



February 9, 2012

Memorandum

To: Members of the Board

From: Melissa L. Loughan, Assistant Director

Wendy M. Payne

Through: Wendy M. Payne, Executive Director

Subj: Federal Reporting Entity- **Tab B —Pro forma Disclosures on the Federal Reserve provided by Treasury¹**

MEETING OBJECTIVES

- To discuss draft pro forma disclosures of information on the Federal Reserve provided by Treasury staff

BRIEFING MATERIAL

The transmittal memorandum includes a discussion of issues and recommendations beginning on page 3 under Staff Analysis and Recommendations. A full list of Questions for the Board appears on page 5. In addition, the following items are attached:

- Attachment 1: Proposed pro forma disclosures provided by Treasury staff.
- Appendix 1: Relevant Excerpts from the Draft ED

You may electronically access all of the briefing material at <http://www.fasab.gov/board-activities/meeting/briefing-materials/>

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

BACKGROUND

At the December meeting the Board requested that Treasury representatives present pro forma presentation and disclosures regarding the Federal Reserve based on applying the draft ED requirements.

Certain Board members believed the interpretation of the proposed ED requirements and ultimately how they would affect the display and disclosures about an entity such as the Federal Reserve would be an important consideration during deliberations.

NEXT STEPS

Based on the Board's discussion of the pro forma disclosures of information on the Federal Reserve provided by Treasury staff, and further discussions, the Board will direct staff if additional work or revisions are necessary in the government-wide area.

MEMBER FEEDBACK

If you require additional information or wish to suggest another alternative not considered in the staff proposal, please contact staff as soon as possible. In most cases, staff would be able to respond to your request for information and prepare to discuss your suggestions with the Board, as needed, in advance of the meeting. If you have any questions or comments prior to the meeting, please contact me by telephone at 202-512-5976 or by e-mail at loughanm@fasab.gov with a cc to paynew@fasab.gov.

Staff Analysis

The draft pro forma disclosure of information on the Federal Reserve was provided by Treasury staff. However, there will be representatives from both the Federal Reserve and Treasury present at the meeting to answer questions.

We anticipate the following representatives:

Federal Reserve

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

Treasury

Mark Reger
Deputy Assistant Secretary
Accounting Policy

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

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

Appendix 1 contains relevant excerpts from the Draft ED. As you are aware, core entities are consolidated whereas non-core entities are subject to disclosures after considering the factors and objectives provided in the standard. The standard also provides examples of the types of information that may meet the objectives and provide the necessary understanding of the non-core entity’s relationship, activities, and future exposures.

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

Question 1 for the Board:

Does the Board believe the Treasury’s pro forma disclosure of information regarding the Federal Reserve meets the objectives established for non-core entity disclosures in the Draft ED? Specifically does it provide information to meet the following objectives?

- a. **Relationship:** The nature of the federal government’s relationship with the non-core entity or entities.
- b. **Relevant Activity:** Nature and magnitude of relevant activity during the period and balances at the end of the period.
- c. **Future exposures:** A description and, if possible, quantification, of the federal government’s exposure to gains and losses from the past or future operations of the non-core entity.

Staff notes that the pro forma note discloses

“The following condensed Federal Reserve Banks’ Combined Statements of Condition and Combined Statements of Income and Comprehensive Income are prepared in accordance with the *Financial Accounting Manual for Federal Reserve Banks* (FAM), which is an accrual basis of accounting. The primary difference between FAM and Financial Accounting Standards Board generally accepted accounting principles (GAAP) is the presentation of all SOMA securities holdings at amortized cost rather than fair value presentation required by GAAP.”

Staff has presented Issue 3 *Basis of Accounting for Disclosures Regarding Non-core Entities* in Tab C- Government-wide for discussion of whether the Board believes the basis of accounting for disclosures regarding non-core entities should address entities that may prepare reports on a comprehensive basis of accounting other than GAAP. However if the Board wishes to ask specific questions to the Federal Reserve representatives regarding this topic, it might be best to do so during this session.

Question 2 for the Board:

Does the Board have any questions regarding the Federal Reserve Bank’s use of a comprehensive basis of accounting other than GAAP and differences that should be considered?

Question 3 for the Board:

Does the Board have any comments about the pro forma disclosure or specific questions for the Treasury or Federal Reserve representatives?

