Federal Accounting Standards Advisory Board

December 1, 2011

Memorandum

To: Members of the Board

From: Eileen W. Parlow, Assistant Director

Through: Wendy M. Payne, Executive Director

Subj: Earmarked Funds – **TAB E**[1]

MEETING OBJECTIVES

To reach agreement on the issues listed below. As a result of the decisions made at the December 2011 meeting, staff expects to be able to present a preballot draft Statement of Federal Financial Accounting Standards (SFFAS) to members for consideration at or before the February 2012 Board meeting.

Issues for Board decisions:

1. How to guide decision makers so that some component entities report information on earmarked funds[2] relating to the statement of changes in net position on the face of the statement.
2. Whether to include the option for an alternative format (parenthetical display within the line item titles) for component entity reporting on the face of the financial statements (balance sheet, or balance sheet plus statement of changes in net position (see item (1) above).
3. Whether the effective date should be the current fiscal year (FY), with early implementation permitted (or not permitted).

[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.

[2] Although the Board reached consensus on a new term for "earmarked funds" (the new term will be "funds from dedicated collections") this document uses the existing term to avoid confusion.

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BRIEFING MATERIAL

This transmittal memorandum includes a discussion of issues and recommendations. In addition, the following item is attached.

Attachment: Staff draft SFFAS with tracked changes[3]

Note: The attached staff draft SFFAS includes edits recommended by members and staff for clarity. It does <u>not</u> include changes to the exposure draft (ED) that will be made based upon the Board's decisions on the issues that are presented in this memorandum.

BACKGROUND

At the October meeting, staff presented a summary and analysis of responses received on the Earmarked Funds exposure draft (ED). Most of the proposals in the ED, such as a new term for "earmarked funds," received concurrence from the majority of the respondents and were not flagged for discussion by members or staff.

The primary open item for discussion was whether to require component entities to report on earmarked funds on the face of the statement of changes in net position or whether to permit reporting of this information in a note. The ED asked respondents for comments on a minority proposal that component entities should not be required to display information on earmarked funds on the face of the balance sheet and statement of changes in net position and that disclosure in the notes is sufficient. A majority of respondents agreed with this proposal, primarily because presenting too much information on the face of the statements makes them unreadable, and because the notes are subject to audit, the information in the notes should be as reliable as the information presented on the face of the statements.

Based on the feedback from respondents, staff recommended that component entities should be required to continue to display disaggregated information for earmarked funds net position on the face of the balance sheet, and should be permitted to display information on earmarked funds related to the statement of changes in net position in the notes. A majority of members approved this proposal. However, several members asked that staff develop draft language that would guide decision makers towards the Board's intent that certain component entities continue to report on the face of the statement of changes in net position. The Board requested draft language for three options:

A. Language in the basis for conclusions to explain the Board's intent regarding the alternatives for display

[3] Board members preferring a "clean copy" of the staff draft SFFAS should request one from Terri Pinkney at 202-512-7350 or pinkneyt@fasab.gov.

B. An addition to the accounting standards that would provide factors for component entities to consider when deciding among alternatives for display.

C. An addition to the accounting standards that would require component entities with the government's major earmarked funds to continue to display on the face of the Statement of Changes in Net Position.

In addition, the Board decided that it would address the two other open items after it reaches consensus on the above issue. The two other open items are: (a) whether to retain the optional reporting format (parenthetical amounts in the line item titles) and (b) the effective date of the new requirements.

NEXT STEPS

If the Board reaches agreement on the above issues, staff will prepare a preballot draft SFFAS for Board review at or before the February 2012 meeting.

STAFF ANALYSIS AND RECOMMENDATIONS

1: How to guide decision makers so that certain component entities report information on earmarked funds relating to the statement of changes in net position on the face of the statement.

Staff has developed the three options that were identified by the Board at the October meeting and provided a staff analysis and recommendation for this issue. The three options identified by the Board are:

A. An addition to the basis for conclusions (BfC) to encourage agencies with the government's largest programs funded with dedicated collections to report on the face of the statement of changes in net position
B. An addition to the standard providing factors for agencies to consider when deciding among alternatives for display
C. A 50% requirement (or a requirement citing the "predominant source of funding") in the standard regarding reporting amounts related to the statement of changes in net position for component entities

In addition, the Board agreed that staff should develop a draft requirement that component entities should have a reference to the earmarked funds note on one or more line items of the statement of changes in net position if not reporting amounts on the face of the statement. Such a requirement could be combined with any of the three options above.

