Federal Accounting Standards Advisory Board

October 7, 2011

Memorandum

To: Members of the Board

From: Eileen W. Parlow, Assistant Director

Through: Wendy M. Payne, Executive Director

Subj: Analysis of Comments on the exposure draft, *Revisions to Identifying and Reporting Earmarked Funds: Amending Statement of Federal Financial Accounting Standards 27* and Staff Recommendations – **Tab E, Attachment 2**[1]

MEETING OBJECTIVES

To review responses to the exposure draft, *Revisions to Identifying and Reporting Earmarked Funds: Amending Statement of Federal Financial Accounting Standards 27* and make decisions on issues raised. Decisions made at the meeting will enable staff to develop a draft standard for your consideration.

STAFF ANALYSIS

[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.

Overall Summary of Reponses to Questions

- **Important Note:**
  Not every issue was addressed by each respondent. The denominator of the summary below is the number of responses that addressed the issue described and not the total number of comment letters received.

- All of the respondents (22 of 22) **agree** with the Board's proposal to amend SFFAS 27 to state explicitly that the source of the "specifically identified revenues or other financing sources" in paragraph 11 must be external to the federal government.

- All of the respondents (21 of 21) **agree** with the Board's proposal to exclude pensions, other retirement benefits, other post-employment benefits, and other employee benefits provided to federal employees (civilian and military) from the reporting requirements for earmarked funds.

- A majority of respondents (14 of 22) **agree** with the Board's proposal to continue to use the existing format of separate lines or columns to display information on earmarked funds on the face of the balance sheet and statement of changes in net position, or to use an alternative format.

- A majority of the respondents (11 of 20) **agree** with the minority proposal that component entities should not be required to display information on earmarked funds on the face of the balance sheet and statement of changes in net position and that disclosure in the notes is sufficient.

- A majority of respondents (16 of 21) **agree** with the proposal that the component entity level reporting should be in sufficient detail to fully support the government-wide reporting requirements.

- A majority of respondents (17 of 22) **agree** with the proposal to rescind potentially confusing guidance on eliminations for component entities and instead provide that combined or consolidated amounts are permitted and that amounts be labeled accordingly.

- All of the respondents (21 of 21) **agree** with the Board's proposal to rename "earmarked funds" and make conforming grammatical changes in SFFAS 27. Several respondents suggested edits to the new name.

- A majority of respondents (18 of 20) **agree** with the Board's proposal that to be classified as an earmarked fund, a fund should be predominantly funded by revenues from non-federal sources or have non-federal revenues supporting the fund that are material to the reporting entity, and with the proposed guidance for situations where the proportion of funding sources may change from year to year.

- A majority of respondents (15 of 19) **agree** with the Board's proposal that the amendments to SFFAS 27 have an effective date of periods beginning after September 30, 2011.

Issues Raised -- Staff Analysis and Recommendations

Broad Issue 1: Definition, Classification and Terminology

1 a) All respondents agreed with the requirement for an external source of funds.

100% of the respondents agreed with the Board's proposal to specify that the source of the qualifying earmarked revenue (dedicated collections) must be external to the federal government.

1 b) All respondents agreed with the exclusion of certain funds

100% of the respondents agreed with the Board's proposal that funds established to account for pensions, other retirement benefits, other post-employment benefits and other employee benefits for federal employees (military and civilian) should not be reported as earmarked funds.

1 c) Most respondents agreed with the Board's proposal addressing predominant source of funding.

90% of the respondents agreed with the Board's proposal that to be classified as an earmarked fund, a fund should be predominantly funded by revenues from non-federal sources or have non-federal revenues supporting the fund that are material to the reporting entity, and with the proposed guidance for situations where the proportion of funding sources may change from year to year.

[For reference, the proposed guidance on mixed sources of finding appears in new footnote 5a on page 24 of the ED:

> Footnote 5a: In situations where there is a mixed source of funding (so that not all of the revenue and other financing sources meet the criteria in paragraph 11) and the proportion and/or amounts vary from year to year so that it is difficult to determine a predominant source and/or assess materiality, acceptable options for classification include but are not limited to:
>
> 1. long-term expectations rather than periodic results that may fluctuate
> 2. 36-month averages
>
> Changes in classification of funds from year to year should be disclosed.]

