excluded from the definition of G-PP&E. KPMG has requested that we either change the GPP&E definition or re-title the proposed standard to include assets under construction within the scope of the standard.

Mr. Allen noted that unlike state and local government, it would seem highly improbable for the federal government to undertake any material or significant construction project and not bring it to completion. We should either include a separate category for these types of assets or simply not included assets under construction within the scope of the standard.

Although Mr. Dacey shared Mr. Allen's sentiment, he stated that it is difficult to say that such an event would never occur. He does not see any harm in including this category within the scope of the standard. However, as previously noted by members, the Board does appear to want management to perform excessive procedures in this area. Notwithstanding, one would think that a major or material construction in process effort that is somehow damaged or impaired would come to the attention of management. He is not troubled by leaving this as a separate category because the same principles seem to apply, but he also agrees that it is probably not likely to come up in practice. Mr. Dacey emphasized that we just cannot say that such a situation would never arise.

Mr. Allen asked members if they were comfortable with the staff recommending the two categories that proposed impairment standard should apply to; GPP&E and assets

under construction. Moreover, the board can decide not to address assets under construction.

Mr. Showalter noted that if one considers construction in process a subset of GPP&E, certainly this category would be immaterial. However, highlighting it necessitates that one considers the concept of materiality and thus, should quickly come to the conclusion that it is immaterial.

Mr. Allen noted that his preference would be to only have things in the standard that would have a significant or material impact.

In deference to Mr. Steinberg and others with federal experience, Mr. Showalter responded by stating that he believes the government does in fact initiate and complete projects that might be impaired from the very beginning. It seems that this is more likely at the federal level than at the state or local level due to the mere fact of the federal government's size.

Mr. Schumacher asked Mr. Dacey if assets under construction could be material to a component.

Mr. Dacey replied that it is hard to say that it would not ever apply.

Mr. Schumacher then stated he does not see a disadvantage in leaving the construction in process reference in the document. It is not causing any additional costs and at least is comprehensive by covering all long-lived assets including those under construction.

However, Mr. Dong stated that the perception is that we are calling something out and highlighting it even though we believe it to be immaterial.

Mr. Allen stated that he does not believe that the federal government would ever initiate a project that it would not complete. However, he does not object to leaving assets under construction within the scope of the standard. With that being said, Mr. Allen wanted to avoid the "stop and pause" analysis that would ensue between auditor and preparer.

Mr. Dacey did note that the board did specifically exclude internal use software from the standard.

Mr. Showalter then stated that this is a different question than the previous question that dealt with whether or not processes exist at an entity. In this case, all that an entity would need to do is compare its construction in process amount to its total G-PP&E amount to ascertain its presumed immateriality.

Turning to Mr. Showalter, Mr. Allen then asked if assets under construction are presumed immaterial, why are we proceeding down this path.

Mr. Showalter replied because of auditor concerns.

Mr. Dacey concurred with Mr. Showalter and stated that assets under construction are capitalized assets and that if we were to exclude them from the standard, we would have to give a sufficient rationale.

Mr. Allen then summarized that the board's position was to recommend two categories; GPP&E and construction in process. The chairman asked if any member disagreed.

Mr. McCall thought that by spelling it out it the board called too much attention to an immaterial item.

Mr. Steinberg noted that he does not disagree with the concept being proposed but that there is a long history of treating construction in process as GPP&E. He would not recommend calling it a separate category but rather ensure that preparers understand to include construction in process assets.

Mr. Reger then asked Mr. Steinberg if staff should separate this in some other manner.

Mr. Steinberg replied that although he agreed with many of the KPMG recommendations, he would not agree with this one to change the title to include construction in process. The basis being that the board always considered construction process as being part of general property plant and equipment.

Mr. Allen then turned to page 7, footnote 4 and stated that this language would include construction in process as being part of GPP&E.

Ms. Payne suggested that staff come back with options for rewording this at the next board meeting.

Mr. Allen replied that the sentiment is to include construction in process within the scope of the standard without creating a separate category. Noting no objection, Mr. Allen moved to the next question.

3. Par. 8 (page 7) - Do members wish to revise the definition by removing "gradual" such that the definition reads: 'Impairment is a sudden, significant and permanent decline in the service utility of G-PP&E, or expected service utility for construction work in process'?

Staff advised the board that four respondents took exception to the use of the term "gradual." Some noted that it caused confusion with the concept of depreciation. Staff's proposal is to remove the term gradual from the definition such that impairments would then be limited to sudden, significant, and permanent declines in service utility.

Mr. Allen then noted that he would have a problem limiting all impairments to events or circumstances that could be deemed sudden. For example, technology for environmental cleanup can change over a 5 to 10 year time frame thus being gradual and not sudden. In essence, if we remove gradual we should also remove the term sudden.

Mr. Granof concurred noting that mold deterioration is not sudden but gradual.

Mr. Showalter noted that the point being made by the respondents was that the term gradual was confusing in light of depreciation.

Mr. Dacey stated that impairment seems to be declines in service utility other than those declines recognized through depreciation.

Mr. Allen asked that staff quote a definition proposed by one of the respondent's. A DOE respondent suggested the following:

The Board proposes to establish a requirement to recognize impairment losses when there is a significant and permanent decline in the service utility of G-PP&E that is not already recognized by routine depreciation.

Mr. Dacey stated that although he agreed in general with the concept of the respondent's suggested definition, he did not agree with some of the words as it would make the definition overly complex. He noted we may be able to define expected and put parameters around what we expect but this also gets into the notion of routine depreciation. The clarity between impairment and depreciation is addressed in question five.

In summary, Mr. Allen noted that this is a concept we are going to follow but we are not going to include the terms gradual or sudden.

4. Par. 12 (page 8) - Do members believe the nature of the indicators of potential impairment could be clarified by adding:

The indicators identified below are not conclusive evidence that a measurable or reportable impairment exists. Entities should carefully consider the surrounding circumstances to determine if a test of potential impairment may be unnecessary given the circumstances.

Staff reviewed that some respondents believed the presence of indicators is conclusive evidence that an impairment loss exists. This is not the board's intent and as such, staff recommends additional language at paragraph 12 and re-titling that paragraph to emphasize "potential" impairments.

Mr. Granof agreed but does not see the point in using "potential." He does not object to its use but sees no benefit from its use. No one should take indicators as being conclusive evidence of impairment.

Mr. Allen asked if Mr. Granof if he objected to the use of the term "potential," as it is used throughout the document. The term tries to convey the conditional nature of the assessment. Mr. Allen asked members for their views noting that he hopes to see a final version in August.

Mr. Showalter stated that the use of the term potential underscores that we are attempting to elevate this matter to material items. We should emphasize in the basis for conclusions that the indicators are not conclusive.

Mr. Dacey then noted that management would need to also go to step 2 and that step 1 by itself cannot be deemed conclusive.

5. Par. A22-24 (page 26) – Do members support including a discussion of the distinction between depreciation and impairment in the basis for conclusions?

Mr. Dacey brought up an example concerning a building whose service life estimate changes significantly. Would this be accounted for via depreciation, by shortening the useful life estimate, or via impairment? This is the differentiation that is being sought by the respondents.

Mr. Reger then noted that apart from the operating environment bringing about change, what happens when the building itself changes. As a result, the depreciation plan no longer has viability. How do we capture this concept?

Mr. Dacey further elaborated that even given an impairment event, there could be instances when adjusting depreciation is not significantly different.

Staff noted there does not seem to be a bright line where one could tease out change in mission or function to determine if it would be best handled via depreciation or impairment. If an entity adopts historical asset useful life information that captures some of these impairment events, it stands to reason that they have a basis not to recognize an impairment loss because the shortened useful life estimate would have inherently already recognized such costs.

Picking up on staff's concept, Mr. Reger then postulated that if management changed the use of a building not because of a change in the building but because of management desire or plan to use it for a different purpose, that recognition would be handled via depreciation. However, if the building can no longer function for its intended purpose because of a technological change or mold damage that would be impairment.

Mr. Dong asked if the latter case would be considered an unplanned changed.

Mr. Reger replied in the affirmative as long as you could continue to use the asset for a purpose.

Mr. Allen explored an example of a school that is now used for book storage. This standard would ask you to evaluate the value of the asset's new use of storing books as opposed to educating children. This would result in an impairment loss if the current value is presumed to be lower than the previous value associated with the building being a school.

Mr. Reger concurred with Mr. Allen's conclusion that a loss would need to be calculated but rather than recognizing a loss it would be handled via depreciation.

Mr. Allen clarified the standard's intent by saying that although the depreciation on the "shell" of the building would be the same and continue, the value of the cost of service has changed and needs to be recognized as an impairment loss.

Mr. Reger then asked what would happen if management decided to change the building's use yet again. Then the improvements associated with the change would change the value of the building and add to the depreciation.

Mr. Allen responded in the affirmative. However, going the other way from school to warehouse would be an impairment loss. In other words, changed circumstances have resulted in an impairment loss.

Staff clarified that if management had in fact considered such changes in the development of their useful life estimates, they would not need to recognize an impairment loss.

Mr. Allen agreed and noted that staff does not believe that one can easily tease these matters out as there is no bright line.

Mr. Dong sought clarification concerning the change in use example and whether it would result in an impairment loss.

Mr. Allen replied by stating that an impairment loss would exist if the cost of services has been materially impacted and was not planned; such as a school being converted to a book warehouse due to unforeseen change in demographics. However, if school officials planned to do the conversion they would have built it into their depreciation schedule.

Mr. Reger noted that he thought Mr. Allen's synopsis was a bit of a stretch because the building is still a viable school regardless if there are no students to attend. The building continues to possess the ability to serve as a school.

Mr. Dong attempting to confirm his understanding restated that once management made that change from school to book warehouse we are going to recognize an impairment loss. However, if there is a higher value use, we would handle that differently?

Messrs Allen and Reger agreed that we would need clarity to the wording regarding what is a change in depreciation versus recognizing an impairment loss.

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

- **Federal Reporting Entity**

Federal Reporting Entity Minutes

Staff directed members' attention to Tab B, the first of three tabs containing briefing material on the federal reporting entity project. Staff noted it is the core document because it contains a draft exposure draft (ED) that contains revisions to the standards based on deliberations at prior meetings as well as suggested changes to concepts related to the federal entity.

