Federal Accounting Standards Advisory Board

August 16, 2012

Memorandum

To: Members of the Board

From: Julia E. Ranagan, Assistant Director

Monica R. Valentine, Assistant Director

Through: Wendy M. Payne, Executive Director

Subject: Risk Assumed – **Tab E**[1]

MEETING OBJECTIVES

To obtain member's views on the issues presented in this memo so that staff can begin addressing these issues in a timely manner.

BRIEFING MATERIAL

- ❒ Staff Memo
- ❒ Attachments (Recommended Reading for Context and More Information)
  - o Attachment 1 – Excerpts from Agency Financial Reports
  - o Attachment 2 – Excerpts from the Financial Report of the U.S. Government
  - o Attachment 3 – Examples of Disclosures in Foreign Federal Financial Statements
  - o Attachment 4 – Office of Management and Budget (OMB) Schedule of Spending Guidance
- ❒ Appendices (Optional Reading for Reference and More Information)
  - o Appendix 1 – FASAB Standards on Contingencies
  - o Appendix 2 – FASAB Standards on Insurance and Guarantees
  - o Appendix 3 – May 9, 2012 Meeting on Commitments and Obligations
  - o Appendix 4 – June 12, 2012 Meeting on Insurance and Guarantees

[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

The risk assumed project is taking a broad look at all types of transactions and events that may result in future outflows as a result of the federal government's mission, operations, and current or past actions. Staff held its first two task force meetings on two explicit groupings of risk assumed: (1) commitments and obligations, including contracts, grants, and treaties on May 9, 2012, and (2) insurance and guarantees on June 12, 2012. As a result of those meetings and related research, staff has identified several issues that it would like to discuss with the board that are detailed in the staff analysis and recommendation section that follows.

Member feedback on the issues presented will direct staff on the next steps to take in the project.

STAFF ANALYSIS AND RECOMMENDATIONS

1: CURRENT RISK ASSUMED REPORTING – Current risk assumed reporting on insurance and guarantees is inconsistent and, in some cases, duplicative

Statement of Federal Financial Accounting Standards (SFFAS) 5, *Accounting for Liabilities of the Federal Government*, contains standards for liabilities of the federal government, including (1) contingencies and (2) insurance and guarantee programs other than social insurance and loan guarantees.[2]

Optional Reading for Context

- Appendix 1 – FASAB Standards on Contingencies at pages A159 through A162 for an excerpt of the contingencies standards from SFFAS 5, paragraphs (pars.) 35 – 42, and the basis for conclusions (BfC), pars. 144 – 147.
- Appendix 2 – FASAB Standards on Insurance and Guarantees at pages A163 through A177 for an excerpt of the insurance and guarantee standards from SFFAS 5, pars. 97 – 121, and the BfC, pars. 185 – 193).

SFFAS 5 requires insurance and guarantee programs, other than social insurance and loan guarantees, to:

a) recognize a liability for unpaid claims incurred, resulting from insured events that have occurred as of the reporting date. This liability is to include items that are known with certainty, items that have been incurred but not yet reported (IBNR), and an accrual for contingent liabilities that are probable and measurable. Life insurance programs are to recognize a liability for future policy benefits (a liability to current policyholders that relates to insured events, such as death or disability) in addition to the liability for unpaid claims incurred (SFFAS 5, par. 104); **and,**

b) disclose the amount of additional risk assumed—beyond that which is already recognized as a liability—in required supplementary information (RSI). The standard does not define risk assumed but states that it is generally measured by the present value of unpaid expected losses net of associated premiums, based on the risk inherent in the insurance or guarantee coverage in force. (SFFAS 5, Par. 105)

[2] Accounting and reporting for social insurance is addressed primarily in SFFAS 17, *Accounting for Social Insurance*, and SFFAS 37, *Social Insurance: Additional Requirements for Management's Discussion and Analysis and Basic Financial Statements*. Accounting and reporting for all federal loan guarantee programs is addressed in SFFAS 2, *Accounting for Direct Loans and Loan Guarantees*.

Two of the federal government's largest insurers—the Pension Benefit Guaranty Corporation (PBGC) and the Federal Deposit Insurance Corporation (FDIC)—prepare financial statements using principles issued by the Financial Accounting Standards Board (FASB). SFFAS 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*, par. 9, permits this practice, stating that "general purpose financial reports prepared in conformity with accounting standards issued by the FASB also may be regarded as in conformity with GAAP for those entities that have in the past issued such reports."

FASB's *Accounting Standard Codification*© (ASC), Sections 450-20–Loss Contingencies, and 944-40–Claim Costs and Liabilities for Future Policy Benefits, provide standards for recognizing and disclosing loss contingencies, including the risk of loss from catastrophes assumed by property and casualty insurance entities.[3] PBGC and FDIC apply ASC© 450-20 by recognizing probable and measurable losses as liabilities and disclosing information about reasonably possible losses in the notes to the financial statements.

SFFAS 5, par. 106, provides additional disclosures for insurance and guarantee programs administered by government corporations, specifically stating "when financial information pursuant to FASB's standards on federal insurance and guarantee programs conducted by government corporations is incorporated in general purpose financial reports of a larger federal reporting entity, the entity should report as RSI what amounts and periodic change in those amounts would be reported under the 'risk assumed' approach referred to in [par. 105]. In other words, in addition to the liability for unpaid claims from insured events that have already occurred (including any contingent liability that meets criteria for recognition), such reporting entities should also report as RSI risk assumed information."

As discussed further in the second issue of this memo (beginning on page 12), par. 106 of SFFAS 5, in effect, requires larger federal agencies to report information that is reported as a note disclosure in the general purpose financial report of a government corporation as RSI when consolidating the information. This practice has resulted in inconsistent and, in some cases, duplicative reporting, as detailed on the pages that follow.

[3] Accounting and reporting of contingencies related to the risk of loss that is assumed by a property and casualty insurance entity or reinsurance entity when it issues an insurance policy covering risk of loss from catastrophes is more specifically addressed in ASC© 944-40; however, entities most often reference ASC© 450-20 as the source of guidance for its loss contingencies note. FASB has a current project on insurance contracts to improve, simplify, and converge the financial reporting requirements for insurance contracts.

Recommended Reading for More Information

- Attachment 1 – Excerpts from Agency Financial Reports beginning on page A3 for excerpts of contingency and risk assumed reporting in agency financial reports.
- Attachment 2 – Excerpts from the Financial Report of the U.S. Government beginning on page A99 for excerpts of contingency and risk assumed reporting in the CFR.

As part of a review of agency financial reports and the consolidated financial report of the U.S. Government (CFR), staff noted the following examples of inconsistency:

➔ **PBGC risk assumed information is reported in the CFR in more than one place (reasonably possible contingencies note and risk assumed RSI)**

Excerpt from Risk Assumed reported in CFR as RSI

Risk Assumed Information as of September 30, 2011, and 2010

(In billions of dollars)	2011	2010
Present value of unpaid expected losses, net of associated premiums:		
Pension Benefit Guaranty Corporation	250.2	190.0
Department of Agriculture	8.8	7.5
National Credit Union Administration	7.4	7.5
All other	0.9	2.0
Total	267.3	207.0
Periodic changes in risk assumed amounts:		
Pension Benefit Guaranty Corporation	60.2	21.8
Department of Agriculture	1.3	(1.4)
National Credit Union Administration	(0.1)	1.6
All other	(1.1)	0.4
Total	60.3	22.4

Excerpt from Note 22: Contingencies reported in CFR

Insurance Contingencies

At the time an insurance policy is issued, a contingency arises. The contingency is the risk of loss assumed by the insurer, that is, the risk of loss from events that may occur during the term of the policy. The Government has insurance contingencies that are reasonably possible in the amount of $267.0 billion as of September 30, 2011, and $224.2 billion as of September 30, 2010. The major programs are identified below:

- PBGC reported $250.2 billion and $190.0 billion as of September 30, 2011, and 2010, respectively, for the estimated aggregate unfunded vested benefits exposure to the PBGC for private-sector single-employer and multiemployer defined pension plans that are classified as a reasonably possible exposure to loss.
- Of the remaining $16.8 billion for 2011, FDIC reported $16.5 billion as of September 30, 2011, and $34.2 billion as of September 30, 2010, for identified additional risk in the financial services industry that could result in additional loss to the Deposit Insurance Fund should potentially vulnerable insured institutions ultimately fail. Actual losses, if any, will largely depend on future economic and market conditions.

➔ **FDIC risk assumed-type information is reported in two places in the CFR's contingencies note, but nothing is reported for FDIC under risk assumed in the CFR's RSI.**

Excerpt from Note 22: Contingencies reported in CFR

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Deposit Insurance

Deposit insurance covers all types of deposit accounts such as checking, NOW and savings accounts, money market deposit accounts, and certificates of deposit (CDs) received at an insured bank, savings association, or credit union. The insurance covers the balance of each depositor's account and shares, dollar-for-dollar, up to the insurance limit, including principal and any accrued interest through the date of the insured financial institution's closing. As a result, the Government has the following exposure from Federally-insured financial institutions:

- FDIC has estimated insured deposits of $6,777.0 billion as of September 30, 2011, and $5,423.0 billion as of September 30, 2010, for the Deposit Insurance Fund.
- NCUA has estimated insured shares of $782.4 billion as of September 30, 2011, and $750.9 billion as of September 30, 2010, for the National Credit Union Share Insurance Fund.

