September 30, 2015

Memorandum

To: Members of the Board

From: Melissa L. Batchelor, Assistant Director

Wendy M. Payne
Through: Wendy M. Payne, Executive Director

Subj: Reporting Entity Question- **Tab G**[1]

MEETING OBJECTIVES

The objective of this session is to address a question regarding Statement of Federal Financial Accounting Standards (SFFAS) 47, *Reporting Entity*—whether prior year financial statements should be restated if a material change in the reporting entity results.

BRIEFING MATERIAL

The staff analysis is attached along with a question for the Board on page 7. You may electronically access all of the briefing material at http://www.fasab.gov/board-activities/meeting/briefing-materials/.

Attachment A—Staff Analysis

BACKGROUND

SFFAS 47 was issued in December 2014 with implementation effective for periods beginning after September 30, 2017. Earlier implementation is not permitted. The financial management community is working on SFFAS 47 implementation guidance and some questions are surfacing.

[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.

NEXT STEPS

Staff will continue to work with the financial management community as needed and confirm any issues with the Board that staff believes appropriate.

MEMBER FEEDBACK

Please contact me as soon as possible to convey your questions or suggestions. Communication before the meeting will help make the meeting more productive. You can contact me by telephone at 202-512-5976 or by e-mail at batchelorm@fasab.gov with a cc to paynew@fasab.gov.

Attachment A- Staff Analysis

Statement of Federal Financial Accounting Standards (SFFAS) 47 was issued in December 2014 with implementation effective for periods beginning after September 30, 2017. Earlier implementation is not permitted. The financial management community is working on SFFAS 47 implementation guidance and some questions are surfacing.

One particular question was presented that staff wanted to confirm the Board's position—whether prior year financials should be restated if a material change in the reporting entity results. If restated, this would mean FY 2017 financial statements would be restated when FY 2018 is presented.

While staff does not believe the Board discussed this matter specifically during the development or due process of SFFAS 47, some aspects imply no restatement was intended.

For example, when the Board considered the effective date and whether early implementation should or should not be permitted, there was material included that related to this issue. In the staff briefing paper for that discussion, staff included an excerpt from the Treasury comment letter that stated:
"Treasury CFO agreed but commented the proposed effective date seems reasonable as long as changes in reporting entity, if applicable, follow the past practice that these types of changes are not retroactively restated in comparative statements."

Based on staff's review of the minutes and transcript, there was not a discussion on the comparative statements. Instead the focus was on the implementation timeline of the sponsors, guidance they would provide, delaying the implementation date one year and not permitting early implementation so there would be government-wide consistency.

After this discussion the Board also agreed to include language in the basis regarding guidance. Paragraph A70 provides a description about the guidance from the sponsor agencies but may also considered open to FASAB guidance if needed as it states "…..The effective date considered this and allowed sufficient time for a coordination of efforts as well as development of any needed implementation guidance."

Relevant FASAB Literature

SFFAS 21, *Reporting Corrections of Errors and Changes in Accounting Principles*, covers changes in accounting principles and errors. Paragraphs 12 of SFFAS 21 states that "…For the purposes of this standard, changes in accounting principles also include those occasioned by the adoption of new federal financial accounting standards." Paragraph 13 also provides that

> "Unless otherwise specified in the transition instructions section of a new FASAB standard, for all changes in accounting principles that would have resulted in a change to prior period financial statements:

> (a) The cumulative effect of the change on prior periods should be reported as a "change in accounting principle." The adjustment should be made to the beginning balance of cumulative results of operations in the statement of changes in net position for the period that the change is made.
> (b) Prior period financial statements presented for comparative purposes should be presented as previously reported; and
> (c) The nature of the changes in accounting principle and its effect on relevant balances should be disclosed in the current period. Financial statements of subsequent periods need not repeat the disclosure."

Based on the above and considering the Board was silent regarding transition instructions in SFFAS 47, any adjustments resulting from the adoption of a new accounting standard should be made to the beginning balance of cumulative results of operations in the statement of changes in net position for the period that the change is made. Thus, no change would be made to the ending net position of the previous year.

However, in developing SFFAS 21, the previous Board believed changes in reporting entity to be somewhat different and explained in the basis for conclusions that changes in entity are not addressed and the Board may consider that matter later as follows:

> Other Accounting Changes
> 24. Although accounting estimates and changes in reporting entity are identified as accounting changes in other accounting literature, the Board did not address these issues because they require further study and were not addressed in paragraph 76 of SFFAS No. 7.

Technical Bulletin (TB) 2003-1, *Certain Questions and Answers Related to the Homeland Security Act of 2002* was issued to answer certain questions arising from the creation of the Department of Homeland Security and other transfers of operations between federal entities directed by the Homeland Security Act of 2002. The importance of this TB is that it was guidance that related to new reporting entities (similar to what may result in consolidation entities from SFFAS 47 that consolidate new organizations) and it provided that they would not have to restate prior year financials. While staff recognizes that TB 2003-1 dealt with organizations that were all components of the federal government as a whole and SFFAS 47 may potentially consolidate new organizations from outside the federal government, staff believes the rationale for not restating the prior year financial statements still applies. The basis for conclusions in TB 2003-1included the following discussion:

> 28. APB 20 defines a "change in entity" as:
>
>> This type [of accounting change] is limited mainly to (a) presenting consolidated or combined statements in place of statements of individual companies, (b) changing specific subsidiaries comprising the group of companies for which consolidated financial statements are presented, and (c) changing the companies included in combined financial statements. A different group of companies comprise the reporting entity after each change. (Financial Accounting Standards Board, Original Pronouncements, Change in Reporting Entity (par. 12))

29. APB 20 requires restatement when a “change in entity” occurs. Restatement means the “recasting of a previously determined (and published) balance sheet or operating statement, and its republication where there has been a substantial change in accounting principles or policies.” (Kohler’s Dictionary for Accountants) For private-sector entities a complete set of comparable financial statements for an individual reporting entity is critical to lending and investing decisions.[2] The current and prior period financial statements assist in discerning the earning power and credit-worthiness of entities thus trends in assets, liabilities and results of operations are essential.