Draft Federal Reserve Proforma Disclosure – Treasury Financial Statements

Staff noted that Treasury had worked with representatives from the Federal Reserve (FR), including Mr. Greg Evans who is present at the meeting, to draft a note to the Department of the Treasury financial statements, not the government-wide financial statements, describing the Federal Reserve and its relationship with the Treasury Department (see Attachment A). Staff explained that, since many of the changes to the ED had centered around giving the members some level of comfort about the disclosures that would result from the proposed standard, the note was being provided to members so they can review it, provide feedback, and raise any continuing concerns they might have and that will inform the board's discussion of the edits proposed to the ED.

Mr. Reger remarked that the three criteria in paragraph 70 of the current draft ED—relationship, relevant activity, and future exposures—guided the discussion in the draft Federal Reserve note. He clarified that Carole Banks, who prepares the Treasury Department's financial statements, helped write this first draft of a note that would appear in the department's financial report. The note would then be expanded and contracted, as appropriate, for the consolidated financial report of the U.S. Government (CFR). He said they were starting with the Treasury note because that is how information flows up into the CFR and they are hoping to have some form of this note appear in Treasury's 2012 statements.

Mr. Reger stated that the note was prepared following a few guidelines: (1) no numbers are to be disclosed in the Federal Reserve note that would not otherwise appear in Treasury's financial statements, (2) the disclosure addresses the criteria in the draft ED, and (3) the disclosure would be short enough to actually be a note and not an epistle.

Mr. Reger stated that Mr. Evans has been a very helpful partner in putting the material together and later, when the board talks about the implementation date for the proposed standard, he will talk about how difficult it was to come up with timeline information, even among the very willing and cooperative partners involved. He also acknowledged Mr. Dacey's helpful feedback on the many drafts that were created during the process. Mr. Reger said they were interested in receiving the board's input on this first draft of

the footnote . Mr. Evans added that the draft note does not include references to core or non-core entities because those classifications do not exist yet in the standards.

Mr. Steinberg questioned why the note is not from the governmentwide perspective rather than just the Treasury perspective. Mr. Reger responded that the notes in the CFR are compiled from information in the agency statements and all of the material information related to the Federal Reserve (e.g., TARP, etc) does come from Treasury (the Federal Reserve does have some immaterial interaction with a few other agencies).

Mr. Dacey responded that if members like all of the information contained in the Treasury note, it could possibly be carried forward to the CFR. He also noted that he did not believe that Mr. Reger could presuppose what the Treasury Department was willing to disclose in its agency financial report (AFR), so he had to go through the process of involving the Treasury Department to find out exactly what they would be willing to include in their AFR.

Mr. Showalter said he thought the note does a good job of addressing the criteria of relationship and relevant activity but he thinks the note is missing a more robust discussion of the future exposures to the government. However, that discussion might be more appropriate for the CFR because it seems to him that the exposures would apply more at the governmentwide level than to Treasury.

Mr. Reger said they did think about it and referred members to the last paragraph of the disclosure – FRB Residual Earnings Transferred to the Department – noting that the only exposures existing between the Federal Reserve and the federal government that can be quantified are these residual earnings, the revenue item that is transferred into the Treasury Department as general funds. He stated that there are other activities that occur, but they could not come to a conclusion with supporting evidential matter that suggested there are other material exposures.

Mr. Showalter questioned whether the note should discuss the setting of monetary policy and its effects, whether quantifiable or not. Mr. Dacey responded that those types of things, such as the interest rate on federal securities, have an indirect effect. He noted that the note describes the Federal Reserve's activities, including formulating and conducting monetary policy, so it would be a matter of how much more detail members would want to be included.

Mr. Reger acknowledged that the purpose of putting the note together was to put it in front of members to get comments on exactly what members expected to see in such a disclosure.

Mr. Granof said he has the same concern he had previously; the Federal Reserve is perhaps the largest organization in the history of mankind and it is carrying out functions that are associated with a sovereign government. He believes that when presenting the financial report of the entire government, it is important to discuss not only the exposures to the federal government but also transactions that have affected outside parties. For example, if the Federal Reserve, acting on behalf of the federal

government, makes loans to other banks, or engages in other significant transactions to assist European governments or banks, he believes that is the type of information that should be reported in the CFR.

Chairman Allen said that, when he read the paragraph on the earnings transfer, he thought it was missing some type of financial perspective—how much, what percentage of revenue, etc. He said he thought the concept was applied well, but including the dollar magnitude would help to put the disclosures in perspective. He added that perspective from the Treasury Department's viewpoint is not as important as perspective from the federal government as a whole.

Mr. Reger said the disclosure includes references to all of the notes where specific numbers are already being reported in both Treasury's AFR and the CFR and those things would continue to be reported where they are.

Chairman Allen said that the last sentence of the first part of the disclosure—"The FR System is not included in the federal budget, and in accordance with Statement of Federal Financial Accounting Concepts 2, the FR Systems' assets, liabilities, and operations are not consolidated into the Department's financial statements."—might be a natural place to start the next sentence with "However, see note X that gives some perspective of the total amount of revenue..." He agreed with Mr. Granof that, because of the magnitude and their role in carrying out fiscal policy, the note disclosure should also include a perspective discussion with amounts.

Chairman Allen added that a discussion of risk would be important also. If policy decisions are carried out well, it benefits the nation; if they are not, it puts the nation at risk, but he is not sure how that could be quantified. He asked if a generic discussion would be meaningful.

Mr. Granof responded that the disclosure should not be generic; it should describe the key transactions that the Federal Reserve has been engaged in, such as intervention activities.

Mr. Dacey responded that he thought the discussions of assets, liabilities, and revenue sources would indicate the primary activities of the Federal Reserve – what they are investing in, primarily what the liabilities are for, and where the earnings came from – but the question is how far down into the details of the activities they engage in should the disclosure go. He added that some of the activities that end up in the press may not be material to the Federal Reserve.

Mr. Granof responded that the newspaper recently discussed \$600 billion in currency exchange transactions (swaps) engaged in by the Federal Reserve. He stated that the amount was clearly material and has major policy implications and, in reporting on the federal government as a whole, he would expect that this type of activity would at least be described in some detail in a note about the Federal Reserve's activities.

Mr. Reger noted that there are many different types of activities and transactions discussed throughout Treasury's AFR; this draft note was attempting to discuss only the relationship and business activities directly back and forth between the federal government and the Federal Reserve.

Mr. Granof added that the draft disclosure is excellent as far as it goes, but he is looking for something beyond this.

Ms. Payne said it seems that Mr. Granof is seeking something beyond traditional financial reporting and more towards reporting on performance related risks – the risks of how monetary policy is conducted, stability of the financial system, and the different relationships.

Mr. Granof responded that he would not characterize what he is looking for as reporting of risk; he said risk is one thing but he thinks it would be appropriate to report on the actual transactions that took place.

Mr. Reger said that he struggles with the idea of disclosing that type of information even in the CFR. He said he can see those types of disclosures in the Federal Reserve's financial report; however, in Treasury's AFR and the CFR, he thinks the discussion should center around the relationship between the activities of the federal government and the Federal Reserve. He said that some people may believe the federal government controls the actions of the Federal Reserve, but he has come to realize that there is a big distinction between the two. While they may undertake similar actions simultaneously, the two are very separate. For example, the Federal Reserve may enter into collateralized loans to banks under existing conditions. The federal government may also make loans using taxpayer money with different criteria, but the two actions are very distinct.

Mr. Reger said he believes Mr. Granof is looking for a holistic note that describes all of the actions of the Federal Reserve and the federal government and he said he would argue the draft note disclosure along with the existing note disclosures on AIG is the best they can do given their knowledge of what has been done and their lack of control over the actions of the Federal Reserve.

Mr. Steinberg pointed out that paragraph 71 of the draft ED requires disclosures for entities that are exercising sovereign powers, such as its mission, the relationship of its mission to federal policy objectives, its organizational structure, and a reference to its financial report. Mr. Steinberg said when he suggested those disclosures, he thinks he also included a requirement to report on its activities because it is the knowledge or the lack of knowledge of all of these things that the Federal Reserve is doing to attempt to keep our economy—and the world's economy—afloat that he thinks is of interest.

Mr. Steinberg added that the disclosures in the CFR about what it did to help General Motors and AIG are extensive. He said he is looking for something similar for the Federal Reserve—what kind of activities were undertaken and what exposures to the federal government, if any, could result from those activities. He said he believes the

Federal Reserve puts out a descriptive report every month that could inform the disclosures that should be included in the Treasury and governmentwide financial reports.

Mr. Steinberg added that the Federal Reserve is undertaking these activities on behalf of the federal government as a sovereign entity and as such, the activities and results should be disclosed by the federal government.

Mr. Reger acknowledged that the financial reports of the federal government report on the roles and activities of the federal government. To the extent that a reader wants information on the Federal Reserve's roles and activities, he or she would have to turn to the Federal Reserve's financial reports. Mr. Reger went on to state that, if there were exposures to the federal government as a result of actions undertaken by the Federal Reserve, he agrees they should incorporate a discussion of those exposures into a disclosure in the CFR. At this time, the only exposure for the federal government that they could quantify based on the Federal Reserve's activities was the potential lack of earnings to be transferred in as general funds and those numbers are not particularly significant (\$20 – \$80 billion in recent years).

Mr. Steinberg asked why the reader should have to look at two reports if he or she wants to know what the federal government has done financially to keep the economy going. He noted that would be like having to look at the CFR and Interior's AFR to find out what the federal government has done to promote recreation.

Mr. Reger responded that, in this case, the Federal Reserve is somewhat of an independent organization. Congress intentionally created the Federal Reserve to conduct monetary policy outside of the regular, day-to-day control of the federal government.

Mr. Granof replied that is the heart of the issue and asked whether, for reporting purposes, they are carrying out sovereign functions, functions that are traditionally associated with the federal government.

Mr. Dacey noted that he thinks the sections on principal assets and liabilities and revenues are intended to indicate the major sources of assets, liabilities and revenues without giving specific amounts. Mr. Dacey asked Messrs. Steinberg and Granof if they expect there is some materiality threshold, quantitative or qualitative, at which point the report should disclose everything the Federal Reserve did.