Excerpt from Risk Assumed reported in CFR as RSI

Risk Assumed Information as of September 30, 2011, and 2010

(In billions of dollars)	2011	2010
Present value of unpaid expected losses, net of associated premiums:		
Pension Benefit Guaranty Corporation	250.2	190.0
Department of Agriculture	8.8	7.5
National Credit Union Administration	7.4	7.5
All other	0.9	2.0
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Department of Agriculture	1.3	(1.4)
National Credit Union Administration	(0.1)	1.6
All other	(1.1)	0.4
Total	60.3	22.4

(Note: nothing is reported for FDIC)

➔ **National Credit Union Administration (NCUA) risk assumed information only reports total insurance in force of $795.3 billion and the same contingency amounts that are reported in Note 7: Insurance and Guarantee Program Liabilities for the Share Insurance Fund (SIF).**

Excerpt from Note 7: Other Liabilities reported in NCUA's Annual Report

The activity in the Insurance and Guarantee Program Liabilities from supervised credit unions and AMEs for the years ended December 31, 2011 and 2010 was as follows:

(Dollars in thousands)	For the Year Ended December 31, 2011	For the Year Ended December 31, 2010
Beginning balance	$ 1,225,281	$ 715,846
Reserve Expense (Reduction)	(525,678)	737,596
Insurance losse claims paid	(105,099)	(277,801)
Net Estimated Recovery/Claim on AMEs	12,113	49,640
Ending balance	$ 606,617	$ 1,225,281

The Insurance and Guarantee Program Liabilities at December 31, 2011 and 2010, were comprised of the following:

- Specific reserves were $16.4 million and $173.5 million, respectively. Specific reserves are identified for those credit unions where failure is imminent or where additional information is available that may affect the estimate of losses
- General reserves were $590.2 million and $1,051.8 million, respectively.

In addition to these recorded contingent liabilities, additional adverse performance in the financial services industry could result in additional losses to the NCUSIF. The ultimate losses for insured credit unions will largely depend upon future economic and market conditions, and accordingly, could differ significantly from these estimates.

Excerpt from RSI reported in NCUA's Annual Report

Risk Assumed Information

Insurance and Guarantee Program Liabilities

Insurance in Force

As of December 31, 2011, the aggregate outstanding insured shares of the insured credit unions were approximately $795.3 billion. This amount represents the maximum potential future guarantee payments that the NCUSIF could be required to make under the share insurance program, without consideration of any possible recoveries. Additionally, pursuant to Section 217 (b)(2)(A) of the FCU Act, to the extent that the required funding for the guarantee obligations exceeds the funds available in the TCCUSF, the NCUSIF will provide the necessary funds. These amounts bear no relationship to the NCUSIF's anticipated losses.

As discussed previously herein, NCUA identifies credit unions at risk of failure through the supervisory and examination process, and estimates losses based upon economic trends and credit unions' financial condition and operations. NCUA also evaluates overall economic trends and monitors potential credit union system-wide risk factors, such as increasing levels of consumer debt, bankruptcies, and delinquencies. NCUA applies the CAMEL rating system to assess a credit union's financial condition and operations. The CAMEL rating system is a tool to measure risk and allocate resources for supervisory purposes. NCUA periodically reviews the CAMEL rating system to respond to continuing economic and regulatory changes in the credit union industry. The aggregate amount of reserves recognized for credit unions at risk of failure was $606.6 million and $1.23 billion as of December 31, 2011 and 2010, respectively. At December 31, 2011 and 2010, the general reserves were $590.2 million and $1,051.8 million, respectively. At December 31, 2011 and 2010, the specific reserves resulting from supervised credit unions' failures were $16.4 million and $173.5 million, respectively.

➔ **NCUA risk assumed information reported in the CFR is made up of the reserve amounts in NCUA's SIF and Stabilization Fund as of September 30. The reserve amounts as of December 31 are reported as liabilities in NCUA's financial statements.**

Excerpt from Risk Assumed reported in CFR as RSI

Risk Assumed Information as of September 30, 2011, and 2010

(In billions of dollars)	2011	2010
Present value of unpaid expected losses, net of associated premiums:		
Pension Benefit Guaranty Corporation	250.2	190.0
Department of Agriculture	8.8	7.5
National Credit Union Administration	7.4	7.5
All other	0.9	2.0
Total	267.3	207.0
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Pension Benefit Guaranty Corporation	60.2	21.8
Department of Agriculture	1.3	(1.4)
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All other	(1.1)	0.4
Total	60.3	22.4

Excerpt from support from NCUA for the amounts reported to Treasury for the CFR[4]

Fund	as of 9/30/11 (in millions)	
Share Insurance Fund Reserves	$ 998.5	
Stabilization Fund Reserves	6,365.5	
Total Reserves	$7,364.0	≈ $7.4 billion

The total amount reported as risk assumed and insurance and guarantee program liabilities for NCUA in the CFR as of September 30, 2011, was $7.4 billion.

Reserve amounts from NCUA's SIF and Stabilization Fund Published Financial Statements

Fund	as of 12/30/11 (in millions)
Share Insurance Fund Reserves	$ 606.6
Stabilization Fund Reserves	2,944.2
Total Reserves	$3,550.8

[4] Per NCUA supporting documents FASAB staff received from Treasury's Financial Management Service on August 7, 2012.

The total amount reported as risk assumed and insurance and guarantee program liabilities in NCUA's published financial statements for the Share Insurance Fund and Stabilization Fund as of December 31, 2011, was $3.5 billion. The significant difference in the reserve balance between September 30, 2011, and December 31, 2011, of $3.8 billion or 52%, is due to program changes within the Stabilization Fund that apparently occurred during that timeframe.

➔ **Farm Credit System Insurance Corporation (FCSIC) does not disclose an amount for reasonably possible in its financial report.**

While FCSIC is required to maintain a reserve of two percent of outstanding insured obligations, includes a detailed discussion of risk management in its annual report, and discloses the total amount of insured obligations ($184.2 billion) in Note 1: Insurance Fund – Statutory Framework, the extent of FCSIC's reporting of estimated insurance obligations is that management is not aware of any probable insurance payments to be made in the future. This disclosure is made in its summary of significant accounting policies note (see below). There is no discussion of reasonably possible insurance payments to be made in the future, or whether the reserve of two percent of insured obligations is believed to be sufficient to cover those payments.

Excerpt from FCSIC's Note 2: Summary of Significant Accounting Policies

Liability for Estimated Insurance Obligations—The liability for estimated insurance obligations is the present value of estimated probable insurance payments to be made in the future based on the Corporation's analysis of economic conditions of insured System banks.

The insured System banks' primary lending markets are borrowers engaged in farming, ranching, and producing or harvesting of aquatic products, and their cooperatives. Financial weaknesses in these market segments and the effect of general market conditions on the System's borrowers could adversely affect the banks' financial condition and profitability. Insured System banks also face risks from changing interest rate environments and the need to maintain ongoing access to financial markets. Adverse changes in the financial condition and profitability of insured System banks resulting from increased levels of credit, financial, or other risks could occur in the future which would have a material effect on the liability for estimated insurance obligations.

The Corporation actively monitors the creditworthiness and financial position of the insured System banks. Management is not aware of any events or circumstances at this time which would require a liability for estimated insurance obligations to be recorded.

➔ **Export-Import Bank provides export-credit insurance to exporters but there is no risk assumed information reported as RSI in its annual report or the CFR.**[5]

Export-Import Bank's Export Credit Insurance Program helps U.S. exporters sell their goods overseas by protecting them against the risk of foreign-buyer or other foreign-debtor default for political or commercial reasons, allowing them to extend credit to their international customers. Insurance policies may apply to shipments to one buyer or many buyers, insure comprehensive (commercial and political) credit risks or only political risks, and cover short-term or medium-term sales. Export-Import Bank reported $9.3 billion in outstanding insurance at the end of fiscal year 2011.

Export-Import Bank's Annual Report contains extensive reporting on its loans, guarantees, and insurance in its management's discussion & analysis (MD&A) and notes to the financial statements, including schedules of authorized loans, guarantees, and insurance; risk of foreign currency fluctuation; repayment risk; concentration risk; operational risk; organizational risk; and interest risk, but it does not report "risk assumed" in RSI in conformance with the guidance in SFFAS 5. There is no information reported in the CFR on export insurance.

Staff Recommendation

The risk assumed project was initially undertaken to determine what additional information should be reported by the federal government about the significant risks it assumes beyond what is currently required for insurance and guarantee programs. However, as a result of the inconsistent and, in some cases, duplicative reporting of risk assumed information for insurance and guarantee programs, which is already required, staff believes it would be appropriate to revisit the current standards on risk assumed for insurance and guarantee programs in a more timely manner. Therefore, staff recommends that it begin drafting revised guidance for insurance and guarantee programs to clarify current reporting requirements and not wait until a comprehensive standard on reporting for all risks assumed is developed. Staff would utilize the insurance and guarantee task force members to develop recommendations and proposed options that would be presented to members for consideration at a future board meeting. Staff would continue researching other risks assumed by the federal government while developing revised standards for insurance and guarantee programs.

[5] Source: Export-Import Bank 2011 Annual Report; available online at http://www.exim.gov/about/reports/ar/; last accessed June 4, 2012.

Question 1

Does the board approve the staff recommendation to begin developing revised standards for insurance and guarantee programs to address the inconsistent and duplicative reporting in a more timely manner (i.e., as the first phase of the overall project)?

(Note: Members are not being asked what the revised standards should look like at this point; this is a preliminary poll of the board to determine if members desire more timely results in the area of risk assumed reporting for insurance and guarantee programs to address the inconsistent and duplicative reporting that currently exists. The majority view of the board in response to this first question will direct staff how soon to return to the board with recommendations and proposed options for reporting on risks assumed by insurance and guarantee programs.)

2: CURRENT STANDARDS – Existing FASAB standards on risk assumed overlap standards for contingency reporting.