One respondent (SEC) commented that:

- We agree with the proposed language that indicates that the predominant source of funds should be from non-federal sources, and that the agency should be given some flexibility in applying this requirement, but did not agree with the inference in revised paragraph [26] that the reporting of an individual fund as earmarked or not-earmarked could change from year to year. Paragraph [23], item 3 includes the following disclosure requirement:

> [23.] 3. Any change in legislation during or subsequent to the reporting period and before the issuance of the financial statements that significantly changes the purpose of the fund or that redirects a material portion of the accumulated balance.

Earmarked funds are normally driven by legislative requirements for the use of the revenues. The underlying legislative requirements normally remain stable. The reporting entity should be required to review legislative intent, funding sources and other information, identify a fund as either earmarked or not-earmarked in the long-term, and continue with that reporting.

The presentation of a fund as earmarked or non-earmarked should change only if the nature or use of the fund changes as a result of legislative action or other significant events. This change should be treated as a change in accounting. The principle of consistency requires consistent presentation from year to year. For a fund to frequently switch between earmarked and non-earmarked due to relatively minor variations in fund activities would not benefit the user of financial information.

Staff analysis and recommendation for 1 (a), (b), and (c) above:

Staff believes that the guidance proposed in the ED is helpful for preparers and allows an appropriate level of judgment in cases of mixed sources of funding. The requirement to consider long-term expectations should preclude the undesirable outcome that funds frequently "switch between earmarked and non-earmarked." Staff recommends no substantive changes[2] to the Board's proposals in the ED addressing external source of funding, exclusions, and predominant source of funding.

Question for the Board:

Does the Board agree with staff recommendation of no substantive changes to the Board's proposals that address external source of funding, exclusions, and predominant source of funding?

[2] See editorial changes at Broad Issue 3a, page 16.

1 d) All respondents agreed that the term "earmarked funds" should be changed.

100% of the respondents agreed that the term "earmarked funds" should be changed.

Although all of the respondents who addressed this topic agreed that the term "earmarked funds" should be changed, five of the twenty-one respondents suggested edits to the term that the Board proposed in the ED (Funds from Dedicated Collections).

Two of the respondents (GSA and DOL OIG) suggested "Funds <u>with</u> Dedicated Collections." One respondent (AGA FMSB) provided two suggestions: "Dedicated Collection Funds" or "Dedicated Revenue Funds." Another respondent (SEC) also suggested "Dedicated Revenue Funds." One respondent (HUD) suggested a shorter term, "Dedicated Collections."

<u>Staff analysis and recommendation</u>:

Staff recommends no changes to the Board's proposal. Most of the respondents agreed with the Board's proposed new term. The proposed terms were only slightly different from the Board's proposal. In addition, staff believes that there is no single term that 100% of respondents would agree is the best possible term.

Question for the Board:

Does the Board agree with staff recommendation of no changes to the Board's proposal in the ED for a new term for "earmarked funds" ("funds from dedicated collections")?

<u>Broad Issue 2: Reporting in the Financial Statements and Notes</u>

2 a) A majority of respondents agree with adding the option of an alternative format

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

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

Respondents who disagreed provided comments such as the following:

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

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

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

Staff analysis and recommendation

Staff recommends no changes to the Board's proposal to add an additional display format of parenthetical amounts. Statement of Federal Financial Accounting Standards (SFFAS) 27 specifies what information is to be reported on the face of the Balance Sheet or the Statement of Changes in Net Position. The non-authoritative Appendix C of SFFAS 27 illustrates a columnar presentation for both statements for a component entity and separate line items for the government-wide Balance Sheet. The Board's proposal would amend SFFAS 27 to allow three types of display format: separate columns, separate line items, or parenthetically for key line items. Because the alternative format is optional, staff believes that the proposed amendment on alternative optional display should be incorporated into the final SFFAS. However, as noted in Issue 2b below, staff also recommends an additional option.

Question for the Board:

Does the Board agree with staff recommendation of no changes to the Board's proposal in the ED for an optional alternative format (parenthetical amounts within line titles)?

2 b) A majority of respondents agree with note-only reporting

A majority (55%) of respondents agree with the minority proposal to permit note-only reporting on earmarked funds.