Mr. Granof responded that, of course, he is only interested in the really significant activities. Mr. Dacey said the reason he is asking is because he is looking at the 2010 Annual Report [of the combined Federal Reserve Banks],¹ and some of the activities the Federal Reserve engages in, such as the central bank liquidity swaps that were \$75 million and \$10 billion, as of 2010 and 2009 respectively, may get publicity in the

¹ 2010 Annual Report, Board of Governors of the Federal Reserve System, pg. 345; available online at <http://www.federalreserve.gov/publications/annual-report/>, last accessed July 2, 2012.

newspaper but appear to be immaterial to the Federal Reserve. He said if it does become material, he thinks it would get added to the description of activities the Federal Reserve is engaged in.

Mr. Reger agreed with Mr. Dacey that every activity that is significant is listed in the draft note's description of the Federal Reserve and includes a reference to another note where there is a more robust discussion of what the activity entails and what the federal government accomplished through that activity. If currency swaps become a major activity, then they would be included in the list as well.

Mr. Showalter noted that the board has been talking about exposures in terms of risk, but the requirement to disclose future exposures [in paragraph 70c.] also includes a description of potential benefits and there are also activities that are being performed by the Federal Reserve on behalf of the federal government that provide benefits to individuals.

Mr. Evans commented that when members use the phrase "on behalf of" it is important to recall that the Federal Reserve performs its activities independently. Mr. Showalter acknowledged that the Federal Reserve is an independent entity but they do not do what they do simply because they want to. Mr. Evans agreed that the Federal Reserve carries out its duties to support its core mission of monetary policy and financial stability, but it is done independently from the federal government.

Mr. Reger added that the federal government takes actions for the same reasons. Mr. Showalter responded that, as Mr. Steinberg stated, the Federal Reserve is an independent entity carrying out functions that are core to the federal government, and a reader should be able to read about the results of those sovereign functions together in one document. He added that everything might be captured in the draft note, but there is anecdotal evidence that it is not.

Mr. Evans responded that the proposed footnote does state that the Federal Reserve is not consolidated and the Federal Reserve is independent of the federal government. He said that if members think the activities of the Federal Reserve should be reported on in the financial reports of the federal government, he does not know how to do so without amounts that the GAO would need to audit the Federal Reserve. Mr. Granof responded that the Federal Reserve is in; there is no question about that because the board believes the Federal Reserve would be considered a non-core entity.

Mr. Dacey said he believed the intention of the last two paragraphs of the proposed note was to define those activities at the Federal Reserve beyond just the relationship with the federal government. Specifically, the note, included GSE debt securities, the mortgage-backed securities, and principal assets. The draft disclosure did not include some of the smaller assets that are held by the Federal Reserve because of materiality considerations.

Mr. Showalter responded that the proposed note talks about the assets and liabilities but what is missing is a discussion of how the assets and liabilities arose, which may

answer Mr. Granof's question about activities. Instead of just talking about the fact that the assets and liabilities exist, you can explain how they came to be.

Mr. Dacey responded that, based on the financial statements, most of the assets appear to be in the System Open Market Account (SOMA) which is used for the unique function of implementing monetary policy. He added that perhaps the note should provide a better explanation of monetary policy up front as a primer so readers will have a better understanding of what exactly formulating and conducting monetary policy entails.

Mr. Reger added that we would not want to explain what monetary policy means right this second. Mr. Dacey agreed, noting the explanation should be conceptual since the actions taken will vary depending on the situation.

Mr. Evans said that an earlier draft of the note read like an economics textbook but they didn't think that is what a financial statement footnote should look like. He added that, now that he is looking again, perhaps they should have a discussion of foreign currency holdings. However, it would not have a dollar amount and it would be a very generic discussion about monetary policy and financial stability (e.g., issuing currency and managing the money supply).

Mr. Granof asked why the disclosure would not include a dollar amount.

Mr. Evans said the dollar amounts are in the Federal Reserve's financial statements and the authors of the draft note believe the Federal Reserve is fundamentally separate from the federal government. Mr. Evans noted the footnote would not have a dollar amount because it isn't a Treasury transaction and would not be auditable from the Treasury's audit. Mr. Evans acknowledged that Mr. Granof believes they are part of the federal government and he is unable to reconcile that.

Mr. Granof replied that the board agreed that the Federal Reserve should be included in the federal government's report.

Mr. Dacey responded that the issue with including numbers is an audit issue. In addition, the current situation changes so quickly that readers would be better off to go to the Federal Reserve's website to see what the current financial situation is rather than trying to characterize it once a year.

Mr. Granof replied that he thought the board agreed that the Federal Reserve should be included in the federal government's reports. Mr. Dacey concurred and Mr. Granof responded that now they are just quibbling about how detailed the financial information should be.

Mr. Dacey said that the disclosure did not include numbers for information that is not part of what GAO audits, but that it included general concepts and a website the readers can go to get up-to-date information on all of the activities of the Federal Reserve.

Chairman Allen said that the note could provide some perspective by noting that “repurchase agreements held during the year varied from \$100 to \$800 billion.” Mr. Dacey responded that creates audit concerns if the disclosures relate to activities and transactions that GAO does not audit.

Mr. Showalter noted that they could disclose some audited numbers.

Mr. Reger replied that they can report numbers for information that has been audited that they can place reliance upon; they can carry that information forward to their statements and give it to GAO. However, for numbers generated by the Federal Reserve that are unaudited, they cannot include those numbers in the federal government’s financial reports because that forces GAO to audit those numbers.

Mr. Granof asked, “Wouldn’t those numbers have been audited?”

Mr. Reger responded that the numbers would be audited to the extent that they are included in the federal government’s financial reports. He noted that there are numbers included throughout Treasury’s AFR and the CFR in various notes. Placement in those notes provides context with related transactions and that is why they chose not to repeat the numbers in the draft note on the Federal Reserve.

Mr. Reger said they had tried to consolidate all of the disclosures related to the Federal Reserve into one note, but it was not useful for the reader who might be looking for a number in context, so they settled on a complete disclosure for the Federal Reserve that references other notes rather than combining them all into one.

Chairman Allen said that it might be helpful for the board if they had all of the other notes to look at too so they could see how they interrelate and exactly what is disclosed throughout the financial report.

Mr. Reger said that it seems the board had agreed in principle that the Federal Reserve System appears to be a non-core entity and they are discussing the extent to which that reporting would help the reader of the federal government’s financial reports. The debate is over what should be included in the federal government’s financial reports, not that the Federal Reserve is fundamentally, integrally, completely part of the federal government. Their activities appear to be governmental in nature and meet the criteria for what the board believes should be included in the federal government’s financial statements.

Mr. Granof said he agrees with that view, noting that the board has concluded that the Federal Reserve is part of the federal government reporting entity to the extent that they are non-core.

Chairman Allen clarified that the board has not concluded that the Federal Reserve is core or non-core; it has set criteria for core and non-core that has led some individual board members to determine that the Federal Reserve is a non-core entity.

Mr. Dong added that it is his understanding that the board has decided that it is not their role to determine whether individual entities are core or non-core. Chairman Allen confirmed that understanding.

Chairman Allen said he would like to read all of the notes for the Federal Reserve together because he keeps asking for perspective and he may very well get that if he reads all of the notes in concert.

Ms. Payne said that staff will pull together the notes that are referenced in the draft note for the next meeting. Mr. Dacey reminded members that these references refer to Treasury's AFR, not the CFR.

Chairman Allen said that reading all of the notes together may get to what Mr. Granof is looking for. Mr. Granof responded that it is hard to say at this point.

Draft ED

Staff directed members' attention to the questions posed in the staff memo at Tab B that are related to the current draft of the ED, *Identifying and Reporting upon Organizations to Include in General Purpose Federal Financial Reports*.

Question 1 – Do members have suggestions regarding the changes made to the disclosure requirements for non-core entities?

Ms. Payne stated that the first question relates directly to non-core disclosures, noting that staff left the last meeting with the impression that the members wanted the examples that were previously in paragraph 71 to be conditional requirements. Ms. Payne stated that staff first tried to set conditions for each item on the list (now 72a-j) and more than half of them would apply only "if relevant."

Ms. Payne further explained that there appeared to be a need for different levels of disclosure based on different categories of non-core entities; for example, interventions, receiverships, and conservatorships may require a lower level of disclosure, then a huge bucket for the usual non-core, and then non-core that exercise sovereign powers of government. Staff decided to develop disclosures for non-core entities that exercise sovereign powers of government and allow judgment to drive the level of disclosure for the rest.

Ms. Payne noted that paragraph 71 of the current draft ED is intended to apply only to those non-core entities that exercise sovereign powers of government. She said that staff thought from the last meeting that it was the relationship to the federal government that members were most concerned about having a better understanding of, how the mission of those entities related to federal policy objectives, and the organizational structures, so paragraph 71 provides for more detailed disclosures about those relationships for "non-core entities exercising power reserved to the federal government as sovereign."

Ms. Payne further explained that paragraph 71 does not waive the applicability of paragraph 70; paragraph 70 applies to all non-core entities and paragraph 71 provides more detail about 70a, upping the bar a bit for one segment of non-core entities. Ms. Payne said some members have responded that the requirements for relevant activity and future exposures in paragraph 70 may get lost so, in the next draft, it might be better to incorporate the requirements for relevant activity and future exposures into paragraph 71 so all three requirements are explicitly included for non-core entities exercising sovereign powers.

Mr. Steinberg responded that paragraph 71 requires additional information to be included and it seems to him that information should come after paragraph 72. He stated that paragraphs 70 and 72, which include disclosure requirements for all non-core entities, should precede paragraph 71, which includes additional disclosure requirements for only those non-core entities exercising sovereign powers.

Chairman Allen said he would support Mr. Steinberg's suggestion because it would address his comment to staff that paragraph 71d should add "in addition to other financial information disclosed;" that edit would not be necessary if paragraph 71 was moved below paragraph 72 that includes the requirements to provide additional financial information. Chairman Allen said he had offered that edit to staff because he did not want paragraph 71 to be viewed as "all I have to do if I am one those types of entities."

Ms. Payne summarized that members would like to move the additional requirements for non-core entities exercising sovereign powers currently in paragraph 71 after the examples in paragraph 72, and asked if members would like to repeat the requirements to disclose relevant activity and future exposures from 70b and 70c in paragraph 71. She clarified that this would not be adding any requirements for 70b and 70c; it would just be repeating for clarity that the objectives stated in 70b and 70c also apply to non-core entities exercising sovereign powers. There were no responses from members so Ms. Payne stated that staff would provide recommended language and placement at the next meeting.