Members of the federal financial management community have expressed concern over what they perceive as a lack of clarity between FASAB standards on contingent liabilities and risks assumed for federal insurance and guarantee programs, most recently at the task force meetings on commitments and obligations and insurance and guarantees (see Appendices 3 and 4, beginning on pages A178 and A199 respectively, for the minutes from those meetings). Based on a review of current reporting, existing standards, and input from federal preparers and auditors, staff believes that FASAB standards on risk assumed do fail to adequately differentiate between contingencies and risk assumed for the various insurance and guarantee programs, leading to the inconsistent and, at times, duplicative reporting documented in the first issue on pages 3 through 11.

Contingency Standards

SFFAS 5, pars. 35 through 42, contain FASAB's standards on contingencies.

SFFAS 5, par. 38, requires that a contingent liability be **recognized** when (1) a past event or exchange transaction has occurred, (2) a future outflow or other sacrifice of resources is probable, **and** (3) the future outflow or other sacrifice of resources is measurable. Par. 39 states that the specific liability may be a specific amount or a range of amounts. If some amount within the range is a better estimate than any other amount within the range, that amount is recognized. If no amount within the range is a better estimate than any other amount, the minimum amount in the range is recognized and the range and a description of the nature of the contingency should be disclosed.

SFFAS 5, par. 40 requires that a contingent liability should be **disclosed** if any of the three conditions for liability recognition listed above are not met and there is at least a reasonable possibility that a loss or an additional loss may have been incurred. Par. 41 states that the disclosure for contingent liabilities that are reasonably possible should include the nature of the contingency and an estimate of the possible liability, an estimate of the range of the possible liability, or a statement that such an estimate cannot be made.

SFFAS 5, par. 42 notes that **contingencies classified as remote need not be reported** in general purpose federal financial reports, though law may require such disclosures in special purpose reports. Par. 42 further states that if information about remote contingencies or related to remote contingencies is included in general purpose federal financial reports (e.g., the total face amount of insurance and guarantees in force), it should be labeled in such a way to avoid the misleading inference that there is more than a remote chance of loss of that amount.

The BfC for SFFAS 5, pars. 144 – 146, discuss the board's decision about the amount to be recognized in par. 39. Par. 144 notes that a majority of respondents preferred that the "expected value" be recognized as a liability instead of the minimum amount. However, par. 145 states that the board "noted that it would be difficult to use 'expected value' to pinpoint an estimate within a range. The expected value method would assign a probability percentage to each of the numbers within the range, but these probabilities would usually be difficult to estimate." Par. 146 states that "the majority of the Board preferred the minimum amount because of established use in other accounting standards."

Risk Assumed Standards

SFFAS 5, pars. 105 through 114, contain the bulk of FASAB's standards on risk assumed.

SFFAS 5, par. 105 states that risk assumed information is important for all federal insurance and guarantee programs (except social insurance, life insurance and loan guarantee programs) and is generally measured by the **present value of unpaid expected losses net of associated premiums**, based on the risk inherent in the insurance or guarantee coverage in force.

As noted in the first issue of this staff memo (see page 4), SFFAS 5, par. 106 requires general purpose financial reports of a larger federal reporting entity to **report financial information pursuant to FASB's standards on federal insurance and guarantee programs conducted by government corporations as RSI**. This means that information that is currently being reported as a note disclosure in the general purpose financial report of a government corporation is required to be reported as RSI when the information is consolidated into the general purpose financial report of a larger federal reporting entity.

Par. 111 explains that insurance programs are ongoing and may be viewed as having long-term characteristics. Thus, from a broader, longer-term perspective, the liability to be recognized, and the amount to be reported as risk assumed in supplementary information, may be conceptually different and materially different from each other. From the broader perspective, **risk assumed would be a longer-term measure and a probabilistic estimate of future costs of these programs**.

The BfC for SFFAS 5, pars. 189 and 190 further explains the board's intent for reporting risk assumed. The board noted that they considered two measurement perspectives for reporting risk assumed and decided that the risk assumed amount should be a broader and longer-term measure of the government's potential cost for on-going insurance programs beyond the cost of coverage outstanding during the reporting year. The board noted that **this approach to risk assumed could be regarded as an indicator of the "fair" or "full cost" premium that should be charged if taxpayers are not to subsidize the**

program. This measure would be a probabilistic estimate of the expected cost under certain assumed economic factors.[6]

Contingencies versus risk assumed

Insurance and guarantee coverage in effect as of the reporting date results in an obligation to provide assets or services to another entity in the future, but there is uncertainty about the possibility of loss; the uncertainty will ultimately be resolved when one or more future events occur or fail to occur. Therefore, staff believes that **all** future claims for insurance and guarantee coverage in effect as of the reporting date are contingent upon a future event that is probable, reasonably possible, or remote.

Where the two standards are in agreement:

If the contingent liability is probable and measurable, FASAB standards on contingencies require that the liability be recognized. FASAB standards on insurance and guarantees also require that a probable and measurable contingent liability be recognized.

Where the two standards are not in agreement:

If the contingent liability is reasonably possible and measurable, FASAB standards on contingencies require that the reasonably possible liability be disclosed in a note to the basic financial statements. Such disclosure should include the nature of the contingency and an estimate of the possible liability, an estimate of the range of the possible liability, or a statement that such an estimate cannot be made. FASAB standards on insurance and guarantees require that reasonably possible contingencies be reported as risk assumed in RSI (although the terms "contingencies" and reasonably possible are not used in the standards on risk assumed) through reporting of the present value of unpaid expected losses net of associated premiums using a probabilistic estimate.

If the contingent liability is remote, FASAB standards on contingencies states that the contingency need not be reported in general purpose federal financial reports, and if it is, it should be labeled in such a way to avoid the misleading inference that there is more than a remote chance of loss of that amount. FASAB standards on insurance and guarantees, as further described in the BfC, require that remote contingencies be reported as risk assumed in RSI (although the terms "contingencies" and remote are not used in the standards on risk assumed) through reporting

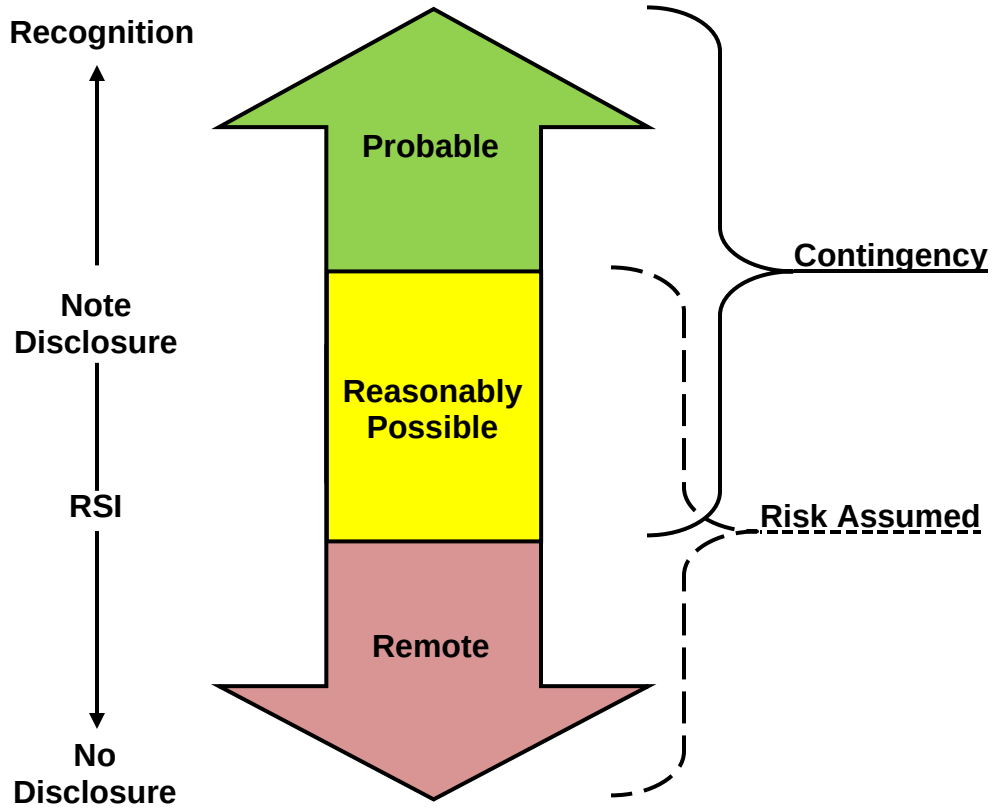
[6] A probabilistic method of estimation uses assumed economic factors to generate a range of estimates and their associated probabilities.

of the present value of unpaid expected losses net of associated premiums using a probabilistic estimate.

In addition, estimates of reasonably possible insurance losses that are reported in the notes to the financial statements in general purpose federal financial reports of government corporations are currently required to be reported as RSI when consolidated into the general purpose federal financial report of a larger reporting entity.

Ignoring measurement differences, **Diagram 1** below illustrates the potential for overlap in reporting reasonably possible contingent liabilities and risk assumed:

Diagram 1: Potential Overlap in Standards on Contingencies and Risk Assumed



In summary, contingent liabilities are required to be reported in basic information—either recognized as a liability in the financial statements, if probable and measurable, or disclosed in a note to the basic financial statements if probable and not measurable, or reasonably possible. Risk assumed information is required to be reported as RSI, a lower reporting category for communicating important information. Therefore, staff believes it may be more appropriate for some reasonably possible insurance and guarantee payments to be disclosed in the notes to the financial statements with reporting on other contingencies, rather than in RSI.