Questions for the Board

1. Does the Board believe the Treasury's pro forma disclosure of information regarding the Federal Reserve meets the objectives established for non-core entity disclosures in the Draft ED? Specifically does it provide information to meet the following objectives?
 - a. **Relationship:** The nature of the federal government's relationship with the non-core entity or entities.
 - b. **Relevant Activity:** Nature and magnitude of relevant activity during the period and balances at the end of the period.
 - c. **Future exposures:** A description and, if possible, quantification, of the federal government's exposure to gains and losses from the past or future operations of the non-core entity.

2. Does the Board have any questions regarding the Federal Reserve Bank's use of a comprehensive basis of accounting other than GAAP and differences that should be considered?

3. Does the Board have any comments about the pro forma disclosure or specific questions for the Treasury or Federal Reserve representatives?

#. Federal Reserve Banks¹

The Federal Reserve Banks (FRBs) are part of the Federal Reserve System, which serves as the nation's central bank and was created by Congress under the Federal Reserve Act of 1913. The FRBs are considered to be independent because they are not included in the federal budget, and the federal government neither has an ownership interest nor does it exercise control. Supervision and control of the FRBs is exercised by a board of directors, of which three are appointed by the Board of Governors of the Federal Reserve System, and six directors are elected by member banks.² In addition, the Board of Governors exercises general supervision of the FRBs.

The central bank is responsible for operating a nationwide payments system, distributing the nation's currency and coin, supervising and regulating bank holding companies and state-chartered banks that are members of the System, serving as fiscal agents of the U.S. Treasury, and providing a variety of financial services for the Treasury, other government agencies, and other fiscal principals. The FRBs are reimbursed for substantially all services provided as fiscal agents. In addition, their payment services to depository institutions are priced to fully recover costs as specified in the Monetary Control Act. The FRBs process federal payments and deposits to the Treasury General Account (which functions as the Government's checking account for deposits and disbursements), service Treasury securities, and act as the federal government's bank.

The FRBs hold Treasury securities, government-sponsored enterprise debt securities, and federal agency and government-sponsored enterprise mortgage-back securities in the System Open Market Account (SOMA) for the purpose of conducting monetary policy, and earn interest income on these assets. Liabilities consist of Federal Reserve notes (currency) and deposits for depository institutions and the Treasury, specifically the General and Supplementary Financing accounts.

The Federal Reserve Board requires each FRB to distribute its residual earnings, after providing for the costs of operations, payment of dividends and the amount necessary to equate surplus with capital paid-in, to the Treasury as Interest on Federal Reserve Notes. If the FRBs earnings during the year are not sufficient to provide for the costs of operations, payment of dividends, and equating surplus and capital paid-in, payments to the Treasury are suspended.

The following condensed Federal Reserve Banks' Combined Statements of Condition and Combined Statements of Income and Comprehensive Income are prepared in accordance with the *Financial Accounting Manual for Federal Reserve Banks* (FAM), which is an accrual basis of accounting. The primary difference between FAM and Financial Accounting Standards

¹ Highlighted text is from the Federal Government Financial Statements.

² Member banks include all national banks and any state-chartered banks that apply and are approved for membership.

Board generally accepted accounting principles (GAAP) is the presentation of all SOMA securities holdings at amortized cost rather than fair value presentation required by GAAP.

Federal Reserve Banks
Condensed Combined Statements of Condition
(in billions)

	12/31/2010	12/31/2009	
Assets			
Gold certificates ¹	11.0	11.0	included
Special drawing rights certificates ¹	5.2	5.2	included
Treasury securities, net ^{1,2}	1,067.0	806.0	included
Government-sponsored enterprise debt securities, net	153.0	167.4	new
Federal agency and government-sponsored enterprise mortgage-backed securities, net	1,004.7	918.9	new
Other assets	187.0	326.5	new
Total assets	2,427.8	2,235.0	new
Liabilities			
Federal Reserve notes, net of F.R. Bank holdings	941.6	887.8	new
Reverse repurchase agreements	59.7	77.7	new
Deposits	985.0	977.0	new
U.S. Treasury General Account & Supplementary Financing Account ¹	340.7	191.6	included
Other liabilities	47.8	49.6	new
Total liabilities	2,374.8	2,183.8	new
Capital accounts			
Total capital	53.0	51.3	new
Total liabilities and capital	2,427.8	2,235.0	new

1. Transactions occur with the Government.

2. Face value of the securities net of premiums and discounts, excluding accrued interest. Government wide financial statements include accrued interest.