Mr. Steinberg stated that the requirements should also state that the disclosures need to be meaningful and all in one place similar to what the board did for social insurance. Ms. Payne responded that she believes paragraph 69 addresses that for all non-core entities but can be repeated for clarity.

Mr. Dacey added that it might be helpful if paragraph 71 led in with a conditional "if" rather than "to ensure" to make it clear that the requirements in that paragraphs only apply to a certain set of non-core entities; otherwise, some readers might misunderstand the conditional nature of the paragraph.

Reconsideration of Core and Non-Core Distinction

Mr. Steinberg said that he agrees with the proposed disclosures for non-core entities, but he does not agree that intervention and bailout entities like New York City, Lockheed Martin, Continental Bank, AIG and so forth, should be considered non-core

entities. He emphasized that those types of entities should not be called non-core entities just because the board wants similar disclosures for them. He said that to him, non-core means it is part of the federal government but it is a non-core part of the federal government.

Chairman Allen added that the Federal Reserve would have to be included in that list because they do not think they are part of the federal government.

Chairman Allen then responded that the board did have a discussion about whether they wanted to add a separate category besides core and non-core and asked Mr. Steinberg if he is requesting reconsideration of that point.

Mr. Steinberg responded that he would like reconsideration because of the way the process is moving. He said initially the draft ED used the terms “core governmental entities” and “non-core entities” and he thought that by taking away the word governmental, people would not assume the non-core entities are governmental entities. However, the way the whole document is currently written, we are saying what should be in the financial statements, and then we are saying some of these things are core to carrying on the government’s operations but some are non-core to carrying out the government’s operations so we are reporting those differently.

Mr. Reger asked Mr. Steinberg what the third distinction he thinks should be made is.

Chairman Allen noted that non-core is supposed to be a very broad basket.

Mr. Steinberg responded that non-core is so broad that it is bringing in things that should have their own title. He said that we only have disclosures about Lockheed Martin and New York City in the federal government’s financial reports because we had to bail them out, but it would be wrong to suggest that they are part of the federal government. To him, the next step below core would be entities that are non-core and carrying on federal governmental responsibilities.

Ms. Payne clarified that core and non-core are based more on the operational characteristics—the governance structure, how independent they are, how they are funded; it is not a statement about whether the entities are core to the mission of the federal government or essential to carrying out governmental objectives. The federal government would not be involved with any core or non-core entity unless it related to a public policy objective, and she thinks it is very confusing to try to make a distinction that way. She added that, recalling from the prior discussions on the distinction between core and non-core, these entities will not be labeled as such in financial reports of the federal government or other communications to the public. She said that she is puzzled as to why another category would be needed if the disclosures that the board wants will be accomplished through the use of the core and non-core distinction and the flexibility that is built in for preparers to consider factors. She does not understand what the undesirable consequence of retaining the core/non-core distinction would be.

Mr. Steinberg responded that it is not a matter of consequence; the ED will be a public document and through it the board will be, in effect, saying that we consider New York City a non-core entity.

Chairman Allen replied that in designating an entity as non-core, we are not saying the entity is part of the federal government. We are saying that in order for the federal government's financial statements to be complete, the federal government must show its interactions in all of these different circumstances and the impact of those interactions. Chairman Allen added that if we start carving out different categories (e.g., interventions), they would still be subsets of non-core.

Mr. Steinberg responded that is the problem—the board has come up with this catchall phrase that infers that things that really do not belong in either core or non-core would be included. He said we should call them what they are – intervention entities.

Chairman Allen emphasized again that the board is not calling those entities part of the government; they are saying they are entities that the federal government has a relationship with sufficient to need to include that information in the financial report of the federal government.

Mr. Reger asked Mr. Steinberg if he was asking for the board to consider once again separating out intervention entities even if they meet the criteria for control because it was never the intent that those entities remain fundamental federal government entities; it is a monetary investment only.

Mr. Steinberg responded that one could look at it that way.

Chairman Allen interjected that a lot of the entities that would be classified as non-core are what Mr. Reger described.

Ms. Payne responded that one of the options the board discussed during its deliberations on the core/non-core distinction was providing an exclusion for situations where the federal government's intent was temporary control or ownership. She explained that the issue with having the exclusion was that the board would have to develop criteria for when that is no longer the intention—or the credible intention—of the federal government (e.g., Amtrak started out as an intervention but is still largely controlled by the federal government). She noted that the board decided not to provide an exclusion but staff can reintroduce the notion if that is the view of the board.

Mr. Dong responded that he does not see the benefit of doing that. Ms. Payne agreed, stating that she does not see the undesirable consequence of retaining the core/non-core distinction as it is. No one has said that there is a disclosure that would be missing if the core/non-core distinction is retained and no one has said that the proposed standards are so inflexible that you will end up with more disclosures than you desire for intervention activities.

Mr. Steinberg said that he thinks it would be inappropriate to imply that these organizations, which were never intended to be part of the federal government, are non-core entities. He said, to him, the way the proposed standards are written, it suggests that these organizations are part of the federal government. He again emphasized that New York City is not part of the federal government and saying that they are a non-core entity implies that they are.

Mr. Dacey noted that the distinction of core and non-core only drives the disclosures to be included in the financial reports and not how the entities will be characterized in the financial reports. He asked Mr. Steinberg if he thought the disclosures in the financial report were misleading.

Mr. Steinberg responded that he thought the disclosures were fine; it is how the entities are being classified in the proposed standard that is troubling to him.

Chairman Allen reminded Mr. Steinberg that the board deliberated on the number of categories to use and decided on two.

Mr. Steinberg responded that was the problem; when the board decided to have the same types of disclosures for all of these entities, they eliminated the different disclosures but left all of the different entities under one big category of non-core.

Mr. Dong asked Mr. Steinberg what information may not be provided as a consequence of the entities being grouped together as non-core.

Mr. Steinberg responded that he is not saying there would be any missing information; he is saying that the standard should not classify the entities as such.

STAFF NOTE: More than one board member discussed Mr. Steinberg's concern about including intervention entities such as AIG and New York City in the same non-core bucket as the U.S. Postal Service and TVA. Staff would like to clarify for the record that the U.S. Postal Service and TVA are in the Budget so, under the current draft of the proposed standards, they would be appropriately classified as core entities, not non-core.

Mr. Dacey asked if there was another word besides non-core that would address Mr. Steinberg's concern. Mr. Steinberg responded that he thinks the board should be very explicit about why the entities are there.

Ms. Payne asked if they could call them "consolidated entities" and "disclosed entities." Mr. Steinberg said that may be acceptable.

Chairman Allen asked Mr. Steinberg to work with staff to develop new language and propose it to the board for reconsideration.

[LUNCH]

Question 2 – Does the Board generally agree with the proposed language to ensure that the same core entity is not consolidated in the financial statements of more than one component reporting entity?

Ms. Payne noted that staff added a provision (paragraph 56b) to ensure that the same core entity is not consolidated in the financial statements of more than one component reporting entity. She noted that the provision includes a role for OMB if there is a lack of clarity and asked if there were any concerns about the new language.

Mr. Dacey replied that the wording directs entities to go to OMB if there is a lack of clarity, but he is not sure if it is clear that the reporting responsibility would always absolutely go to the largest share. He also noted that the phrase “such responsibilities” is not really defined well within the context. He said that he is conceptually okay with the provision but thinks the language needs some clarity.

Ms. Payne responded that the leading sentence for paragraph 56 states “responsibilities as described above” so the “such responsibilities” are those defined in paragraph 55 and said that a paragraph reference may help clarify. Mr. Dacey replied that Ms. Payne’s suggestion would probably work.

Mr. Dong added that the end of the second sentence should be modified with the word “generally” so that it reads “...should generally include the core entity.” rather than stating the requirement in the absolute.

Mr. Showalter said he has an issue with explicitly naming OMB in the paragraph, especially since the standard includes the word “should.” He explained that it could technically be a violation of the standard if an agency had a question about including something and they talked it over among or with another agency and came to a conclusion, without consulting OMB. If the agencies can resolve it among themselves, we would not want a standard that forces them to go to OMB unnecessarily.

Mr. Dacey suggested the use of the word “may.” Mr. Showalter responded that would help, but he thinks the proposed language as currently drafted requires an agency to go to OMB and does not provide for situations where the agency can work it out through discussions with another agency.

Ms. Payne said she agrees with Mr. Showalter because the language says “where it is not clear” rather than something like “when an agency is not able to determine.” Ms. Payne suggested removing the preamble altogether and changing the “should” to “may” so it reads something like “The Office of Management and Budget may assist in determining...” or “...could be consulted...”

Mr. Dacey pointed out that this paragraph would only apply going forward because the agencies will be going through a whole deliberative process to determine what reporting responsibilities they have when this standard becomes effective.

Chairman Allen asked Ms. Payne if she is suggesting to eliminate the phrase “where it is not clear.” Ms. Payne responded that if they are changing “should assist” to “may assist” or “could be consulted,” she does not believe they need a condition preceding the statement. She added that she is not sure they need the provision at all and she is a little bit uncomfortable with including anything about what OMB should, could, or may do in a standard.

Mr. Dacey replied that he would not have any trouble if the provision were removed.

Mr. Granof agreed, asking what would be added to the standard by using the word “may”—of course they can.

Ms. Payne agreed and suggested they strike the provision unless there were any members who objected.

None of the members objected so Ms. Payne said they would strike the last sentence of paragraph 56b that says “Where it is not clear which, if any, component reporting entity should include the core entity, the Office of Management and Budget should assist in determining which, if any, component reporting entity should include the core entity.”

Based on the above comments from members, the new paragraph 56b would read something like:

Core entities can be administratively assigned to only one component reporting entity.^[footnote]
The component reporting entity assigned the largest share of responsibilities such as those
described in paragraph 55 should generally include the core entity.

Question 3 – Does the Board generally agree with the proposed language to provide the necessary information of differences in GAAP that may result in material intragovernmental differences?

Staff explained that question 3 is related to core entities that report using standards issued by the Financial Accounting Standards Board (FASB) as permitted by Statement of Federal Financial Accounting Standards 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*. Staff explained the issue is related to whether these entities should be required to disclose intragovernmental amounts measured in accordance with FASAB standards to facilitate elimination entries in preparation of the CFR.