If probable insurance and guarantee payments are recognized as a liability in the financial statements, and reasonably possible insurance and guarantee payments are disclosed in the notes to the financial statements, it is possible that the present value of remote insurance and guarantee payments would be immaterial and not warrant disclosure as RSI. Therefore, staff questions the benefits of risk assumed reporting for some insurance and guarantee programs and recommends amending SFFAS 5 to require a more robust discussion of the risk assumed by some insurance and guarantee programs in the contingencies note disclosure rather than as RSI. This would be consistent with how agencies that apply FASB standards report insurance risks assumed and provide for discussion of this important information in the notes to the basic financial statements rather than RSI.

RSI versus disclosure

When SFFAS 5 was originally issued in September 1995, par. 106 required risk assumed information to be reported as required supplementary stewardship information (RSSI), a category that is unique to federal financial reporting. After FASAB eliminated the use of RSSI to report information about weapons systems when it issued SFFAS 23, *Eliminating the Category "National Defense Property, Plant, and Equipment*," the board decided to review the classification of all RSSI required by federal accounting standards.

While deliberating SFFAS 25, *Reclassification of Stewardship Responsibilities and Eliminating the Current Services Assessment*,[7] which was issued in July 2003, the board discussed whether to reclassify risk assumed information as RSI or basic. The following paragraphs from the BfC explain the board's thinking on the issue at that time:

> 20. The Board agreed that information about Risk Assumed should be RSI rather than an integral part of the basic financial statements, because the amounts are not sufficiently reliable and measurement methods are still experimental. This information is potentially valuable, but it is not yet a suitable basis for recognition or disclosure.[5] The Office of Management and Budget (OMB), the Government Accountability Office (GAO), and the Congressional Budget Office (CBO) have considered the use of Risk Assumed information as a basis for budgeting for insurance programs. These agencies have concluded that more experience is needed before the measurements can be regarded as sufficiently reliable for budgeting. Similar considerations lead the FASAB to conclude that information about Risk Assumed should be included in financial reports as RSI, at least until agencies and auditors have more experience with this information.

[7] Available online at http://www.fasab.gov/pdffiles/handbook_sffas_25.pdf; last accessed August 9, 2012.

21. The Board believes that analogies with insurance offered by private insurers, (where, for example, an expected premium deficiency on long-duration contracts such as life insurance is recognized), may be misleading due to differences in the length of the policy coverage, nature of insured risk, or other relevant variables. The Board believes that additional guidance from FASAB on definition and measurement of "Risk Assumed" would be necessary before it would be feasible to require recognition or disclosure of this information as an integral part of the basic financial statements. Developing and promulgating such guidance would require a separate project. Before the Board undertakes such a project, it is desirable to encourage continued improvement in agencies' data systems and modeling capabilities to support reporting Risk Assumed. The RSI requirement has the effect of providing this encouragement in an appropriate, cost-beneficial manner. The Board notes that the "state of the art" for such projections is constantly evolving. Should the Board in the future decide that it would be desirable to develop more specific criteria for reporting Risk Assumed, the Board will be able to learn from this ongoing experience.

[5] FASAB uses the term "disclosure" to refer to information that is not recognized on the face of the basic financial statements but is regarded as an integral part of the basic financial statements, essential for fair presentation in conformity with generally accepted accounting principles (GAAP). Normally such disclosures are presented in footnotes, but federal accounting standards published by FASAB do not currently prescribe the format for presentation of such disclosures. GAAP does not prohibit formatting or combining pieces of information in appropriate ways to direct the reader's attention, provided that the results are not misleading.

Staff believes that most agencies' data systems and modeling capabilities have improved since SFFAS 25 was issued. FDIC and PBGC currently report estimates of reasonably possible insurance payments in their financial statements and receive unqualified opinions on those estimates. In addition, the development and use of reasonable estimates have become more standard for all agencies because, in many instances, accelerated due dates for financial statement reporting do not allow time for actual data to be recorded and agencies have had to improve their systems and get better at developing estimates as a result.

However, there are several issues that will need to be addressed by the board if it decides to pursue disclosure of risks assumed by some insurance and guarantee programs in the notes to the financial statements rather than RSI, including the following:

<u>Measurement</u>

- whether to allow for note disclosure of a probabilistic estimate of risk assumed that would include an estimate for remote liabilities (this would be in conflict with SFFAS 5, pars. 39 and 42; also, pars. 144 – 146 of the BfC state that the board was not comfortable using an expected

value approach to measure contingencies)

- whether to instead require an estimate of the expected cash flows for some programs (this could affect the reliability and estimability of the information and require the information to be reported as RSI).

Timing of Underlying Events

- whether to develop contingency standards that differentiate insured and other events that have already occurred (e.g., lawsuit, hazardous spill, flood, etc.) from insured and other events that have not yet occurred (estimated pension plan terminations, estimated loan defaults, estimated bank failures, etc.)

Type of Insurance

- how current reporting for different types of insurance might be affected by the standards to be developed (e.g., terrorism events may be less reliably estimated than pension plan terminations) and whether the resulting distinction would be meaningful

One option to address the above issues is to have contingency disclosures that are specific to insurance and guarantee programs and differentiate between insured events that have already occurred and those that have not yet occurred (the event that initially creates the present obligation is the insurance contract, leading to a contingent liability). Developing a separate disclosure framework for insurance and guarantee programs would help eliminate the current confusion in reporting of insurance and guarantee programs.

Staff Recommendation

Since the board continues to allow government corporations (and other entities that have done so in the past)[8] to primarily apply standards issued by FASB, and the most significant government insurers are government corporations, staff recommends that SFFAS 5 be revised to address the inconsistency in reporting of major insurance and guarantee programs between FASAB and FASB reporting entities.

To most appropriately address the inconsistency, staff recommends that the board develop a separate disclosure framework for insurance and guarantee programs that would specifically resolve issues with reporting that have surfaced in the years since SFFAS 5 was issued. As part of the separate disclosure framework, staff also recommends pursuing disclosure of risks assumed by some insurance and guarantee programs in the notes to the financial statements rather than as RSI.

[8] SFFAS 34, par. 9.

Question 2(a)

Does the board approve the staff recommendation to amend SFFAS 5 to address the inconsistency in reporting of major insurance and guarantee programs between FASAB and FASB reporting entities?

Question 2(b)

Does the board approve the staff recommendation to develop a separate disclosure framework for insurance and guarantee programs?

Question 2(c)

Does the board approve the staff recommendation to pursue disclosure of risks assumed by some insurance and guarantee programs in the notes to the financial statements rather than as RSI?

3: BROADER SCOPE – The term "risk assumed" may not be the appropriate terminology to address broad reporting on future outflows of the federal government.

The primary objective of the risk assumed project is to study the significant risks assumed by the federal government and develop (a) definitions of risk assumed, (b) related recognition and measurement criteria, and (c) disclosure and / or RSI guidance that federal agencies can apply consistently in accordance with GAAP.

At the recommendation of two members at the February 2011 technical agenda-setting session, the board agreed to approach the project on risks assumed by the federal government from a broad perspective to include commitments and/or inter-governmental dependency, and then narrow down as appropriate.

Staff has been researching the broad types of exposures that would result in future outflows for the federal government, including the following:

- Insurance and guarantees, including pension , flood, crop, deposit, share, terrorism risk, airline war risk, overseas investment, and veterans life insurance, loan guarantees, and agricultural guarantees;

- Direct loans and securitizations, including agricultural, student, and small business loans and mortgage and government-sponsored enterprise (GSE) securitizations;

- Market and other financial-related risk, such as market risk (interest rate risk, currency risk, or other price risk), liquidity risk, risk premium, volatility risk, default risk, credit risk (credit default risk, concentration risk, or country risk), systemic risk, and derivatives;

- Entity, dependency, and strategic risk, including operational risk, enterprise risk, intergovernmental financial and programmatic dependency, public debt held by foreign countries, intergenerational debt, opportunity cost, and related-party involvements;

- Entitlement programs, such as Social Security, Medicare, Medicaid, Temporary Assistance to Needy Families (TANF), Supplemental Security Income (SSI), Supplemental Nutrition Assistance Program (SNAP, formerly known as Food Stamps), Unemployment Insurance (UI), Child Support Enforcement and Family Support, Grants for Specified Energy Property, Grants for Low Income Housing Projects, and the Agricultural Disaster Relief Fund (DRF);

- Commitments and obligations, including contracts, grants, treaties and other international agreements, undelivered orders, and long-term leases;

- National defense, security and disaster response, such as natural disasters (e.g., disaster relief), environmental remediation (e.g., oil spills), terrorism, war (e.g., national defense and cost of active war), and security for mass transit;

- Technology, including cyber security and changing technology (e.g., global drone proliferation and deferred technology); and,

- Other potential effects on future outflows, such as regulatory actions, Government-Sponsored Enterprises (non-securitized), Economic Stabilization and Recovery, and recipient behavior (e.g., risk-taking).

Federal agencies are beginning to focus more on risk management (e.g., appointing chief risk officers and creating offices specifically focused on risk management) and incorporate discussions of the above exposures in their general purpose federal financial reports, but most discussions are far from robust.

As noted in staff's April 2012 update to the board, staff has focused on two particular groupings of risk assumed first: (a) insurance and guarantees and (b) commitments and obligations (e.g., grants, contracts, treaties, and other undelivered orders beyond grants and contracts). These two groupings were chosen to be addressed first because of the explicit nature of the exposures. Staff held two separate task force meetings on commitments and obligations and insurance and guarantees on Wednesday, May 9, 2012, and Tuesday, June 12, 2012, respectively.