Federal Reserve Banks
Condensed Combined Statements of Income and Comprehensive Income
(in billions)

	12/31/2010	12/31/2009	
Interest income			
Treasury securities, net ¹	26.4	22.9	new
Government-sponsored enterprise debt securities, net	3.5	2.0	new
Federal agency and government-sponsored enterprise mortgage-backed securities, net	44.8	20.4	new
Other interest income	8.2	17.8	new
Total interest income	<u>82.9</u>	<u>63.1</u>	new
Total Interest and operating expenses	8.1	9.1	
Total non interest income (loss)	6.9	(0.6)	new
Comprehensive income prior to distribution	81.7	53.4	new
Payments to U.S. Treasury as interest on Federal Reserve notes¹	79.3	47.4	included

1. Transactions occur with the Government.

The audited financial statements of the Federal Reserve Banks and the FAM are available at http://www.federalreserve.gov/monetarypolicy/bst_fedfinancials.htm.

Tab B- Appendix 1—Excerpts from the Government-wide portion of the ED

Government-wide GPFFR Consolidation and Disclosure

Core entities

52. The Statement provides for consolidation¹ of core entities' financial statements to facilitate an assessment of the financial position of the federal government and the cost of operations financed by taxpayers. Consolidation aggregates the individual financial statements of entities comprising a reporting entity and results in presentation of information for a single economic entity representing core taxpayer supported activities, resources, and obligations where accountability rests with the Congress and the President.
53. Core entities as defined herein are considered federal entities and should apply GAAP as defined in SFFAS 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*.
54. SFFAS 34 recognizes that a limited number of federal entities prepare and publish financial reports pursuant to the accounting and reporting standards issued by the Financial Accounting Standards Board (FASB). SFFAS 34 provides that GPFFRs prepared in conformity with accounting standards issued by the FASB also may be regarded as in conformity with GAAP. The consolidated government-wide entity should consolidate component reporting entity financial statements for core entities prepared in accordance with SFFAS 34 without conversion for any differences in accounting policies among the entities.

Non-core entities

55. Maintaining a distinction between the finances of core entities and non-core entities will more effectively meet federal financial reporting objectives. However, federal financial reporting objectives cannot be met without information regarding non-core entities.
56. For those organizations classified as non-core entities, this Statement provides for judgment by the preparer in determining the appropriate disclosures based on the factors and principles provided herein.

¹ Consolidation is a method of accounting that combines the accounts of those entities line by line on a uniform basis of accounting and eliminates balances and transactions among the entities. For selected financial statements such as the statement of budgetary resources, a combined financial statement which does not eliminate balances and transactions among the entities is acceptable.

57. Non-core entities need not be grouped by type and no distinction is made by type for purposes of determining the appropriate presentation or disclosure. Disclosures regarding these types of entities and any other types of entities identified as non-core should be provided in accordance with Disclosures for Non-core Entities as detailed in par. 59 to 60 below after considering the factors listed in par. 58.

Factors in Determining Non-Core Entity Disclosures

58. Materiality is an overarching consideration in financial reporting. Preparers should consider both qualitative and quantitative materiality in determining non-core entity disclosures. Beyond materiality, the following factors² should be considered in making judgments about the extent of appropriate non-core entity disclosures:
- a. **Relevance to reporting objectives of the core entity** - Significance of the non-core entity in light of the reporting objectives. This would include the significance of the balances and/or information regarding results of operations and financial position to meeting the operating performance and stewardship reporting objectives.
 - b. **Nature and magnitude of the potential benefits or risks/exposures associated with the relationship**- Information is needed to provide an understanding of the potential financial impact, including financial-related exposures to potential gain and risk of loss, to the core entity resulting from the entity's operations.
 - c. **Organization views/perspective**- How the non-core entity itself accounts for or reports on its relationship with the federal government. For example, whether the organization views itself as an extension of the federal government or operationally independent of the President and the Congress may influence the amount of information disclosed.
 - d. **Complexity of the relationship**- The more complex relationships would involve more detailed disclosures to ensure the relationship is understood by the readers.
 - e. **Extent to which the information interests, or may be expected to interest, a wide audience** - Due to the sensitivity, materiality of the transactions, media attention, or other reasons, interested parties may expect some disclosure regarding the organization or its relationship with the federal government.