Respondents who agreed with the minority proposal provided the following rationales:

- We concur with the task force positions stated in paragraph A17, believing that in many cases, dedicated collections information is best presented in a footnote disclosure rather than the face of the financial statements. The normal reader of financial statements may or may not understand what is truly being presented. We recommend that the current SFFAS 27 requirements for segregation on earmarked funds in statement presentation be removed. We believe the nature of these funds with dedicated collections should be a significant element of management consideration in determining display; however it should just be one of the factors, such as materiality of balances and public interest that traditionally drive decisions on sub-entity presentation of statements and line item segregation of balances. Clearly, there are very significant Federal programs and funds with dedicated collections that do warrant unique presentation. However, there are many funds that will meet the definitions prescribed in the draft, but do not carry balances significantly material, nor a constituency of readers to warrant segregation of fund on the financial statements. (GSA)

- We agree that the disclosure of information for earmarked funds in notes is sufficient. Statement of Federal Financial Accounting Concepts (SFFAC) 2: Entity and Display states that "Financial information is also conveyed with accompanying footnotes, which are an integral part of the financial statements." Because the notes are considered integral to the financial statements, we believe the disclosure of earmarked funds in this manner is sufficient and would still provide readers the necessary information. Further, as the notes to the financial statements are subject to audit, the information disclosed in the notes should be as reliable as the information presented in the financial statements. (Dept. of Labor OIG)

- Agree. This would be consistent with the Non-Entity/Entity note which explains the breakout of the assets or the Covered/Uncovered note which provides further information on the liabilities. The financial statements would provide the general information and if the reader was interested would go to the note for the details. We could then provide side by side comparisons. (Treasury Dept.)

Respondents who disagreed with the minority proposal provided the following comments:

- Users of financial information may be misled if a component entity has no information on the face of the basic financial statements about the magnitude of earmarked funds that are reserved for use for designated activities, benefits, or purposes. (Dept. of Commerce)

- Similar to the members of the FASAB board, the members of the FISC were also split in our views on the presentation of funds from dedicated collections. Some supported the views in paragraph 19 of the ED that if dedicated collections are significant enough to be reported, then those funds should be presented on the face of the financial statements. Others supported the views of the Task Force, as presented in paragraph A-17 of the ED, that disclosure in the notes to the financial statements should be sufficient to inform the reader of the component entity's funds from dedicated collections. (GWSCPA FISC)

Staff analysis and recommendation

Staff believes that the above arguments both for and against face-of-statement reporting have merit. Staff believes that for component level reporting, the existing balance sheet disaggregation of earmarked funds and all other funds should be sufficient to show the magnitude of the extent to which the general fund has borrowed from earmarked funds, which is the primary purpose of earmarked funds reporting.

Staff believes that disaggregating the Statement of Changes in Net Position results in a cluttered and confusing display. Staff recommends that the proposed language regarding disaggregation on the face of the balance sheet (whether parenthetically or otherwise) should be retained, but that the more detailed information in the Statement of Changes in Net Position should be not be required on the face of the statement. Instead the information would be provided through the notes.

Staff believes that some of the comment letters illustrate how the existing requirements of SFFAS 27 present a challenge regarding the concept and labeling of "consolidated" financial statements, because by definition consolidated financial statements are not disaggregated into segments. If disaggregated amounts are shown, the correct label would be "consolidating" statement because the only data that can be accurately labeled "consolidated" is the final column of consolidated totals, and not the statement as a whole.

The staff recommendation to restrict face-of-statement reporting to the Balance Sheet would also help to address the concern of some respondents about how to label the financial statements, in particular, the Statement of Changes in Net Position, in cases where agencies are reporting combined amounts for earmarked funds. For the balance sheet, since the statement would only show disaggregated amounts for net position, and there is no difference between total combined and consolidated net position, staff believes that the Balance Sheet could reasonably be labeled as a "consolidated" Balance Sheet. The Statement of Changes in Net Position would not be disaggregated. The earmarked funds/dedicated collections note would display the amounts for the line items in the Statement of Changes in Net Position only for earmarked funds

> ***Question for the Board:***
> **Does the Board agree with staff recommendation to retain the ED proposal for the balance sheet display options for component entities but to adopt the minority proposal to permit component entities to report disaggregation of the Statement of Changes in Net Position in the financial statement notes?**

2 c) A majority of respondents agree that combined or consolidated amounts may be reported and must be labeled accordingly.

A majority (77%) of respondents agreed with the Board's proposal that combined or consolidated amounts may be reported and must be labeled accordingly.