Optional Reading for More Information

- Appendix 3 – May 9, 2012 Meeting on Commitments and Obligations beginning on page A178 for detailed minutes from the meeting.
- Appendix 4 – June 12, 2012 Meeting on Insurance and Guarantees beginning on page A199 for detailed minutes from the meeting.

At those first two task force meetings, staff requested feedback on the following draft definition of risk assumed developed by staff:

> The possible or probable risk of future outflows that the federal government is expected to incur, in the judgment of a reasonable person, as a result of its mission, operations, and current or past actions. The population of risk assumed may be determined through a review of varied information, including, but not limited to, obligations incurred, commitments undertaken, contracts signed, agency policy, legislative history, economic projections, programmatic responsibility, and risk analysis.

> Risk assumed is generally measured by the present value of unpaid expected outflows net of associated inflows (e.g., premiums), if any, based on management's best estimate of the total risk assumed.
>
> (Source: Staff Draft, April 2012)

The above draft definition was intended to be broad and address reporting about all future outflows, not just those related to insurance and guarantee programs.

While the insurance and guarantees task force participants were more accepting of the definition because they were already familiar with the term "risk assumed" and the use of present value (PV) to measure risk assumed, the commitments and obligations task force meeting found the term "risk assumed" and PV to be troubling. Comments and concerns about the draft definition included the following:

- "risk" has a bad connotation and when making a grant, spending in the future is what was intended and is actually a good thing; the term should be more descriptive such as "expected outflows of obligated grants;"

- future outflows are being exchanged for goods and/or services so they are not considered losses like those arising through risk assumed related to insurance and guarantees;

- it is not clear how the obligated amount for a grant or contract would be different than a contingency, whereby the government has an obligation that is contingent upon receiving the goods and/or services;

- the term "risk assumed" is archaic, the terminology that will be used should give the reader a better inclination as to what exactly is being reported such as "fiscal exposure;" and,

- the definition should not refer to PV because PV adds a level of complexity that would not enhance the disclosure (one participant disagreed with this comment, noting that it would seem appropriate to use a relevant discount rate when reporting on multi-year cash flows).

The term "risk assumed" is closely associated with insurance and guarantee programs and risk of loss. As a result, confusion from the community about the true scope of the project and what exactly is intended to be addressed from a broad perspective has led staff to the conclusion that risk assumed is really only one part of a broader scope and a more appropriate term is necessary that would encompass reporting about risks assumed as well as other fiscal exposures that are facing the federal government.

A good example of why staff believes the term "risk assumed" does not apply broadly to other programs would be social insurance. The statement of social insurance is a perfect example of detailed reporting on estimated net future outflows. These outflows are contingent upon many future events including continued authorization and funding of the program and participant eligibility. While this reporting embodies the spirit of reporting on risk assumed, the program is considered a social benefit and not a risk of loss. While there are many risks that affect the program and related future outflows (interest rate, morbidity rate, beneficiary behavior, etc), this program is a long-term commitment to provide retirement and disability benefits, with benefits being provided to society in direct proportion to the costs being incurred, not a risk that would result in a loss to the federal government.

Alternative Project Names

Through communications with members of the federal community and review of federal financial statements and other reports, staff has considered the following alternative project names:

- **Risk Assumed and Other Contingencies**. If the board agrees to pursue broadening contingent liability disclosures to include more forward-looking outflows such as risk assumed as proposed in the second issue above, the disclosures could include a broad spectrum of contingencies that would be reported in a basic financial statement, note disclosure or as RSI, depending on the factors to consider in distinguishing basic information from RSI.[9] The word "contingent," defined in the most generic sense, means "dependent on something else." Almost all future outflows of the federal government are contingent upon something (e.g., grant payments are contingent upon the grantee incurring eligible expenses, contract payments are contingent upon satisfactory delivery of goods and/or services, disaster relief is contingent upon a disaster occurring, entitlement payments are contingent upon participants meeting eligibility requirements, etc.).

- **Risk Assumed and Other Fiscal Exposures**. The term "fiscal exposures" has long been used by the Government Accountability Office (GAO) to describe the range of federal responsibilities that obligate the government to future spending or create an expectation of

[9] See Table 1: Factors to Consider in Distinguishing Basic Information from RSI in Statement of Federal Financial Accounting Concepts (SFFAC) 6, *Distinguishing Basic Information, Required Supplementary Information, and Other Accompanying Information*, available online at http://www.fasab.gov/pdffiles/handbook_sffac_6.pdf; last accessed August 8, 2012.

future spending.[10] This term found favor with several task force participants.

- **Risk Assumed and Other Off-Balance-Sheet Exposures.** The term "off-balance-sheet exposure" is used in FDIC note 14: Commitments and Off-Balance-Sheet Exposure (see page A17) to disclose total estimated insured deposits ("insurance in force").

- **Risk Assumed and Other Possible Future Costs**. The National Science Foundation (NSF) uses the term "possible future costs" in Note 1P: Contingencies and Possible Future Costs (see page A92) with respect to its disclosures about the potential for termination claims if a cooperative agreement is terminated and the possibility that NSF may choose to accept responsibility for environmental cleanup in Antarctica.

Staff Recommendation

Staff recommends renaming the project on risk assumed to more appropriately encompass the scope of reporting on risks assumed as well as other risks and fiscal exposures that are facing the federal government. Staff favors the title "Risk Assumed and Other Contingencies" because staff believes it would be broad enough to encompass discussions about all types of future outflows and risk beyond risk assumed such as outstanding commitments, active treaties, changing economic conditions, market risk, enterprise risk, and systemic risk.

Question 3

Does the board approve the staff recommendation to rename the project "Risk Assumed and Other Contingencies" to encompass reporting about risks assumed as well as other risks and fiscal exposures that are facing the federal government?

[10] For example, see GAO Report D-03-213, *Fiscal Exposures: Improving the Budgetary Focus on Long-Term Costs and Uncertainties*; available online at http://www.gao.gov/new.items/d03213.pdf ; last accessed August 8, 2012.

4: CURRENT COMMITMENT AND CONTINGENCY REPORTING – Current reporting on commitments and contingencies is inconsistent and, in many cases, not very comprehensive.

Recommended Reading for More Information

- Attachment 1 – Excerpts from Agency Financial Reports beginning on page A3 for excerpts of contingency and risk assumed reporting in agency financial reports.
- Attachment 2 – Excerpts from the Financial Report of the U.S. Government beginning on page A99 for excerpts of contingency and risk assumed reporting in the CFR.

In addition to insurance and guarantee programs, staff has been looking at agency reporting about other explicit commitments and obligations of the federal government that are known at year-end, particularly grants, contracts, and other undelivered orders.

Grants

Grants, except for entitlement and block grants, are generally recorded as budgetary obligations in the financial system when they are awarded to the grantees. However, awarded grants are not recorded as a payable for GAAP reporting until the grantee has reported actual expenses under the grant or a grant accrual is estimated based on grantee expenses incurred but not yet reported. The only information that is typically reported about billions of dollars in outstanding grants is an aggregated number for all grants, contracts, and other undelivered orders in the note to the financial statement (discussed further below).

Entitlement and block grants are generally considered “obligate and pay” which means they are obligated and paid simultaneously; expected payments for entitlement and block grants are not estimated and reported in advance. Two task force participants stated that it would not be worth the exercise to estimate future payments because the programs are required to pay all eligible participants; if the program runs out of money, it has to go back to Congress to request more funding (see pages A188 – A190 for minutes from the meeting).

Furthermore, grantees have long-term expectations about funding that are not recorded as obligations at all because they are not funded. For example, grantees can submit budgets for five years, but only the first year is funded. Information on these grants are reported in the agencies’ grant systems and do not flow to the general ledger, so it would be difficult to extract out-year information for many agencies (see page A192 for minutes from the meeting).

Contracts

Similar to grants, contracts are generally recorded as budgetary obligations in the financial system when they are awarded to the contractors. However, they are not recorded as a payable for GAAP reporting until goods and/or services are actually delivered or, in the case of construction in progress, amounts recorded as payable are based on an estimate of work completed under the contract or the agreement.

Furthermore, multi-year contracts are only funded one year at a time, so obligations that are recorded in the financial system for contracts that span multiple years are limited to the first year.

Other Undelivered Orders

Undelivered orders are goods and services ordered and obligated that have not been received. This includes any orders for which advance payment has been made but for which delivery or performance has not yet occurred.[11]

Undelivered orders includes obligated grants for which expenses have not been incurred by the grantee, obligated contracts for which the contracted goods and/or services have not yet been delivered and accepted, and other miscellaneous obligations such as purchase orders and bulk purchase agreements.

SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*, par. 79, requires that the amount of budgetary resources obligated for undelivered orders at the end of the period be disclosed.

In conformance with SFFAS 7, OMB Circular A-136, *Financial Reporting Requirements*,[12] requires agencies to "disclose the amount of budgetary resources obligated for undelivered orders at the end of the period."

Therefore, undelivered orders are generally disclosed in the notes to the financial statements in one aggregated amount, without any accompanying narrative that explains what the undelivered orders are composed of (grants, contracts, and other) or the extent of the federal government's commitments to multiple-year contracts and grants.

Undelivered Orders reported in the CFR are over $1.3 trillion (see page A109) and generally represent a significant majority of agencies' total unexpended

[11] Source: GAO-05-734SP–A Glossary of Terms Used in the Federal Budget Process; available online at www.gao.gov/new.items/d05734sp.pdf; last accessed April 10, 2012.
[12] Most recent version, dated August 3, 2012, available online at http://www.whitehouse.gov/sites/default/files/omb/assets/omb/circulars/a136/a136_revised_2012.pdf; last accessed August 10, 2012.

appropriations, and this amount only relates to amounts remaining from what was obligated during the year, not the total related grant or contract funds expected to eventually be awarded over the life of the grant program or contract.