² The factors are presented in a list for consideration in the aggregate; no individual weights should be assigned or interpreted.

- f. ***Extent to which there are no alternative sources of reliable information-*** An objective of general purpose federal financial reporting is to meet the needs of users who may have limited access to information or statements and lack the ability to demand the desired information.

Disclosures³ for Non-core Entities

59. Both qualitative and quantitative factors should be considered in determining whether a non-core entity should be presented separately due to its significance or aggregated⁴ with other non-core entities. For each significant entity and aggregation of entities, disclose information to meet the following objectives:
- a. ***Relationship:*** The nature of the federal government's relationship with the non-core entity or entities.
 - b. ***Relevant Activity:*** Nature and magnitude of relevant activity during the period and balances at the end of the period.
 - c. ***Future exposures:*** A description and, if possible, quantification, of the federal government's exposure to gains and losses from the past or future operations of the non-core entity.
60. Examples of information⁵ that may meet the above objectives and provide the necessary understanding of the non-core entity's relationship, activities, and future exposures specific to the federal government include but are not limited to:
- a. The name and description of the non-core entity
 - b. The nature of the relationship between the federal government and the non-core entity including any control or influence over the non-core entity and/or the percentage of ownership interest and voting rights, including key statutory or other legal authorities relating to potential financial impacts
 - c. For intervention actions, the primary reasons for the intervention and a brief description of the federal government's plan relative to operating or disposing of the entity (including timeframes) and/or a statement that the intervention is not expected to be permanent
 - d. A description and summary of assets, liabilities, revenues, expenses, gains, and losses recognized in the financial statements of the core entity as a consequence

³ These may include disclosures required by other standards.

⁴ Aggregation may be based on non-core entity type, class, investment, or a particular event deemed significant by the preparer. The goal would be concise, meaningful and transparent disclosures.

⁵ No individual example is itself a required disclosure nor are the examples required in the aggregate. Therefore, the examples are not alternatives or substitutes one for another. Rather, a disclosure that provides meets the objectives in paragraph 59 should be provided.

of transactions with or interests in the non-core entity and the basis for determining the amounts reported

- e. Summary financial statements, condensed financial information for the non-core entity (e.g. assets, liabilities, fund balances, total expenditures and sources of revenues), or key indicators of financial health and changes in financial health. For example, if the federal government's risk of exposure is significant, then a set of summary financial statements may be appropriate, whereas if the exposures are limited then key indicators of financial impacts with selected financial information (net position and net results) might be appropriate.
 - f. A general reference to non-core entity financial statements and how they can be obtained
 - g. Key terms of contractual agreements regarding potential financial impacts (including those terms of the arrangements to provide financial support and liquidity, including events or circumstances that could expose the federal government to a loss)
 - h. The nature of, and changes in, the risks associated with the control of or other involvement with the entity during the period
 - i. The amount that best represents the federal government's maximum exposure to gain or loss from its involvement with the non-core entity, including how the maximum exposure to gain or loss is determined. If this cannot be quantified, that fact should be disclosed.
 - j. Other information that would provide an understanding of the potential financial impact, including financial-related exposures to potential gain and risk of loss to the government-wide reporting entity, resulting from the non-core entity
61. Non-core entity information disclosed in the government-wide report should be reported on accrual based standards provided in generally accepted accounting principles for its specific type of entity.⁶This includes generally accepted accounting principles for any domain (FASAB, Governmental Accounting Standards Board, or Financial Accounting Standards Board).
62. Although information for the same reporting period as the government-wide reporting entity is preferable, it is not mandatory; particularly if deemed not preferable from a cost-benefit perspective. If a non-core entity's reporting period

⁶ Core government entities should apply the GAAP hierarchy established in SFFAS 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*.

differs from the government-wide reporting entity's and it is not cost-beneficial to align the reporting periods, financial information disclosed for the non-core entity should be for a reporting period ending within the government-wide reporting entity's reporting period.

63. Any significant changes in information occurring from the non-core entity's reporting date to the government-wide reporting entity's reporting date should be disclosed.