Respondents who agreed with the Board's proposal provided comments such as the following:

- Because net position is not affected by eliminations, presentation of eliminations at the component entity level is not necessary. (Dept. of Commerce)
- SFFAS 27 provided confusing guidance on eliminations for component entities by implying that the earmarked funds disclosure should include eliminations between earmarked funds and non-earmarked funds. This requirement does not provide any added value to the financial statement user. The elimination of this confusing guidance is welcomed. (Dept. of Justice OIG)
- We agree with the Board proposal, as there has been great confusion in this regard, and further believe combined presentation of balances is more appropriate than consolidating, as the concepts, purposes, and resulting data supporting eliminations of earmarked fund activity is not well understood, or effects comprehended by normal readers of financial statements. (GSA)

One respondent who agreed with the proposal made the following comment:

- We agree with the flexibility provided by the Exposure Draft. We agree that if an agency presents a disclosure of earmarked funds, this disclosure may be either combined or consolidated. However, if the reporting entity presents columns for earmarked and non-earmarked funds adding up to agency-wide totals, the total column should agree to the principal financial statements to prevent confusion. In this case, a consolidating statement with a single elimination column would be necessary. (SEC)

Respondents who disagreed with the proposal provided comments such as the following:

- If component entities are permitted to present their earmarked information using different methods, it would affect the comparability of the information for users of the financial statements. Further, users would have to interpret each component entity's information differently depending on the method chosen by the component entity. As such, we believe the proposed standard should only include one option for presenting information for earmarked funds. Additionally, we believe the earmarked funds information should be reported as consolidated amounts because the Statement of Changes in Net Position (SOCNP) is a consolidated statement. If information related to earmarked funds is permitted to be presented on a combined basis, it would result in inconsistent methods being applied on the SOCNP as other funds are presented on a consolidated basis. (Dept. of Labor OIG)

- Presenting the components of net position on the balance sheet on a combined basis, as illustrated in option A of Appendix F, means that assets and liabilities would have to be presented on a combined basis in order for the statement to balance. Assume an entity has only two earmarked funds (fund A and fund B) and elects to present the combined earmarked fund information. Fund A provided services to fund B but has not been reimbursed at the balance sheet close so fund A reports the exchange revenue and an accounts receivable balance and fund B reports the cost and an accounts payable balance. Without the elimination entries for intra-entity activities (consolidation), the assets and liabilities on the balance sheet of the component entity will be overstated. SFFAC No. 5, *Definitions of Elements and Basic Recognition Criteria for Accrual-Basis Financial Statements*, paragraph 18, defines an asset as a resource that embodies economic benefits or services that the federal government controls and paragraph 39, defines a liability as a present obligation of the federal government to provide assets or services to another entity at a determinable date, when a specified event occurs, or on demand. The asset and liability balances resulting from the example activity above do not meet these definitions because they are intra-entity balances. The asset does not represent an economic benefit to the entity and the liability does not represent an obligation to provide assets or services to another entity. (KPMG LLP)

<u>Staff analysis and recommendation</u>:

Staff recommends no change to the Board's proposal for component entities to display either combined or consolidated amounts, appropriately labeled.

As previously noted,[3] staff believes that some of the comment letters illustrate how the existing requirements of SFFAS 27 present a challenge regarding the concept and labeling of "consolidated" financial statements, because by definition <u>consolidated</u> financial statements are not disaggregated into segments. If disaggregated amounts are shown, the correct label would be "consolidating" statement because the only data that can be accurately labeled "consolidated" is the final column of consolidated totals, and not the statement as a whole.

[3] See issue 2b, starting on page 9

The comment above by KPMG states that in the illustration shown for Option A in Appendix F of the ED, the assets and liabilities would be overstated if combined amounts were used. However, all the options in Appendix F show that only the net position, and not other balance sheet elements such as assets and liabilities, are disaggregated into earmarked and non-earmarked funds. Current requirements in SFFAS 27 require that only net position should be disaggregated into earmarked funds and all other funds, not assets and liabilities.

For example, if the transaction described in the comment between earmarked fund A and earmarked fund B were for $100, the agency's consolidated totals for earmarked funds would be prepared as follows (see next page):

Below is an illustration of two earmarked funds with the transaction described in the above comment in the amount of $100:

> Assume an entity has only two earmarked funds (fund A and fund B) and elects to present the combined earmarked fund information. Fund A provided services to fund B but has not been reimbursed at the balance sheet close so fund A reports the exchange revenue and an accounts receivable balance and fund B reports the cost and an accounts payable balance.