Mr. Reger responded that he does not know why any agency would continue to report using FASB standards if they are also required to calculate and disclose their amounts using FASAB standards. However, he said he does not know how they can accomplish elimination entries otherwise because they would not know what is material. He said he acknowledges that it will create all kinds of problems for these agencies that continue to prepare their statements based on FASB standards, but he would support the requirement because he sees no other way to obtain the information that is needed from these entities to eliminate material intragovernmental differences.

Mr. Dacey said an alternative is to provide the information independently through the closing package process.

Chairman Allen said that alternative seems very logical to him.

Mr. Showalter said he does not think it is appropriate to include this type of information in the agencies' financial statements when it is intended for one single user. He added that it would be a really ugly note that no one would understand and asked why it would not just be a requirement of the closing package.

Ms. Payne said one advantage to making it a requirement of the closing package relates to materiality. If the requirement is in the standards, agencies have to do it if for line items that are material to them. If the requirement is in the closing package, agencies only have to do it for line items that would be material at the governmentwide level.

Mr. Showalter responded that was his opinion but he wants to ensure that Treasury gets the information it needs to prepare the CFR.

Ms. Payne suggested that the board include the provision in the ED and seek comment on it or delete it.

Mr. Reger responded that he does not think the board should delete the provision unless they are sure the alternative works.

None of the members objected to retaining the provision in the ED and seeking comment on it.

Question 4 – Does the Board have any questions or comments on any of the other proposed changes referenced above or on any of the ones noted throughout the ED?

Ms. Payne asked if there were any other changes in the draft ED that members have substantive comments on.

Mr. Dacey asked what type of criteria would one be looking for in par. 55 and whether it would capture all material transactions. [Note par 55 is as follows: “Core and non-core entities for which a component reporting entity has been assigned accountability responsibilities should be included in its GPFFR. Determining whether accountability was established or assigned to a component reporting entity requires the consideration of certain indicators and the application of professional judgment. Indicators that accountability has been established in the component reporting entity include:....”]

Ms. Payne explained she was trying to address a non-core entity where there is not a transaction. She explained that it was written with the mindset where there wasn't a financial transfer between the core and non-core. For example, with PCAOB there are no direct federal funds transferred to them. In addition, there are organizations like product market associations that are responsible to US Department of Agriculture.

Mr. Dacey asked if there could be a situation where there are material transactions that don't meet par. 55 and therefore don't get reported. He suggested that perhaps there should be a catchall some where for material transactions versus just the managerial or accountability functions and responsibilities as described. Staff agreed to consider the issue before the next meeting.

Mr. McCall asked if par. 28 j. "establish limits or restrictions on borrowing and investments of the organization" covers directing the investment activity or if that is more related to 28b. "direct the ongoing use of the organization's assets." Chairman Allen commented it could also related to 28k. "restrict the capacity to generate revenue of the organization, especially the sources of revenue."

Mr. Mc Call explained his concern relates to the Federal Reserve Board and the Federal Reserve Open Market Committee because they can authorize and direct the investing activities.

Mr. Reger commented that it needs to be clear about the organizations we are referring to and whether it involves the federal government. The indicators would only apply if it involves the federal government and an organization.

Mr. Mc Call asked if the Board of Governors is a federal agency. Chairman Allen agreed the Board is a federal agency but the Banks haven't made that determination. Currently, the two are treated together and haven't been split. Further, the Board of Governors is very immaterial.

Ms. Payne asked in addressing Mr. Mc Call's question if adding an indicator "direct or liquidate investments" would address his concern. He agreed.

Mr. McCall asked if the decision is still open whether the Board of Governors and FOMC is a federal agency. Mr. Reger explained he didn't believe it was the FASAB position to do that, but also the vast amount of evidence may be leading to multiple conclusions.

Mr. Granof explained in par. 59-60 the draft discusses misleading to include and asked what entities were in mind for this provision. Staff explained one example was the Pension Benefit Guarantee Corporation. Although it is included in the DOL's budget, it is a separate entity.

Mr. Dacey asked what the intent behind the edits were to par. 28i "establish, rescind, or amend the organization's governance framework by requiring it to adhere to routine requirements such as annual audits, establishment of internal controls, or other governance matters" and if it was something directed toward the SEC. Staff explained it was edited to make it differ from the persuasive indicator in par. 27c which states "direct the governing body regarding the establishment and subsequent revision of financial and operating policies of the organization." In par. 28 one has to review them in the aggregate for control. Mr. Dacey suggested dropping the latter part of the sentence "by requiring it to adhere to...." Staff agreed to make the change.

Mr. Dacey explained he had concern with the last sentence of par. 59 because the entity could be part of another entity as well, not only the government-wide GPFRR. He wasn't sure how it could be addressed but there may be instances where it doesn't consolidate directly into the government-wide financial statements. Staff will consider this and consult with others.

He also asked why par. 59 – misleading to include - addresses only core. Staff explained that the proposal provides a process to assign a non-core to a core entity so Treasury can get information needed for the CFR. A principal saying it would be misleading to include a non-core would seem contradictory with the need to assign all non-core entities somewhere. Mr. Dacey understood the reason and agreed.

Question 5:

Does the Board generally agree with the proposed language to acknowledge the continuum among non-core entities?

Staff noted question 5 of the staff memo related to non-core entities and the language staff added to acknowledge the continuum among non-core entities. In past discussions, members have questioned whether non-core entities may carry out missions that appear to be "core" missions. However, staff notes most of this was covered in the discussion this morning unless there are other points, the Board can move on. There were no other points on this topic.

With that, staff directed the Board to the second issue-- Conforming Amendments to SFFAC 2.

Question 6:

Does the Board generally agree with the proposed conforming amendments to SFFAC 2?

Staff explained at the April meeting, it was determined that staff would incorporate the conforming amendments to SFFAC 2 into the ED and clean up inconsistent terminology throughout SFFAC 2 as long as the effort spent beyond the required amendments is minimal. The Board also asked that SFFAC 2 include an explanation of the concepts behind the standard being proposed.

Staff explained that included with the Board materials is a Marked Statement of Federal Financial Accounting Concepts 2: Entity and Display. It provides an overview of the existing paragraphs that staff anticipates will be rescinded. Staff explained it also provides a few other suggested wording changes. Specifically, Insert A--Distinguish between Core and Non-core Entities provides language that is proposed before par. 54 of SFFAC 2. This language provides a high level explanation of core and non-core. More importantly, the proposed language describes the need to distinguish between

them and the reason for this distinction in terms of financial statement presentation. Staff notes these are new terms in the proposed standard and very critical to understanding the reporting entity concept in the federal government.

Staff noted the changes marked are minimal, and a member noted some of the paragraphs in the introduction, and perhaps other areas, needs to be updated for earlier issuances. For example, staff also considered recommending deletion of paragraphs 3, 4 and 5 because the new preamble to concepts statements (adopted with SFFAC 5) and SFFAS 34 addresses the points. Staff will make these changes in the next version.

Ms. Payne asked the Board if they believed the revisions struck the appropriate balance between concepts and standards and if the concepts are sufficient to support the standards as proposed.

Chairman Allen explained that he reviewed it more in line with consistency and he didn't have a problem because a lot of the substance was taken out of the concept that is now in the standard.

Mr. Dong asked for clarification on what the Board decided as the approach for the revisions. Ms. Payne explained the Board agreed to incorporate the conforming amendments to SFFAC 2 into a single ED.

Mr. Dacey explained that the standard suggests accountability as a main driver, but that he didn't really gather that in the draft changes to the concepts. He added he didn't think it needed to be lengthy but there should be some discussion. Ms. Payne explained we did link back to accountability through the discussion of concepts statement 1. She agreed that is one of the challenges with our framework because it is divided by topic. She understood the concern and the fact it does stand alone with readers so staff will consider it further.

Question 7:

Does the Board generally agree with the proposed language to distinguish core and non-core entities for SFFAC 2?

Mr. Steinberg explained he believes there is still major issue with the standard itself when one considers the issue of core, non-core, Federal Reserve, and, bail-out entities. He explained that until some of those issues are worked out, it appears we may be trying to put the cart before the horse to say how the concepts should be affected. Chairman Allen explained that was a fair statement, but staff was simply asking for feedback if this was addressing the main areas or if there appeared to be issues. Ms. Payne noted the transmittal stated the Concepts portion won't be presented again until the October meeting due to some of the dates being pushed back.

Chairman Allen explained there may be a need to see it at least twice if our goal is to get it out in October; if that is a hard deadline the Board is trying to meet. Ms. Payne explained the federal reporting entity will be on the agenda in August but it is a question

if Concepts should be discussed at that meeting considering Mr. Steinberg will be presenting a proposal based on the revised outline he drafted over lunch.

Mr. Steinberg explained that he and Mr. Showalter developed an outline during lunch which briefly could be described as:

- Core Federal Government
 - o Displayed through consolidation
 - o Non-consolidated, i.e., displayed through footnote disclosures
- Accountable entities
 - o Receiverships & Conservatorships
 - o Interventions
 - o Non-core governmental entities
- Related Parties
 - o GSEs
 - o Multi-national development banks

He explained the outline addresses concerns such as the Federal Reserve is fulfilling core sovereign programs and should be considered core but a non-consolidated core entity and intervention entities are not non-core. He explained a lot of the wording and concepts are the same but it takes a slightly different restructuring—it includes a core government that fulfills the sovereign entity functions and it is made up of two portions, those organizations that are consolidated and those that are not—which he noted may include the Federal Reserve and Amtrak. Mr. Steinberg explained the next would be Accountable entities which would include the receiverships and conservatorships, Interventions, and other Non-core entities, because these are not part of the government.

Chairman Allen asked if it would be the same reporting requirements. Mr. Steinberg explained yes, it would be the same reporting that has been discussed thus far. Mr. Steinberg added that the GSEs and multi-national development banks could be a related party. He explained it is a different construct and a different way to view the organizations. Chairman Allen noted that the Board still needs to consider the related party paper staff has prepared for this meeting.

Implementation Timeline (See Attachment B)

Chairman Allen explained there was one other item that needed to be briefly discussed before related party and asked Ms. Payne if she wanted to explain the timetable the sponsor agencies had provided.