Option A: Draft language for the BfC

The following draft BfC would reflect Option A above.

Staff recommends that members read the following paragraphs in their entirety, rather than focusing on the revisions, because they describe factors considered significant by the Board members in developing the proposals presented in the ED.

A21. Members of the task force expressed concerns regarding the understandability of the display of separate amounts on the face of the component entity financial statements for funds from dedicated collections and all other funds, as currently required by SFFAS 27. The task force believes that this adds complexity to an already challenging financial presentation. Further, it may prevent display of comparative financial statements on the same page. The task force believed~~s~~ that all information concerning funds from dedicated collections in the component entity financial statements should be disclosed in the notes. A majority of the respondents to the exposure draft also supported the Board's minority proposal to permit component entities to report all information on these funds in the notes.

A22. The Board believes that component entity financial statements need not display funds from dedicated collections and all other fund totals separately on each line item, provided that certain key data remains on the face of the statements. Component entity financial statements must be read with the understanding that they provide information about a single component of the federal government. Each component acts as an agent of that government and restrictions are placed on the use of most funds available to agencies whether the funds are from dedicated collections or not. While special accountability for the use of funds can be conveyed through component entity reports by presenting information on significant individual funds, the cumulative financial implications of total funds from dedicated collections are best understood from the government-wide perspective since the focus is on intra-governmental borrowing.

A23. However, the Board believes that users may be misled if a component entity has no information on the face of the basic financial statements about the magnitude of funds from dedicated collections that are reserved for use for designated activities, benefits, or purposes. The Board believes that, at a minimum, the balance sheet~~s and statements of changes in net position~~ should parenthetically disclose for key line items (cumulative results of operations~~,~~ and unexpended appropriations ~~net position), total financing sources, net cost of operations, and changes in net position)~~ the dollar amounts associated with funds from dedicated collections.

a. For reporting on amounts relating to net position on the balance sheet, ~~C~~component entities may either continue the current presentation under SFFAS 27 (using separate lines or columns), or adopt the alternative parenthetical presentation of dollar amounts for ~~these key line items~~ the components of net position on the face of the balance sheet ~~financial statements~~.

b. For reporting on amounts related to the statement of changes in net position, component entities may continue the current presentation under SFFAS 27 (reporting on the face of the statement in separate lines or columns), adopt the alternative presentation of dollar amounts (parenthetically within the line item titles) for key line items,[4] or report those amounts in the notes. However, it is the Board's intent that component entities report amounts separately on the face of the statement of changes in net position when the component entity's:

[4] Key line items are: cumulative results of operations: beginning balance, total financing sources, net cost of operations, and ending balance; unexpended appropriations: beginning balance, total budgetary financing sources, and ending balance

i. revenues and other financing sources are predominantly funds from dedicated collections, or

ii. funds from dedicated collections are likely to be of immediate concern to constituents, politically sensitive, or controversial.

Illustrative financial statements may be found at Appendix C.

Option B: Draft language for the standard on factors to consider

The following new paragraph would reflect this option.[5] This paragraph could be placed directly following paragraph 19, which describes financial statement presentation for component entities.

[19a] Deciding whether to present information about funds from dedicated collections on the face of the statement of changes in net position requires judgment. The preparer should consider both quantitative and qualitative criteria. Acceptable criteria include but are not limited to:

1. quantitative factors such as
    a. the percentage of the reporting entity's revenues from dedicated collections or
    b. cumulative results of operations from such funds; and
2. qualitative factors such as
    a. whether a fund from dedicated collections is of immediate concern to constituents of the fund,
    b. whether it is politically sensitive or controversial,
    c. whether it is accumulating large balances, or
    d. whether the information provided in the financial statements would be a primary source of financial information for the public.

For example, the Social Security and Medicare programs are of immediate concern to constituents of those programs; both programs have a direct current or future impact on the majority of the general public.