Based on a review of the CFR and agency financial reports, staff noted the following examples of reporting about undelivered orders:

- The majority of agencies disclose one total aggregated amount for undelivered orders, without any further discussion of what types of obligation make up those undelivered orders (e.g., grants, contracts, etc.). For example, the Department of Defense (DoD) disclosed the following, which is typical of federal agency reports:

  30. Undelivered Orders, Unpaid, End of Period

  An unpaid undelivered order exists when a valid obligation has occurred and funds have been reserved but the goods or services have not been delivered. Undelivered orders for the periods ended September 30, 2011 and 2010, were $42,011 million (unaudited) and $43,445 million (unaudited), respectively.

  (Note: The CFR reports $315.9 billion in undelivered orders for DoD in Note 23: Commitments on page A109).

- The U.S. Agency for International Development reports in its Note 1: Summary of Significant Accounting Policies that "unexpended appropriations are the portion of the appropriations represented by undelivered orders and unobligated balances," but it does not disclose the total amount of undelivered orders anywhere in its financial statements (see page A96).

- The Export-Import Bank of the United States does not mention or disclose the total amount of undelivered orders anywhere in its financial statements.[13] The CFR reports $9.7 billion in undelivered orders for Export-Import Bank in Note 23: Commitments on page A109.

[13] Source: Export-Import Bank 2011 Annual Report; available online at http://www.exim.gov/about/reports/ar/; last accessed June 4, 2012.

Schedule of Spending

Recommended Reading for More Information

- Attachment 4 – OMB's Schedule of Spending Guidance beginning on page A151 for current year guidance on presenting a schedule of spending (SOS) as other accompanying information (OAI).

Beginning with fiscal year 2012, OMB Circular A-136 requires agencies to present an SOS that provides an overview of how and where agencies are spending money.

Task force participants at the May 9, 2012, meeting on commitments and obligations noted that the SOS may address staff's concerns that there is no reporting on outstanding obligations by type of obligation (e.g., grant, contract, etc.).[14]

As noted in the illustrative SOS on the next page, the SOS does require agencies to report how the money was issued (e.g., grants, contracts, financial assistance, loans and guarantees, insurance, interest, etc), but, as noted in the explanatory narrative requirements (see pages A153 – A156), the amounts are to tie to "total spending" (i.e., outlays, money that has gone out the door) plus amounts that are "remaining to be spent" (i.e., unpaid obligations, which would include undelivered orders), not just undelivered orders; there is no required breakout of amounts remaining to be spent by type of obligation.

In addition, the amounts reported in the SOS are again related only to total amounts obligated during the year, not the total related grant or contract funds expected to eventually be awarded over the life of the grant program or contract.

[14] At that meeting, staff had not yet been provided with a copy of the draft plans for the SOS. The draft A-136 was released for comment on June 6, 2012, and the final was issued on August 3, 2012.

Illustrative Schedule of Spending

Agency Name
Schedule of Spending
For the Years Ended September 30, 2xxx (CY) and 2xxx (PY)
in millions

	FY 20XX	FY 20XX
What Money is Available to Spend?		
Total Resources	$X,XXX,XXX	$X,XXX,XXX
Less Amount Available but Not Agreed to be Spent	$XX,XXX	$XX,XXX
Less Amount Not Available to be Spent	$X,XXX	$XXX
Total Amounts Agreed to be Spent	**$X,XXX,XXX**	**$XXX,XXX**
How was the Money Spent?		
*Category**		
Object Class	$XX,XXX	$XX,XXX
Object Class	$XXX,XXX	$XXX,XXX
Object Class	$XXX,XXX	$XXX,XXX
Other	$XX,XXX	$XX,XXX
*Category **		
Object Class	$XXX,XXX	$XXX,XXX
Object Class	$XX,XXX	$XX,XXX
Other	$XX,XXX	$XX,XXX
Total Spending	$XXX,XXX	$XXX,XXX
Amounts Remaining to be Spent	$XX,XXX	$XX,XXX
Total Amounts Agreed to be Spent	**$X,XXX,XXX**	**$XXX,XXX**
Who did the Money go to?		
For Profit	$XXX,XXX	$XXX,XXX
Government	$XXX,XXX	$XXX,XXX
Higher Education	$XX,XXX	$XX,XXX
Individuals	$XXX,XXX	$XXX,XXX
Not-For-Profits	$XX,XXX	$XX,XXX
Other	$XX,XXX	$XX,XXX
Total Amounts Agreed to be Spent	**$X,XXX,XXX**	**$XXX,XXX**
How was the Money Issued?		
Non-Financial Assistance Direct Payments	$XXX,XXX	$XXX,XXX
Contracts	$XXX,XXX	$XXX,XXX
Grants	$XXX,XXX	$XXX,XXX
Loans and Guarantees	$XX,XXX	$XX,XXX
Financial Assistance Direct Payments	$XXX,XXX	$XXX,XXX
Other Financial Assistance	$XX,XXX	$XX,XXX
Insurance	$XX,XXX	$XX,XXX
Interest and Dividends	$XX,XXX	$XX,XXX
Other Payment Types	$XX,XXX	$XX,XXX
Total Amounts Agreed to be Spent	**$X,XXX,XXX**	**$XXX,XXX**

Staff Recommendation:

As discussed in the operating performance and stewardship objectives of federal financial reporting,[15] federal financial reporting should assist report users in evaluating the service efforts, costs, and accomplishments of the reporting entity; the manner in which these efforts and accomplishments have been financed; and the management of the entity's assets and liabilities. In addition, federal financial reporting should assist report users in assessing whether the government's financial position improved or deteriorated over the period and if future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due. Understanding the additional obligations incurred and risks assumed by the nation's government beyond what is reported in traditional federal financial statements is crucial to obtaining a more complete picture of the nation's finances.

Staff recommends that additional reporting on outstanding grants, contracts, and other undelivered orders beyond one aggregate number in the notes to the statements should be pursued.

Question 4(a)

Does the board approve the staff recommendation to pursue reporting on outstanding grants, contracts, and other undelivered orders beyond one aggregate number in the notes to the statements?

Foreign Disclosures

Recommended Reading for More Information

- Attachment 3 – Examples of Disclosures in Foreign Federal Financial Statements beginning on page A112 for examples from Canada and Australia of detailed disclosures about commitments and contingencies, including contractual obligations.

If the board approves the staff recommendation to pursue reporting on outstanding grants, contracts, and other undelivered orders beyond one aggregate number in the notes to the statements, staff is interested in members' preliminary views on how detailed such reporting should be.

[15] SFFAC 1, *Objectives of Federal Financial Reporting*, pars. 14-16; available online at http://www.fasab.gov/pdffiles/handbook_sffac_1.pdf; last accessed August 9, 2012.

To provide some background for the board's discussion on this matter, Attachment 3, Examples of Disclosures in Foreign Federal Financial Statements, beginning on page A112 contains examples from Australia and Canada of detailed disclosures about commitments and contractual obligations.

For example, on page A130, Australia presents a schedule of commitments by type and by maturity. This type of schedule presents all outstanding commitments and then breaks them out by maturity, similar to our note disclosure for capital leases and operating leases.

Another example, on page A115, is Canada's schedule of minimum payments, which shows the minimum amounts required to satisfy obligations under contractual obligations each year from 2012 to 2016, and the total for amounts due in the year 2017 and subsequently. Again, this would be similar to our note disclosure for capital leases and operating leases, but relates to all contractual obligations.

Canada goes on, on pages A116 to A121, to provide a detailed listing of individual contractual obligations (transfer payment agreements, capital assets, purchases and operating leases) by category and by entity. This type of detail may be excessive for all contractual obligations but may be informative for the most significant contracts. Also, including a column that indicates, for each major contractor/grantee, the percentage of revenue provided through contracts/grants with the government over total contractor/grantee revenue would go a long way in reporting on the level of inter-dependency and potential related parties.

Staff Recommendation:

Staff recommends pursuing detailed disclosures about all contractual obligations and other commitments, similar to current disclosures about capital and operating leases.

Question 4(b)

Does the board approve the staff recommendation to pursue detailed disclosures about all contractual obligations and other commitments, similar to current disclosures about capital and operating leases?

Additional Commitments and Contingencies Reporting

Through a review of agency financial reports, staff has determined that additional reporting on commitments and contingencies beyond undelivered orders is inconsistent and, in most cases, not very comprehensive.

Staff believes the lack of consistency and detail in most agency reports is understandable given the minimal guidance provided in SFFAS 5 for disclosing contingencies (see Appendix 1 – FASAB Standards on Contingencies at pages A159 through A162). The examples below merely serve to highlight the diverse reporting among agencies.

The following six agencies reported on some of their contractual obligations and major long-term commitments:

- The Department of Commerce reports the following in relation to its major long-term contracts in Note 16: Commitments and Contingencies (excerpt from Note 16 shown below in thousands):[16]

Commitments:

The Department has entered into long-term contracts for the purchase, construction, and modernization of environmental satellites and weather measuring and monitoring systems. A summary of major long-term commitments as of September 30, 2011 is shown below.