Ms. Payne explained that Messrs. Dacey, Dong and Reger had committed to providing a timeline for implementation based on the draft standards under discussion. The timeline was to inform the Board's discussion and assist in determining the proposed effective date. The bottom line is approximately 24 months between issuance and effective date. She noted staff didn't make a specific recommendation, but asked if there were any comments on the timeline at this time.

Mr. Reger wanted to note there were two huge caveats with the timeline—it took a considerable amount of time working with one organization to draft disclosures and that time of release should be considered. He noted some of it could occur before it is sent to the sponsors for review. Therefore, the times are approximate and may not be sequential but can be considered a good estimate for determining implementation. It appeared it would take approximately 24 months. Further, 24 months may be on the low end of an estimate depending on the timing of the release. Mr. Reger explained we may come across certain entities that will require more time as they may not think they need to be included etc.

Mr. Dacey explained the 24 month clock would start when the standard is sent to the principals for their 90 day review.

Chairman Allen thanked the members for the update and appreciated the efforts on developing the timeline.

Tab D Related Party

Staff noted the objective for the June Board meeting is to consider options for addressing related party. Staff has proposed a related party definition and disclosures that would be issued as part of the Exposure Draft (ED) *Identifying and Reporting upon Organizations to Include in General Purpose Financial Report*.

Staff explained the Board considered related parties in June 2011 but deferred making a decision at that time. The Board had determined it would make decisions regarding related party at a later date--once the other sections of the federal reporting entity standard were complete. Board concerns from previous discussion included whether we needed the category, if there were examples, and how to prevent those organizations that may meet the inclusion principles from falling to related party. Staff kept these concerns in mind while developing the recommendation.

Staff believes the Board should define 'related party' and address it within the federal reporting entity standard for several reasons:

- Related party reporting is such a fundamental notion within GAAP and the auditing standards that addressing how related party concepts apply in the federal domain is important.

- There is still a need for the related party category to disclose those organizations that aren't covered by the proposed standards where there may still be a relationship of influence.
- One can't anticipate all types of relationships the federal government may have or might have in the future that need to be reported.

Chairman Allen noted the universe of entities the federal government may have relationships with and there could be countless relationships considered and he thought that may be a reason to not have a related party category. It appears when you consider the commercial definition; the federal government does very little true arms length transactions which is what one tries to accomplish with a related party definition. He explained it was a valid point that staff makes that there are organizations where we have relationships that exist where there is some influence but he struggles with the cut-off.

Mr. Dong asked if there were examples of organizations that might fall through without the category. Chairman Allen explained in the staff paper, staff considered two potential relationships—government sponsored enterprises and multilateral development banks and provided an overview of the background, relationship/influence, and risks/exposures for the Board's consideration.

Mr. Showalter explained that once you go down the path, he believes there will be organizations that could fall out of core and non-core that should be disclosed so we should provide guidance. He doesn't believe we should be silent. However, he believes the definition as staff proposed is too broad and is not auditable. He believes we need to be clear about the types of related party that we believe may exist. For example, if government sponsored enterprises and multilateral development banks are potential related parties, then say that. Mr. Showalter explained that is how other standard setters approach it, they don't really define related party, they say what they are or what one should consider. However, he agrees with staff in that it needs to be addressed.

Mr. Granof noted that GASB 14 presents a flowchart with broad questions and it brings one down to a related party without actually defining a related party because it is a continuum.

Mr. Dong asked if there was a potential for duplication with related party and the misleading to exclude inclusion principal. Chairman Allen stated that could be another option to say the misleading to exclude includes these relationships where there is significant influence and they should be disclosed. In that case, we wouldn't have to define related party.

Mr. Showalter explained the auditor would have issue because you must have a population that you are looking at, what is the population of all other organizations.

Ms. Payne noted when the project first began (it was before the interventions activities and economic crisis) the CBO member on the Board wanted to find a way to report

GSEs. If the interventions activity had not occurred, one question would be - how GSEs would be viewed? Obviously they would also come up in the risk assumed project.

Mr. Reger explained he views non-core as related party and that's why he has difficulty coming up with defining another category.

Mr. Showalter explained he still believes we need it and that we should be specific as to what types of organizations. Ms. Payne suggested we could take that approach and deal with other types of relationships in risk assumed.

Chairman Allen explained he has some concern with using common terminology, then changing it from what the accepted or common definition may be.

Mr. Steinberg explained that he thought the reason GSEs were a related party is because of the implied guarantee and that is something that could be criteria. However, if the federal government steps in and takes action then they move up to non-core.

Chairman Allen noted that staff suggested one option was to explore in the risk assumed project. He believes related party addresses things that are not true arms length transactions, and because they are not, one needs to disclose the nature of the relationship, etc. to allow a level playing field to help one make an assessment about relationships and they are written for outside investors. Chairman Allen said we don't have investors, but we have citizens. So one must consider what type of information the citizens' care about and that is exposure and risk in these relationships.

Mr. Reger explained he had concern with specifying the types of related party in a principles based statement. We should develop principles, not list organization types. Mr. Steinberg explained he already provided one—implied guarantee. Also it can't be core or non-core.

Mr. Granof explained you could also look to some of the examples in the illustrations that weren't included—organizations that were created, etc. Then you have to consider what information you want, not that much but something needs to be said.

Mr. Dong asked again why the misleading to exclude approach could not be used. He had a hard time seeing the shortcoming with that. He understood someone had stated there was a concern with it being open ended but he sees that concern with this approach as well.

Mr. Reger explained the inclusion principles are considered first and there is the underlying control whereas in this situation, control is not part of it. Also, another distinction in the categories would be less reporting for related party when compared to non-core.

Mr. Showalter suggested another approach would be to take things off the table that aren't considered related party—as staff discussed in the paper, broad categories such

as treaties and other things should be removed from consideration. He explained this would help narrow the list down.

Chairman Allen suggested we frame the staff questions more narrowly after hearing the Board input. Ms. Payne explained there appears there is Board consensus we need to say something about the related party category. She would like the Board to confirm that they want to keep the related party reporting category and requirement and whether they would prefer an approach where it is specific by list of organizations that might qualify or where members would like to see the related party focus. Staff will then come back with a few options.

Chairman Allen suggested it could be along the lines of something the federal government created. Ms. Payne noted she is hesitant about the created-by notion because there are many organizations the federal government creates but it no longer has an ongoing relationship with.

Mr. Showalter reiterated his earlier points, but added if there is concern with calling them related parties, one option is to call them related entities. He added that there should be a series of principles or examples of what to consider or exclude to help narrow the population.

Mr. Shumacher explained it would be beneficial to have the related party with guidance to assist in what should be considered or to narrow down what not to consider.

Mr. Dacey agreed there are probably entities that are related, but he agreed there needs to be a way to narrow it down so only appropriate types are disclosed. He isn't sure how to develop it in a way so that it is similar to the concept of "misleading to exclude," but that is what the Board should be aiming for. Some of the factors might be the ability to significantly influence the other one and perhaps there are other factors. In summary, he believes we need the category but it must be narrowed because some of the things in the past we considered related party are now non-core and there may not be that many left but there should be a door left open for consideration of those that may remain.

Mr. Dong explained the conversations have revolved around several things today -- capturing things that may be on the cracks, whether the misleading to exclude would work, and if there is a subset of non-core.

Chairman Allen agreed more needs to be done, but from the standpoint of understanding the financial position and implied risk and obligations. He wants to know what's missing from the federal government's financial statements. From that, it may be best taken in the risk assumed project—does the note on contingency cover these types of things.

Mr. Reger explained he agrees the concept needs to stay. However, he believes it is a subset of the non-core, those organizations which we don't need to disclose as much information. This is a pretty well defined term for other standard setters.

Mr. Dacey explained the AICPA initially asked us to develop a standard on related parties.

Mr. Steinberg suggested this could still be considered in the construct he is proposing, related parties and GSEs as an example. Mr. Steinberg suggested the book *All the Devils are Here*, which is about the financial meltdown. It has a chapter devoted to GSEs and perhaps criteria could be pulled from that.

Mr. McCall noted he liked the term related entities and may describe how the federal government interacts.

Mr. Granof suggested that we define non-core in such a way that we capture all entities and have flexibility with the disclosures as appropriate. With that, related party wouldn't be required.

Staff will come back with options for the Board to consider.

The Board previously discussed the issue of whether component reporting entities (CRE) should disclose additional information to better recognize the relationship and contextual information that is conveyed about the component reporting entity of a sovereign government. Staff explained that FASAB has not established requirements for a description of the CRE other than the discussion of the organization and mission required in the Management's Discussion and Analysis section (MD&A).

Staff noted that most key points are addressed individually in agency MD&A and notes either as a result of existing standards, OMB form and content requirements, or voluntarily. However, coverage and placement differs among the agencies.

Staff believes the description of the entity should include, at a minimum, an explanation that the CRE is a component of the U.S. government and a discussion of going concern implications arising from that status.

Ms. Payne asked the Board if they want to pursue requiring certain minimum information regarding the CRE's status as a component of the U.S. government as part of this project. Staff had suggested the following possible disclosures: a. Notice that the CRE is a component of the U. S. government, a sovereign entity; b. Discussion of going concern (need for continued authorizations and appropriations); c. Discussion of costs not included in CRE statements; d. Caution regarding inability to liquidate liabilities not covered by budgetary resources; and e. Explanation regarding non-entity assets. Staff explained that they thought items d and e were not as important as a through c.

Mr. Steinberg explained that he does see most of this information in the footnotes based on his review of the statements, but they must be doing it because of the OMB guidance. He agrees the information should be there and therefore should be part of the standards.

Chairman Allen noted that GASB has requirements for component units that prepare statements outside of the primary unit. He is a supporter of that principle of describing the financial relationship of other organizations to the primary government.

Chairman Allen asked if there were any other comments.

Mr. Dong explained he was trying to get a better understanding of what information was not being disclosed or why this was needed.

Ms. Payne explained it is a current A-136 disclosure requirement that component reporting entities include a statement in MD&A that they part of the US government. Based on the review of reports, the statement is there, but in reading the financial statements it's unclear what may be interpreted from that. The Board discussed previously whether citizens and analysts know what the required statement means and if it should go further to explain. For example, a member previously noted that because a CRE is a component it must get continued authorizations from Congress; assets can't be used for its own purposes; liabilities can't be paid absent an appropriation, and asked if readers are alerted to these facts.