Option C: A 50% rule in the standard regarding options for the statement of changes in net position reporting for component entities

[19a] Component entities should report on the face of the statement of changes in net position if the reporting entity's total revenue and other financing sources for funds from dedicated collections either

1. constitute 50% or more of the reporting entity's total revenue and other financing sources, or

[5] Staff note: This draft language is modeled after existing paragraph 24 of SFFAS 27, which describes factors for agencies to consider in selecting individual funds to be reported on individually.

2. the reporting entity's funds from dedicated collections are likely to be of immediate concern to constituents, politically sensitive, or controversial.

An alternative version of this rule (without a numerical rule) could be:

[19a] Component entities should report on the face of the statement of changes in net position if the reporting entity's total revenue and other financing sources for funds from dedicated collections either

1. constitute the predominant source of the reporting entity's total revenue and other financing sources, or
2. funds from dedicated collections are likely to be of immediate concern to constituents, politically sensitive, or controversial.

The second criterion in each of the above options is necessary in order to accomplish the Board's intent regarding existing funds from dedicated collections, because the Board would prefer that the Department of Health and Human Services (HHS) continue to report on the face of the statement of changes in net position. However, the funding for HHS is predominantly appropriations. For example, in FY 2011, HHS funding sources were $ 637.3 in appropriations and $183.8 billion in dedicated collections.

Additional language for note reference

The following draft language could be combined with any of the above options (A, B, or C):

[19b][6] Component entities that report information relating to line items in the statement of changes in net position in a note should add a reference to the note on the face of the statement for the following line item titles:

1. cumulative results of operations:
    a. beginning balance,
    b. total financing sources,
    c. net cost of operations, and
    d. ending balance
2. unexpended appropriations:
    a. beginning balance,
    b. total budgetary financing sources, and
    c. ending balance

[6] If the Board selects Option A for Issue 1, this paragraph would be numbered 19a rather than 19b.

Staff analysis and recommendation

Staff believes that Options A, B, and C above are likely to produce similar results in that most component entities with relatively immaterial amounts of funds from dedicated collections would report on the face of the balance sheet and not on the face of the statement of changes in net position. However, staff believes that Option B (add factors to consider to the accounting standard) would be the most appropriate option for the following reasons:

- The Basis for Conclusions (Option A) does not constitute authoritative guidance. The purpose of the BfC is to provide a history and background of the development of the SFFAS and to explain factors that the Board considered significant in making decisions about the final issuance. Accordingly, staff believes that the BfC is not the ideal venue for encouraging financial statement preparers to select a particular reporting option when more than one option is permissible under the accounting standards.
- A simple 50% rule (Option C) would exclude Medicare (HHS) because the predominant source of funding for HHS is appropriations from the general fund. Adding an exception to the rule would include HHS in agencies required to report on the face of the statement of changes in net position. However, a percentage rule may present implementation difficulties in situations where the proportion of dedicated collections is close to 50% but may vary from year to year. Because of this, staff recommends the "factors to consider" option in order to allow judgment by preparers. The similar "factors to consider" language in SFFAS 27 for the classification of individual funds in has not caused any questions, problems, or implementation controversies of which staff is aware.

Staff believes that the additional language regarding the note reference is a good addition and should be included regardless of which option the Board selects.

Question 1(a):

Does the Board agree with staff recommendation to use Option B, "factors to consider," regarding component entity reporting on funds from dedicated collections for amounts relating to the statement of changes in net position?

Question 1(b):

Does the Board agree that the additional language requiring references to the note on the face of the statement of changes in net position to be included, regardless of which option is supported by the Board?

2: Whether to include the option for an alternative format (parenthetical display within the line item titles) for component entity reporting.

The Board proposed that component entities would have the option to continue to use the existing format to display information on earmarked funds on the face of the balance sheet and statement of changes in net position, or to use an alternative format with amounts displayed parenthetically in the line title for specific key line items.

A majority of respondents to the ED (64%) agreed with the Board's proposal.

Respondents who disagreed provided comments such as the following:

- The display of the alternative format on the balance sheet is cluttered and confusing. In addition, component entities using one standardized format will help the public users to understand component financial information and facilitate government-wide reporting processes. (Dept. of Justice OIG)

Several respondents agreed with the proposed option, but also stated that they do not plan to use the alternative format. For example:

- Agree. However, Treasury will not be following the alternative format for the following reasons (1) our financial statements are automated. In order to produce the alternative format we would have to produce our financial statements, obtain the amount for earmarked, revise our crosswalk, have our programmers hardcode the amount (high risk for us) in the title line, and rerun the financial statements in the alternative format. (2) this is more confusing as we now have dollar amounts in the title line. (3) we will now need auditor coverage over title lines. (Treasury Dept.)