30. Federal financial reporting objectives do not focus on the earning power or credit worthiness of the component entities of the government. Instead, federal financial reporting objectives focus on:

a. Compliance with laws and regulations governing the use of resources (budgetary integrity);
b. Evaluating the service efforts and accomplishments of a reporting entity (operating performance) as well as the entity’s management of assets and liabilities;
c. Assessing the government’s financial position and changes in its financial position (stewardship); and
d. Assuring that systems and controls support compliance with laws and regulations (systems and controls).

31. Restatement may obscure information about the changes directed by the HS Act since restatement would portray financial information as if the event occurred prior to its enactment and effective date. Portraying the actual results of operations including actual transfers of assets and liabilities for which an entity is legally accountable is most consistent with federal reporting objectives. Thus, staff does not believe restatement aids in meeting federal financial reporting objectives.

32. Further, staff does not believe that comparable financial statements for all affected entities could result from the restatement envisioned by APB 20. Staff does not believe that the changes required by the HS Act are “changes in entity” as defined in APB 20. APB 20 describes a change in entity as “changing specific subsidiaries for which consolidated financial statements are presented.” The APB 20 description does not fit all of the changes required by the HS Act. The HS Act requires concurrent changes within

[2] FASB Concepts Statement 1: Objectives of Financial Reporting by Business Enterprises states that:
—Financial reporting should provide information that is useful to present and potential investors and creditors and other users in making rational investment, credit, and similar decisions. The information should be comprehensible to those who have a reasonable understanding of business and economic activities and are willing to study the information with reasonable diligence.
—Financial reporting should provide information to help present and potential investors and creditors and other users in assessing the amounts, timing, and uncertainty of prospective cash receipts from dividends or interest and the proceeds from the sale, redemption, or maturity of securities or loans. Since investors' and creditors' cash flows are related to enterprise cash flows, financial reporting should provide information to help investors, creditors, and others assess the amounts, timing, and uncertainty of prospective net cash inflows to the related enterprise.
—Financial reporting should provide information about the economic resources of an enterprise, the claims to those resources (obligations of the enterprise to transfer resources to other entities and owners' equity), and the effects of transactions, events, and circumstances that change its resources and claims to those resources.

entities that are transferred as well as realignment of entities and operations that are part of a single larger entity both before and after the change.

33. Respondents to the March 21, 2003 exposure draft supported the staff's assertion that APB 20 is not applicable. Some respondents suggested that the scope of the Technical Bulletin be expanded so that APB 20 would not be applied to any future changes at the federal level. Staff has not incorporated this suggestion but has recommended that the Board consider it when an opportunity to address new issues arises in the future.

OMB Guidance

This matter is of particular importance because the Board's decision may result in a potential conflict or inconsistency with OMB Circular A-136, *Financial Reporting Requirements*.

OMB Circular A-136 has the following provisions in section II.4.9.1 Note 1 *Significant Accounting Policies (***emphasis added***)*:
In addition, the summary of significant accounting policies should **disclose any significant changes in the composition of the reporting entity** or significant changes in the manner in which the reporting entity aggregates information for financial reporting purposes. These changes, in effect, result in a **new reporting entity, and their impact should be reported by restating the financial statements for all prior periods** presented in order to show the new reporting entity for all periods presented, except for certain portions of Funds from Dedicated Collections, as described in SFFAS No. 27, as amended by SFFAS No. 43.

Staff Recommendation

While some may believe it important to present comparative statements because it would be misleading if there was a material change in the reporting entity, staff does not believe it would be cost beneficial to restate prior year financial statements.

Staff believes the research and outreach performed during the development of TB 2003-1 provided sufficient analysis that a restatement for a change in entity in the federal government environment would not be appropriate because federal financial reporting objectives do not focus on the earning power or credit worthiness of the component entities of the government.

Further, based on the Board's discussions during development of SFFAS 47, it appeared most Board members were thinking about it prospectively and did not expect restatement.

If Board members agree, staff believes no further Board action would be required and SFFAS 21 paragraph 13 would apply. Thus, any adjustment would be made to the beginning balance of cumulative results of operations in the statement of changes in net position; no restatement would be made to the previous year; and a high level disclosure would be made regarding the change and its effect on balances.

If the Board agrees, staff also suggests that OMB update OMB Circular A-136 section II.4.9.1 Note 1 *Significant Accounting Policies* to be consistent with the Board decision and guidance provided in SFFAS 21.

Question for the Board:

Does the Board agree with the staff recommendation that prior year financial statements should not be restated and that SFFAS 21 paragraph 13 applies regarding implementation of SFFAS 47?