Mr. Dacey explained he is supportive and believes it is important information for the reader and should be in GAAP.

Mr. Dong explained he isn't convinced of the issue and if there is a problem, he doesn't see why it could not be addressed under A-136.

Chairman Allen stated he supports the requirement and would be prescriptive in Note 1.

Mr. Reger suggested that it could be accomplished in A-136.

Messrs. McCall and Granof indicated support for the requirement.

Chairman Allen explained the majority of the Board supported the recommendation and directed staff to determine the best method. Ms. Payne indicated she would work with OMB regarding options.

Tab C—Illustrations

Staff explained the last item for discussion in the federal reporting entity project would be to consider the draft illustrations in applying the standards. The Board reviewed illustrations in April and asked staff to consider the following concerns and suggestions:

1. Guard against the possibility that the illustrations will be overly relied upon in practice and cause preparers and auditors to reach inappropriate conclusions.
2. Avoid appearing to reach bright line conclusions in more complex cases.
3. Include key facts and circumstances and describe how entities might reach a conclusion based on the key facts and circumstances provided.
4. Use wording that aligns closely with the exposure draft and the flowchart.
5. Include entities in the illustrations to cover the variety of circumstances in the draft standards.

Ms. Payne provided an overview of the changes staff incorporated in the illustrations. Improvements were included in the preamble, the headings, and the wording of the tentative conclusions. In addition, to address the concern regarding bright line conclusions, wording regarding consideration of “other factors” and the application of “professional judgment” by the preparer and the auditor was included to remind of the brevity of the analysis presented in illustrations in contrast to what may be needed in actual practice.

The basis for each tentative conclusion is provided using wording that aligns closely to the exposure draft. This ensures the illustrations have a consistent structure that aligns with the flowchart. In addition, the summary table has been improved. However, staff is concerned that the table appears to oversimplify the decision making process and requests Board member thoughts on whether it should be retained but also welcomed input on any aspects of the illustration package.

Mr. Granof explained he believed the illustrations were greatly improved.

Mr. Showalter suggested that you need the entire narrative (versus the table) to read for a full understanding of the details and therefore did not necessarily see the need for the table.

Chairman Allen explained that he didn't see a problem with the table as it may assist users in which example they may want to review further.

Messrs. Mc Call, Steinberg, Reger, Dong, and Allen voted to retain the table so it will stay in.

Ms. Payne explained it can stay in for the ED and staff can reassess after the ED process.

CONCLUSION: The following decisions were made at the June meeting:

- Staff will provide the Board with all referenced Federal Reserve notes (from the draft note provided at the meeting) for consideration at the August meeting.
- The additional requirements for non-core entities exercising sovereign powers currently in paragraph 71 will move after the examples in paragraph 72. In addition, requirements to disclose relevant activity and future exposures language from 70b and 70c will be repeated in paragraph 71 for clarity of the objectives.
- Paragraph 71 will be led in with a conditional “if” rather than “to ensure” to make it clear that the requirements in the paragraphs only apply to a certain set of non-core entities.
- Mr. Steinberg to work with staff to develop new language and propose it to the board for reconsideration at the next meeting.

- Paragraph 56b was revised as :
 - Core entities can be administratively assigned to only one component reporting entity.^[footnote] The component reporting entity assigned the largest share of responsibilities such as those described in paragraph 55 should generally include the core entity.
- The Board will retain the provision in the ED to provide the necessary information for differences in GAAP that may result in material intragovernmental differences and seek comment on it to determine whether it needs to remain.
- Adding an indicator “direct or liquidate investments” to par 28.
- Drop the latter part of par. 28i , specifically “by requiring it to adhere to routine requirements.”
- Staff will provide a revised Concepts piece that includes additional revisions, including par 3-5 and will also consider a member’s concern whether accountability should be elaborated upon or at least a stronger link.
- Staff will develop options for related parties which may include calling them related entities. Approaches may include:
 - A narrow definition with a series of principles or examples of what to consider or exclude to help narrow the population.
 - Misleading to exclude approach
 - Mr. Steinberg’s revisions to the core and non-core categories
- The Board approved the recommendation of requiring certain minimum information regarding the CRE’s status as a component of the U.S. government as part of this project.
- Staff will research and consult with others on two issues raised by Board members:
 - Consider if there could be a situation where there are material transactions that don’t meet par. 55 and therefore don’t get reported. Perhaps there should be a catchall for material transactions versus just the managerial or accountability functions and responsibilities as described.
 - Consider the last sentence of par. 59 because the entity could be part of another entity as well, not only the government-wide GPFFR.

- **Presenting Fiscal Projections**

Overview

The Board discussed that the Auditing Standards Board (ASB) has organized a task force to consider guidance for auditors engaged in auditing prospective information. The ASB primarily organized the task force as a result of the Governmental Accounting Standards Board's (GASB) Preliminary Views of the Governmental Accounting Standards Board on major issues related to Economic Condition Reporting: Financial Projections. The document discusses requiring states and local governments to prepare 5-year projections as required supplementary information (RSI) and this view raised some concerns within the audit community. Consequently, the task force would address those concerns and any concerns that have developed with respect to the following federal requirements for prospective financial information:

- Statement of Federal Financial Accounting Standards (SFFAS) 17, Accounting for Social Insurance, requires prospective measures for presentation in the Statement of Social Insurance; and
- SFFAS 36, Comprehensive Long-Term Fiscal Projections for the U.S. Government, requires long-term fiscal projections be presented as required supplemental information (RSI) in the consolidated financial report of the U.S. for fiscal years 2010, 2011, and 2012, after which time the fiscal projections will become a basic financial statement.

Also, given the audit concerns, members discussed the challenges associated with achieving the effective date for presenting the long-term fiscal projections as a basic financial statement.

The Board decided to await feedback from the ASB regarding: a) the type of assurance that could be provided on the prospective information being required of the federal government and certain federal agencies; and 2) what additional guidance may be needed. Also, a proposal to defer the effective date for presenting long-term fiscal projections as a basic financial statement would need to be presented to the Board not later than the December 2012 meeting. Details of the meeting discussion follow.

Discussion

Mr. Simms introduced the discussion and noted that the ASB has organized a task force to review the auditor's responsibility for prospective financial information. Because FASAB has standards that require prospective financial statements, this might be an

opportune time to discuss whether the Board would like to communicate any views that the task force should consider in its deliberations.

Mr. Allen noted that he would like the task force to consider guidance that would lead to providing some level of assurance on the statements or explain what testing was performed rather than simply stating that the entity did not present the required information. Also, Mr. Showalter asked rhetorically, why should auditing continue to bifurcate financial estimates from non-financial estimates? He noted that more and more financial accounting is being based on estimates, including forward looking estimates, and the two types of estimates are coming together rather than being distinguished. During the Board's mission statement deliberations, there was a discussion on whether performance measures could be considered a financial measure or non-financial measure and it was determined that it was a financial measure. Mr. Showalter would like to encourage the task force to bring together the auditing (AU Section 342, Auditing Accounting Estimates) and attestation standards (AT Section 101, Attest Engagements, AT Section 301, Financial Forecasts and Projections, AT Section 401, Reporting on Pro Forma Financial Information, and AT Section 701, Management's Discussion and Analysis) and develop more definitive guidance on how to audit estimates.

Mr. Dacy noted that the issue is whether the Board would like the prospective information to be a basic financial statement or required supplementary information. The categorization would determine the level of assurance.

Mr. Dong expressed concern about being able to implement SFFAS 36 by fiscal year 2013. The standard requires the presentation of long-term fiscal projections as a basic statement by that time. However, the requirement to have the data subjected to audit scrutiny may limit the ability to provide a full story on the long-term fiscal sustainability issue.

Mr. Jim Dalkin, Chair of the Prospective Information Task Force, joined the discussion and noted that the Auditing Standards Board received the GASB's preliminary views document. The document discusses requiring states and local governments to prepare 5-year projections as RSI and a number of auditors had concerns about whether the auditing standards were sufficient for dealing with such requirements. The Prospective Information Task Force was organized to address this issue and concurrently address parallel issues with respect to federal requirements for prospective information.

Mr. Dalkin noted that GASB's prospective information requirements are fundamentally different from FASAB's in that GASB's requires RSI while FASAB requires basic information. Regarding GASB's requirement, the task force believes that there is sufficient audit guidance. However, with respect to FASAB's requirement to present long-term fiscal projections as a basic financial statement, the Board would be requiring auditors to provide a reasonable level of assurance on that statement and the question is whether that level of assurance can be achieved. The statement involves 75-year projections and is fundamentally based on budget data and a significant amount of assumptions.

Mr. Dalkin noted that last year's long-term projections appear to indicate that the government saved \$10 trillion in one year. However, a significant amount of that savings is contingent upon the Budget Control Act being implemented as planned and assumptions related to healthcare working as planned. These issues pose challenges for auditors in trying to provide that reasonable level of assurance and the task force is considering whether such projections can be audited in the context of what they normally audit.

Mr. Reger noted that the audit assurance seems to revolve around two principles: 1) is there some assurance around the underlying data that is being used to perform an analysis; and 2) policies, processes, and procedures that are applied to reach a conclusion. The question is whether a reasonable level of audit assurance can be achieved if the underlying data is from budget data that has not been audited. Mr. Dacey clarified that the agency budget execution data is audited and provides the starting point.

Mr. Dalkin noted that there is a concern with how to audit budget documents and he noted there are several issues with respect to the long-term projections. Auditors typically engage in auditing historical data but, now, the issue is prospective data with significant assumptions about how individuals act toward different issues like healthcare. The projections also involve modeling and economics rather than accounting. Additionally, last year's projection makes it appear that the government may not have a sustainability problem because it saved \$10 trillion in one year and, based on the disclosures, could possibly have a surplus in the next year. Moreover, economists may not agree on whether some projections are achievable and, if they cannot come to some agreement, can the auditor reasonably provide an opinion on the amounts. Consequently, projections involve a number of issues and, as a basic financial statement, the auditor would be asked to provide an opinion on whether they are reasonably good numbers.