Major Long-term Commitments:

	FY 2011						
Description	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016	Thereafter	Total
Geostationary Operational Environmental Satellites	$ 819,600	$ 817,000	$ 816,900	$ 817,500	$ 562,500	$ 1,233,100	$ 5,066,600
Convergence Satellites	1,160,000	960,000	740,000	610,000	834,500	3,655,000	7,959,500
Polar Operational Environmental Satellites	40,900	40,900	40,900	40,900	22,900	3,000	189,500
Climate Sensors	55,400	51,100	50,600	35,500	25,700	21,400	239,700
Ocean Surface Topography	53,000	29,000	2,000	2,000	1,000	2,000	89,000
Deep Space Climate Observatory	38,300	25,400	3,800	2,400	5,700	7,500	83,100
Other Weather Service	135,518	118,161	104,117	104,225	82,150	82,506	626,677
Other	87	-	-	-	-	-	87
Total	$ 2,302,805	$ 2,041,561	$ 1,758,317	$ 1,612,525	$ 1,534,450	$ 5,004,506	$ 14,254,164

- The Railroad Retirement Board Note 10: Commitments and Contingencies contains the following general statement about "contractual arrangements:"[17]

As of September 30, 2011, the RRB had contractual arrangements which may result in future financial obligations of $29.7 million.

[16] Source: Department of Commerce 2011 Performance and Accountability Report; available online at http://www.osec.doc.gov/ofm/OFM_Publications.htm; last accessed June 4, 2012.
[17] Source: Railroad Retirement Board 2011 Performance and Accountability Report; available online at http://www.rrb.gov/bfo/perf_plans_rpts.asp; last accessed June 4, 2012.

- The Department of Justice's complete Note 16: Contingencies and Commitments (shown below) reports on the estimated range of loss of its contingent liabilities (with no narrative discussion of what the amounts are being accrued for) and additional "firm purchase commitments" for solar panel material as follows:[18]

Note 16. Contingencies and Commitments

	Accrued Liabilities	Estimated Range of Loss	
		Lower	Upper
As of September 30, 2011			
Probable	$ 68,652	$ 68,652	$ 190,144
Reasonably Possible		86,576	135,569
As of September 30, 2010			
Probable	$ 101,760	$ 101,760	$ 214,237
Reasonably Possible		95,585	124,326

Additionally, FPI has entered into firm purchase commitments for solar panel material totaling $36,801 of which $13,129 is to be delivered in FY 2012 and $23,672 is to be delivered in FY 2015.

- The Department of Homeland Security (DHS) reports the following in Note 21: Commitments and Contingent Liabilities:

D. Other Contractual Arrangements

In addition to future lease commitments disclosed in Note 19, the Department is committed under contractual agreements for goods and services that have been ordered but not yet received (undelivered orders) at fiscal year-end. Aggregate undelivered orders for all Department activities are disclosed in Note 30. In accordance with the *National Defense Authorization Act for Fiscal Year 1991* (Pub. L. 101-510), the Department is required to automatically cancel obligated and unobligated balances of appropriated funds five years after a fund expires. Obligations that have not been paid at the time an appropriation is cancelled may be paid from an unexpired appropriation that is available for the same general purpose. As of September 30, 2011, DHS estimates total payments related to cancelled appropriations to be $242 million, of which $111 million for contractual arrangements may require future funding.

TSA entered into a number of Letters of Intent for Modifications to Airport Facilities with 11 major airports in which TSA may reimburse the airports up to 90 percent (estimated total of $1.5 billion) of the costs to modify the facilities for security purposes. These letters of intent (LOI) would not obligate TSA until funds have been appropriated and obligated. An LOI, though not a binding commitment of federal funding, represents TSA's intent to provide the agreed-upon funds in future years if the agency receives sufficient appropriations to cover the agreement. TSA received $200 million in both FY 2011 and FY 2010 (unaudited) to fund LOIs. These funds are available for payment to the airports upon approval by TSA of an invoice for the modification costs incurred. As of September 30, 2011, TSA has received invoices or documentation for costs incurred totaling $4 million for the invoices that have not yet been paid.

[18] Source: Department of Justice 2011 Performance and Accountability Report; available online at http://www.justice.gov/ag/publications.htm; last accessed June 4, 2012.

- In its Note 22: Commitments under HUD's Grant, Subsidy, and Loan Programs, the Department of Housing and Urban Development (HUD) included extensive disclosures on its long-term commitments to provide grants, subsidies, or loans including the following schedule of obligations and contractual commitments (dollars in millions):

	Undelivered Orders				
Programs	Unexpended Appropriations	Permanent Indefinite	Investment Authority	Offsetting Collections	Undelivered Orders - Obligations, Unpaid
FHA	$ 170	$ 212	$ -	$ 1,541	$ 1,923
Section 8 Rental Assistance	10,438	-	-	-	10,438
Community Development Block Grants	18,109	-	-	-	18,109
HOME Partnership Investment Program	4,924	-	-	-	4,924
Operating Subsidies	1,126	-	-	-	1,126
Low Rent Public Housing Grants and Loans	6,788	-	-	-	6,788
Housing for Elderly and Disabled	3,297	-	-	-	3,297
Section 235/236	1,364	1,112	-	-	2,476
All Other	7,857	-	-	-	7,857
Total	$ 54,073	$ 1,324	$ -	$ 1,541	$ 56,938

HUD also discloses in Note 22, that beginning in 1988, Congress began appropriating funds "up-front" for the entire contract term (up to 40 years) in the initial year for Section 8 and Section 235/236 programs, so the undelivered orders of nearly $13 billion for these programs include the maximum amounts available under existing agreements and contracts (see pages A88 – A91).

- The Smithsonian Institution reports the following in relation to its outstanding construction contracts in Note 15: Commitments and Contingencies:[19]

> ***(c) Construction***
>
> The Smithsonian has various commitments related to construction projects in process throughout its museums with significant projects at the National Museum of African American History and Culture ($21.7), National Museum of Natural History ($9.4), the Smithsonian Environmental Research Center ($10.8), and the Arts and Industries Building ($30.1). Remaining commitments under related contracts aggregated approximately $72.0 at September 30, 2011.

Staff believes that the above reporting examples may be due, in part, to the following requirement in OMB Bulletin A-136, Section II.4.3.4:

> In addition to the contingent liabilities required by SFFAS No.5, the following commitments will also be disclosed: (1) an estimate of obligations related to canceled appropriations for which the reporting entity has a contractual commitment for payment, and (2) amounts for contractual arrangements, which may require future financial obligations.

[19] Source: Smithsonian Institution 2011 Financial Statements available online at http://www.si.edu/about/policies/; last accessed June 4, 2012.

This requirement imposed by OMB agrees in concept with what staff recommended above, but does not appear to be complied with by most government agencies since staff did not find similar disclosures in more agency financial reports.

Staff also noted the following examples of inconsistent disclosures:

- DoD recognizes a contingent liability for the difference between the estimated costs incurred to date by contractors and the total amounts authorized to be paid. In Note 15: Other Liabilities, DoD states that it has recognized a contingent liability for estimated future payments which are conditional pending delivery and government acceptance due to the probability that the contractors will complete their efforts and deliver satisfactory products (see page A52).

- DoD classifies its legal contingencies into three buckets with associated dollar amounts: "reasonably possible," "remote," and "unable to determine the probability of loss." The majority of DoD's $12.4 trillion estimate ($12.3 trillion) is in the third ("unable to determine") category (also on page A52).

- DoD discloses its commitments for operating leases in a separate note (Note 25: Other Disclosures) that is near the end of the disclosures and not cross-referenced to anything (see page A53).

- NCUA does not include a general commitments and contingencies note that discloses lease commitments and existence of pending litigation. A brief acknowledgement of loss contingencies is made in Note 1: Summary of Significant Accounting Policies under the heading "Insurance and Guarantee Program Liabilities" (see page A22)

- As noted on page 9, FCSIC's financial report does not include any discussion of reasonably possible insurance payments to be made in the future, or whether the reserve of two percent of insured obligations would be sufficient to cover those payments. There are also no disclosures of other contingencies such as litigation (see page A47).

- The Nuclear Regulatory Commission does not have a general note on commitments and contingencies. It does include a discussion of contingent litigation in Note 1: Summary of Significant Accounting Policies.[20]

- As pointed out on page 24, FDIC reports its insurance in force in Note 14: Commitments and Off-Balance-Sheet Exposure (see page A17).

[20] Source: Nuclear Regulatory Commission 2011 Performance and Accountability Report; available online at http://www.nrc.gov/reading-rm/doc-collections/nuregs/staff/sr1542/; last accessed June 4, 2012.

In addition, FDIC includes an extensive disclosure of systemic risk in Note 16: Systemic Risk Transactions (see page A18 – A20).

- Department of Labor includes a discussion of its concentration of risk in Note 23: Material Concentration of Risk (see page A59).

- The Department of Energy includes an extensive discussion of purchase power and transmission commitments and irrigation assistance, including a schedule of future commitments in its Note 18: Contingencies and Commitments (see pages A61 – A64).

- In its Note 17: Commitments and Contingencies, the Department of Transportation includes disclosures about the pre-authorization of state construction budgets, letters of intent regarding grant agreements, aviation insurance, marine war risk insurance, environmental liabilities and Amtrak (see pages A66 – A70).

- In its Note 28: Commitments and Contingencies, the Department of the Treasury discloses information about treaties and international agreements, loan commitments, callable capital in multilateral development banks, terrorism risk insurance, exchange stabilization agreement, and arrangements to borrow (see pages A85 – A86).

Staff Recommendation

Staff believes that a more detailed disclosure framework for commitments and contingencies would result in more comprehensive disclosures that are more consistent across agencies and would result in the type of reporting that the risk assumed project intended. Therefore, staff recommends that the board pursues development of a detailed disclosure framework for commitment and contingency reporting.

Question 4(c)

Does the board approve the staff recommendation to pursue developing a detailed disclosure framework for commitment and contingency reporting?