Staff analysis and recommendation

At the October meeting, staff recommended no changes to the Board's proposal to add an additional display format of parenthetical amounts, because the alternative display is optional. One member indicted a preference for deleting this option, but indicated that it is not important enough to warrant spending much time debating.

Existing requirements do not restrict the format that agencies may use to report on the face of the statements. Accordingly, staff believes that the alternative format is already permissible under existing standards, and that this concern might be addressed by deleting reference to the alternative format from the proposed standard but retaining the examples of parenthetical reporting in the Appendix.

Staff recommends the following language for the BfC:

> The exposure draft included an optional format for component entities to report on dedicated collections on the face of financial statements using parenthetical amounts within line item titles. The Board believes that because existing requirements do not restrict the format that agencies may use to report on the

face of the statements, no changes are needed to the standard for this option to be permitted. The illustrative financial statements at Appendix C display several ways that amounts could be displayed, including parenthetical amounts within line item titles. Appendix C is not intended to be all inclusive and other acceptable alternatives may be developed by preparers.

Question 2:

Should the final standard omit mention of the alternative format in the standard but include the alternative format (parenthetical display) for component entities in the illustrations that were included in the appendix of the ED?

3: Whether the effective date should be the current fiscal year, with early implementation permitted (or not permitted).

79% of the respondents to the ED agreed with the proposed effective date of the current fiscal year.

Respondents that agreed with the proposed effective date generally believe that the proposed amendments do not require significant changes to the component financial statements.

Respondents that disagreed with the proposed effective date generally believe that the effective date should be fiscal year (FY) 2013 and provided the following rationale:

- We believe that a required effective date of FY 2012 is too soon to implement changes for interim reporting because paragraph 15 on Page 19 requires that in the year the standard becomes effective, entities should restate prior period amounts displayed on the face of the financial statements. The first quarter interim financial statements for FY 2012 are prepared as comparative statements and are due to the Office of Management and Budget on January 23, 2012. Therefore, we believe that FASAB should delay the required effective date to FY 2013. (Dept. of Labor)
- While we expect to be able to implement the proposed changes quickly, we do not agree with the proposed effective date. An effective date of "periods beginning after September 30, 2011" would require application of these requirements in the first quarter 2012 financial statements due to the Office of Management and Budget in mid January, 2012. Implementation by this date is not feasible. The implementation date selected should allow time for the issuance of the standard by the Board, issuance of preliminary guidance by OMB and Treasury, and careful review of reporting options by agencies.

  We recommend that the effective date be changed to "periods beginning after September 30, 2012, with early implementation permitted." This will give agencies with numerous and complex earmarked funds adequate time to review disclosure options. (SEC)

At the October 2011 meeting, some members noted that FASAB requirements are generally intended to address fiscal year-end reporting. The OMB representative confirmed that agencies' quarterly reporting requirements are for unaudited information that is provided only to the Office of Management and Budget.

The members decided to postpone a decision on this item until the Board reaches a consensus on 1 and 2 above.

Staff analysis and recommendation:

Staff believes that the proposed amendments to SFFAS 27 do not impose a significant reporting burden, and some of the provisions are intended to reduce the reporting burden. Accordingly, staff recommends no change to the Boards' original proposed effective date of FY 2012.

Question 3:

Does the Board agree with staff recommendation for no change in the proposed effective date of FY 2012?

QUESTIONS

Question 1 (a) Does the Board agree with staff recommendation to use Option B, "factors to consider," regarding component entity reporting on funds from dedicated collections for amounts relating to the statement of changes in net position?

Question 1 (b) Does the Board agree that the additional language requiring the note references should be included, regardless of which option is supported by the Board?

Question 2: Should the final standard omit mention of the alternative format in the standard but include the alternative format (parenthetical display) for component entities in the illustrations that were included in the appendix of the ED?

Question 3: Does the Board agree with staff recommendation for no change in the proposed effective date of FY 2012?