The task force is developing a discussion paper regarding these issues and the GASB's requirements and will present the paper to the ASB for a discussion. Mr. Reger noted that, rather than dealing with the auditor's ability to opine on a projection, the conclusions in the paper should deal with the underlying data associated with the basis for the actuarial projection or the processes and procedures and the likelihood that the actuarial projection has some level accuracy. Mr. Allen added that the federal environment was different at the time the Board developed the long-term fiscal projections standard and asked that the task force provide some feedback to the Board on what would be needed to provide a level of assurance on the information. Also, if the task force does not believe that a level of assurance can ever be provided, the Board would need to know that so that it could reconsider its thinking about whether the information should be basic.

Mr. Showalter noted that the task force should consider what type of assurance could be provided given that the assumptions for the projections are properly disclosed and sensitivity analyses are provided. Mr. Dalkin noted that the task force is considering whether the attestation standard, AT 301, could be expanded. Currently, the standard

is intended for use on a commercial entity engagement. However, using the attestation standard would change the audit opinion because one section of the opinion would address the historical information while the other section would address the projections. Mr. Dalkin also noted that the task force is concerned about whether the auditor could make a determination on whether the projections “present fairly” the financial condition of ..., given the level of variability involved. Mr. Allen noted that it would be helpful if the task force could provide FASAB with alternative ways of providing a level of assurance.

Mr. Dacey noted that it would also be interesting to know if the task force has identified any additional disclosures that would help readers understand the information.

Mr. Reger noted that the intent to present the long-term fiscal projections as a basic financial statement may not make sense until the auditor has developed standards for auditing the statement. Ms. Payne noted that a proposal to defer the effective date for presenting long-term fiscal projections as a basic financial statement would need to be presented to the Board not later than the December 2012 meeting. Mr. Allen noted that he would not have a problem with delaying implementation, but the Board would need the feedback from the ASB to make an ultimate decision regarding the standard.

Conclusion: The Board will await feedback from the ASB regarding: a) the type of assurance that could be provided on the prospective information being required of the federal government and certain federal agencies; and 2) what additional guidance may be needed. Also, a proposal to defer the effective date for presenting long-term fiscal projections as a basic financial statement would need to be presented to the Board not later than the December 2012 meeting.

- **Steering Committee Meeting**

The Steering Committee discussed the budget projections through FY2014 and did not recommend changes. Regarding the staff vacancy, members endorsed filling the position. Ms. Payne committed to working toward that with the GAO budget, work force planning and human capital staff.

Adjournment

The Board meeting adjourned at 4:15 PM.

Attachment A—Federal Reserve Proforma Disclosure

DRAFT - Federal Reserve Proforma Disclosure – Treasury Financial Statements (Excerpt of Footnote on Principal Relationships)

A. FEDERAL RESERVE SYSTEM

The Federal Reserve System (FR System) was created by Congress under the Federal Reserve Act of 1913 (FR Act). The Federal Reserve System consists of the Federal Reserve Board of Governors (Board), the Federal Open Market Committee (FOMC), and the Federal Reserve Banks (FRBs). Collectively, the FR System serves as the nation's central bank and is responsible for formulating and conducting monetary policy, issuing and distributing currency (Federal Reserve Notes), supervising and regulating financial institutions, providing nationwide payments systems, and providing certain fiscal services to federal agencies and principals. Monetary policy includes actions that influence the availability and cost of money and credit as a means of helping to promote national economic goals.

The Department interacts with the FRBs in a variety of ways, including the following:

- The FRBs serve as the Department's fiscal agent in executing a variety of transaction on behalf of the Department. The Department reimburses the FRBs for these services, the cost of which is included on the Consolidated Statement of Net Costs.
- The FRBs hold Treasury and other federal securities in the FRBs' System Open Market Account (SOMA) for the purpose of conducting monetary policy (Note 16).
- The FRBs hold gold certificates issued by the Department in which the certificates are collateralized by gold (Note 6).
- The FRBs hold Special Drawing Rights (SDRs) certificates issued by the Department which are collateralized by SDRs (Notes 5 and 12).

The Department also consults with the FR System on matters affecting the economy and certain financial stability activities (Notes 7, 11 and 26). The above activities are accounted for and disclosed in the Department's consolidated financial statements. The FR System is not included in the federal budget, and in accordance with Statement of Federal Financial Accounting Concepts 2, the FR Systems' assets, liabilities, and operations are not consolidated into the Department's financial statements.

Federal Reserve System Structure

The Board is an independent organization governed by seven members who are appointed by the President and confirmed by the Senate. The full term of a Board member is fourteen years, and the appointments are staggered so that one term expires on January 31 of each even-numbered year. The Board has a number of supervisory and regulatory responsibilities for institutions including, among others, state-chartered banks that are members of the FR System, bank holding companies, and savings and loan holding companies. In addition, the Board has general supervisory responsibilities for the 12 FRBs, and issues currency (Federal Reserve Notes) to the FRBs for distribution.

The FOMC is comprised of the seven Board members and five of the 12 FRB presidents, and is charged with formulating and conducting monetary policy primarily through open market operations (the purchase and sale of securities in the open market), the principal tool of national monetary policy. These operations affect the amount of reserve balances available to depository institutions, thereby influencing overall monetary and credit conditions.

The 12 FRBs are chartered under the Federal Reserve Act, which requires each member bank to own the capital stock of its FRB. Supervision and control of each FRB is exercised by a board of directors, of which three are appointed by the Board of Governors of the FR System, and six are elected by their member banks. The FRBs perform a variety of services and operations including participating in formulating and conducting monetary policy; providing nationwide payment systems (including large-dollar transfers of funds, automated clearinghouse (ACH) operations, and check collection), and distributing currency and coin. The FRBs also serve as fiscal agents, providing a variety of financial services for the Department, other federal agencies and fiscal principals, and serves as the U.S. Government's bank. Additionally, the FRBs provide short-term loans to depository institutions and loans to participants in programs or facilities with broad-based eligibility in unusual and crucial circumstances when approved by the Board.

Principal Assets and Liabilities of the Federal Reserve System

The FRBs' most significant assets include Treasury securities, government-sponsored enterprise (GSE) debt securities, and federal agency and GSE mortgage-back securities in the System Open Market Account (SOMA) for the purpose of conducting monetary policy. Treasury securities held by the FRBs totaled \$X.X trillion and \$1.7 trillion at September 30, 2012 and 2011, respectively (Note 16). The FRBs earn interest income on all securities held. These assets are generally subject to the same market (principally interest-rate) and credit risks as other financial instruments.

The FRBs offer loans to eligible borrowers typically on a short-term basis under a variety of programs, each with a specified interest rate. In certain cases, and with Board approval, FRBs may offer loans to other borrowers for longer terms. In all cases, loans issued by FRBs must be collateralized to the satisfaction of the FRBs to minimize credit risk.

The most significant liabilities of the FRBs are its deposit liabilities both with depository institutions and the U.S. Treasury (specifically the General and Supplementary Financing accounts – refer to Note 16), and for currency in circulation. Federal Reserve Notes are the circulating currency of the United States, and represent a liability of the FRBs that is collateralized by the assets of the FRBs.

Financial and other information concerning the FR System, including financial statements for the Board and the FRBs, may be obtained at <http://www.federalreserve.gov/monetarypolicy/bst.htm>.

FRB Residual Earnings Transferred to the Department

FRBs generate their own income, primarily from interest earned on securities, reimbursable services provided to federal agencies, and the provision of priced services to depository institutions as specified by the Monetary Control Act of 1980. Although the FRBs generate substantial earnings from carrying out open market operations, their execution of these

operations is for the purpose of accomplishing monetary policy rather than generating earnings. Each FRB is required by Board policy to transfer to the Department its residual (or excess) earnings, after providing for the cost of operations, payment of dividends, and reservation of an amount necessary to equate surplus with paid-in capital. The FRB residual earnings are recorded as custodial revenues on the Statements of Custodial Activity. They constituted three percent of total custodial revenues collected in fiscal years [2012] and 2011.

Entity Implementation Timeline

062512

Purpose:

This is a preliminary list of the implementation steps created for the sole purpose of estimating the amount of time required between the final issuance of the new Entity Standard and the effective date.

Phase 1 - Formulate Guidance and Reporting Tools (8 months):

- Formation of a Steering Committee
- Draft guidance, policies, reporting templates, and determine documentation requirements
- Agency/GAO review guidance and policies (also, share draft guidance and policies with potential CORE and NON-CORE entities that were either self-identified or identified through outreach by OMB and Treasury during the comment period on the exposure draft)
- FMS develops procedures/process for integrating CORE and NON-CORE information collection into yearend collection systems (Government-wide Financial Reporting System)
- FMS develops plans for consolidation and publication of NON-CORE disclosure data
- Treasury publishes the final guidance and reporting tools

Phase 2 - Educating the Community on the Implementation Steps (2 months):

- Treasury communicates final guidance and reporting tools to potential CORE and NON-Core entities identified in Phase I
- OMB/Treasury educates agencies about the new guidance
- OMB/Treasury and GAO educate IG/audit community about the new guidance, the annual reporting tools, and audit requirements for CORE and NON-CORE information

Phase 3 - Entity Determinations (8 months):

- Agencies/Entities, in coordination with their auditors, conduct preliminary determination of CORE and NON-CORE entities
- Treasury/Agencies notify all the affected entities of the preliminary determinations
- Treasury, OMB, and GAO review preliminary determinations by agencies/entities and OMB assists with administrative assignments of CORE entities to a CORE entity for reporting purposes as necessary and within the boundaries of OMB Authority
- Dispute resolution is used to clarify CORE and NON-CORE designations
- The list of CORE and NON –CORE entities is finalized and published

Phase 4 - First Reporting Cycle:

- Agencies submit documentation of annual determinations of applicability
- CORE entities submit agency information and reports in accordance with guidance
- NON-CORE entities provide information for inclusion in agency financial statements
- Treasury consolidates information and issues new NON-CORE disclosures

Other Timing Considerations

- The implementation steps outlined above begin when FASAB provides the Principals with a final copy of the standard for their 90 day review
- In addition to the 18 months schedule detailed above, it is anticipated that there would need to be an additional 3 months (September-December) added for each year-end included in the implementation period (as limited work on this project would occur during that time).
- Timing would be affected if:
 - identified CORE or NON CORE entities are not already compiling sufficient information to satisfy reporting requirements
 - Disputes concerning an entity designated CORE or NON CORE are not resolved timely by Treasury/OMB
 - An entity fails to report required information timely