Table 1: Summary of Agency Disclosures about Commitments and Contingencies, Undelivered Orders, and Risk Assumed

Agency	FASAB/ FASB	Revenue		Expenses		Report Disclosures[21]	Page
		Amount	Major Types	Amount	Major Types		
Pension Benefit Guaranty Corporation	FASB	$5.8 billion	Investment income and premiums	$8.8 billion	Actuarial losses and losses from financial assistance	$C, **$PC**, **$RP**	A4
Federal Deposit Insurance Corporation (*Deposit Insurance Fund*)	FASB	$16.3 billion	Assessments	($2.9 billion)	Provision for insurance losses (reduction)	$C, **$PC**, **$RP**	A11
National Credit Union Administration (*Share Insurance Fund*)	FASAB	$212 million	Investment income	($400 million)	Provision for insurance losses (reduction)	**$PC**, $RA, $UO	A22
National Credit Union Administration (*Temporary Corporate*	FASAB	$2.3 billion	Premiums and Fees	$124.8 million	Insurance and guarantee loss	**$PC**, $RA, $UO	A29

[21] C = Commitments (other than undelivered orders), O = Other, PC = Probable Contingency, RA = Risk Assumed, RP = Reasonably Possible Contingency, and UO = Undelivered Orders. **Bolded** letter means the disclosures are more informative than those in other agency reports (A bolded "**C**" denotes that the agency reported on more than just leases and undelivered orders. A bolded "**PC**" or "**RP**" denotes that the agency reported on something substantive other than litigation). Underlined letter means the disclosures are less informative than those in other agency reports. "$" means an amount is disclosed in addition to narrative (e.g., $RP).

Table 1: Summary of Agency Disclosures about Commitments and Contingencies, Undelivered Orders, and Risk Assumed

Agency	FASAB/ FASB	Revenue		Expenses		Report Disclosures[21]	Page
		Amount	Major Types	Amount	Major Types		
Credit Union Stabilization Fund)							
Agriculture	FASAB	$159.5 billion	Appropriations	$159.3 billion	"Ensure that All of America's Children Have Access to Safe, Nutritious, and Balanced Meals" and "Assist Rural Communities to Create Prosperity so They Are Self-Sustaining, Repopulating, and Economically Thriving"[22]	$C, $PC, $RA, $RP, $UO	A39
Farm Credit System Insurance Corporation	FASB	$169 million	Premiums and interest income	$3 million	Administrative	$C, $O	A41

[22] Agriculture reports costs by strategic goal in its statement of net costs; it does not report costs by major type (e.g., grant, contract, personnel and payroll, etc.) anywhere in its agency financial report (AFR).

Table 1: Summary of Agency Disclosures about Commitments and Contingencies, Undelivered Orders, and Risk Assumed

Agency	FASAB/ FASB	Revenue		Expenses		Report Disclosures[21]	Page
		Amount	Major Types	Amount	Major Types		
Defense	FASAB	$873.1 billion	Appropriations	$799.2 billion	Operations, Readiness & Support[23] and Military Personnel	$C, $O, $PC, $RP, $UO	A51
Homeland Security	FASAB	$63.6 billion	Appropriations	$64.8 billion	FEMA, CBP, USCG[24]	**$C**, $RA, **$RP**, $UO	A54
Labor	FASAB	$127.1 billion	Appropriations and employer taxes	$139.5 billion	Unemployment benefits and disability benefits	O, $UO	A59
Energy	FASAB	$50.3 billion	Appropriations	$56.6 billion	Transform Our Energy System, Secure Our Nation, and The Science and Engineering Enterprise[25]	$C, **$O**, $UO	A61
Transportation	FASAB	$72.7 billion	Excise taxes and	$80.3 billion	Surface transportation and air	$C, **$O**, **$RP**, $UO	A66

[23] Defense does not explain what types of expenses make up the category "Operations, Readiness & Support" anywhere in its AFR.
[24] DHS reports costs by major responsibility segment in its statement of net costs. It does not report costs by major type anywhere in its AFR.
[25] Energy reports costs by strategic goal in its statement of net costs; it does not report costs by major type anywhere in its AFR. Also, 37 percent of its net costs are not assigned to any of its goals and are further described in a separate note.

Table 1: Summary of Agency Disclosures about Commitments and Contingencies, Undelivered Orders, and Risk Assumed

Agency	FASAB/ FASB	Revenue		Expenses		Report Disclosures[21]	Page
		Amount	Major Types	Amount	Major Types		
			appropriations		transportation[26]		
Health and Human Services (HHS)	FASAB	$924.4 billion	Appropriations and taxes	$945.6 billion	Medicare and health[27]	$C, $PC, $RP, $UO	A71
Education	FASAB	$93.5 billion	Appropriations and interest income	$89.9 billion	"Increase College Access, Quality, and Completion," "Improve Preparation for College and Career from Birth Through 12th grade," "Ensure Equitable Educational Opportunities for All Students," and "American Recovery and Reinvestment	RP, $UO	A74

[26] Transportation reports costs by major program in its statement of net costs; it does not report costs by major type anywhere in its AFR.
[27] HHS reports costs by responsibility segment in its statement of net costs with Centers for Medicare and Medicaid Services having the significant majority; Figure 2 in the MD&A section breaks its net costs into the following four major budget functions: Medicare, health, income security, and education & training. A table in OAI shows the net cost of the top 20 programs. It does not report costs by major type anywhere in its AFR.

Table 1: Summary of Agency Disclosures about Commitments and Contingencies, Undelivered Orders, and Risk Assumed

Agency	FASAB/ FASB	Revenue		Expenses		Report Disclosures[21]	Page
		Amount	Major Types	Amount	Major Types		
					Act and Education Jobs Fund"[28]		
Treasury	FASAB	$458.1 billion	Appropriations	$421.5 billion	Financial Program, Economic Program, and non-entity costs (mostly federal debt interest)[29]	$PC, $RP, $UO	A76
Housing and Urban Development	FASAB	$59.9 billion	Appropriations	$61.1 billion	Section 8[30]	$PC, $RP, **$UO**	A88
National Science Foundation	FASAB	$7.3 billion	Appropriations	$7.3 billion	Research and related activities[31]	$C, RP, $UO	A92
Environmental Protection Agency	FASAB	$11.5 billion	Appropriations	$11.6 billion	Clean Air, Clean and Safe Water, Land Preservation and Restoration, Healthy	$C, $PC, $RP, $UO	A94

[28] Education reports costs by major strategic goal in its statement of net costs. It does not report costs by major type anywhere in its AFR.
[29] Treasury reports costs by major program in its statement of net costs. It does not report costs by major type anywhere in its AFR.
[30] HUD reports costs by responsibility segment in its statement of net costs. It does not report costs by major type anywhere in its AFR.
[31] NSF reports costs by major program in its statement of net costs. It does not report costs by major type anywhere in its AFR.

Table 1: Summary of Agency Disclosures about Commitments and Contingencies, Undelivered Orders, and Risk Assumed

Agency	FASAB/ FASB	Revenue		Expenses		Report Disclosures[21]	Page
		Amount	Major Types	Amount	Major Types		
					Communities and Ecosystems		
Small Business Administration	FASAB	$6.1 billion	Appropriations	$4.1 billion	Growing Businesses and Creating Jobs	$C, $UO	A96
U.S. Agency for International Development	FASAB	$12.5 billion	Appropriations	$12.4 billion	Economic Growth, Investing in People, Governing Justly and Democratically, and Humanitarian Assistance	$C, $PC, $RP	A96
Department of State	FASAB	$31.6 billion	Appropriations	$30.1 billion	Achieving Peace and Security, Investing in People, Strengthening Consular and Management Capabilities	$C, $RP, $UO	A97

The objective of this session is to **obtain member's views** on the issues presented in this memo **so that staff can begin addressing these issues in a timely manner.**

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 Julia Ranagan at 202-512-7377 or ranaganj@fasab.gov and Monica Valentine at 202-512-7362 or valentinem@fasab.gov with a cc to paynew@fasab.gov.

QUESTIONS

Question 1 – CURRENT RISK ASSUMED REPORTING

1. Does the board approve the staff recommendation to begin developing revised standards for insurance and guarantee programs to address the inconsistent and duplicative reporting in a more timely manner (i.e., as the first phase of the overall project; see pages 3 through 11 for related discussion)?

Questions 2a – 2c – CURRENT STANDARDS

2a. Does the board approve the staff recommendation to amend SFFAS 5 to address the inconsistency in reporting of major insurance and guarantee programs between FASAB and FASB reporting entities (see pages 4 and 12 through 19 for related discussion)?

2b. Does the board approve the staff recommendation to develop a separate disclosure framework for insurance and guarantee programs (see pages 12 through 19 for related discussion)?

2c. Does the board approve the staff recommendation to pursue disclosure of risks assumed by some insurance and guarantee programs in the notes to the financial statements rather than as RSI (see pages 12 through 19 for related discussion)?

Question 3 – BROADER SCOPE

3. Does the board approve the staff recommendation to rename the project "Risk Assumed and Other Contingencies" to encompass reporting about risks assumed as well as other risks and fiscal exposures that are facing the federal government (see pages 20 through 24 for related discussion)?

Question 4a – 4c – CURRENT COMMITMENT AND CONTINGENCY REPORTING

4a. Does the board approve the staff recommendation to pursue reporting on outstanding grants, contracts, and other undelivered orders beyond one aggregate number in the notes to the statements (see pages 25 through 30 for related discussion)?

4b. Does the board approve the staff recommendation to pursue detailed disclosures about all contractual obligations and other commitments, similar to current disclosures about capital and operating leases (see pages 30 through 31 for related discussion)?

4c. Does the board approve the staff recommendation to pursue developing a detailed disclosure framework for commitment and contingency reporting (see pages 32 through 36 for related discussion)?