Note that the elimination entry reduces assets and liabilities, but does not either increase or reduce net position.

	Earmarked Fund A	Earmarked Fund B	Combined Totals	Eliminations	Consolidated Totals
Accounts Receivable	100		100	100 Cr	0
Total Assets	100	0	100		0
Accounts Payable		100	100	100 Dr	0
Total Liabilities		100	100		0
Cumulative Results of Operations	100	-100	**0**		**0**
Total Net Position	100	-100	**0**		**0**
Total Liabilities and Net Position	100	0	0		0

Option A of Appendix F illustrates that on the balance sheet only net position is disaggregated. Because combined and consolidated net position are the same, balance sheet reporting of combined or consolidated earmarked funds would be identical.

The staff recommendation to require face-of-statement reporting only on the Balance Sheet would help to address the concern of some respondents about consistency and labeling of the financial statements, in particular, the Statement of Changes in Net Position, in cases where agencies are reporting combined amounts for earmarked funds. For the balance sheet, since the statement would only show disaggregated amounts for net position, and there is no difference between total combined and consolidated net position, staff believes that the Balance Sheet could reasonably be labeled as a "consolidated" Balance Sheet. The Statement of Changes in Net Position would not be disaggregated. The earmarked funds/dedicated collections note would display the amounts for the line items in the Statement of Changes in Net Position only for earmarked funds and could be labeled combined for clarity or presented as a consolidating schedule.

> ***Question for the Board:***
>
> **Does the Board agree with staff recommendation of no changes to the Board's proposal that component entities display either combined or consolidated amounts, appropriately labeled?**

2 d) A majority of respondents agree with an explicit requirement for data to be in sufficient detail to support government-wide reporting.

A majority (76%) of respondents agreed with an explicit requirement that the data must be in sufficient detail to support government-wide reporting.

Respondents who disagreed commented that:

- We believe that the information needed to support the government-wide reporting requirements could be collected by means other than general purpose financial reports, such as through the Governmentwide Financial Report System (GFRS) and financial management policies and procedures of the U.S. Department of the Treasury, Financial Management Service. Furthermore, we believe that this language, which is meant to assist the U.S. Department of the Treasury in complying with paragraphs 29—33 of SFFAS 27, sounds open ended and undefined as it is written and compliance with such an accounting standard may be difficult to audit. (Dept. of Labor)
- We agree that the preparers of the U.S. of the U.S. Government-wide financial statements need sufficient information for the preparation of those financial statements. However, we do not believe that the evaluation of the sufficiency of this information can be done by the preparer and auditor of the component entity's financial statements. We recommend the following revision to the proposed sentence to remind preparers that the information is used by the preparer of the U.S. Government-wide financial statements:

  > "The information <u>is intended to provide</u> ~~must be in sufficient~~ detail to support reporting requirements for the U.S. Government-wide financial statements <u>described in</u> ~~(see~~ paragraph 29~~)~~." (KPMG)

<u>Staff analysis and recommendation</u>:

Staff believes that the objections that the requirement is open-ended and undefined can be remedied by adding the following edit to clarify the citation for the government-wide reporting requirements:

The information must be in sufficient detail to support the reporting requirements for the U.S. Government-wide financial statements ~~(see~~ <u>in</u> paragraph<u>s</u> 29 <u>and 30</u>~~)~~.

Question for the Board:
Does the Board agree with staff recommendation for an edit to clarify the citation for the government-wide reporting requirements?

2 e) A majority of respondents agree with the proposed effective date of fiscal year (FY) 2012.

79% of the respondents agreed with the proposed effective date of FY 2012.

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

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

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

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

Staff analysis and recommendation:

Staff believes that the proposed amendments to SFFAS 27 do not impose a significant reporting burden, and some of the provisions are intended to reduce the reporting burden.

However, as noted by the respondents cited above, first quarter reporting for FY 2012 is due in mid-January of 2012. Due process for the issuance and the 90-day FASAB principal review of a SFFAS will not permit the issuance of the proposed amendments prior to required quarterly reporting for FY 2012. Accordingly, staff recommends that the effective date should be FY 2013, with earlier implementation encouraged.

Question for the Board:

Does the Board agree with staff recommendation to change to the Board's proposed effective date to periods beginning after September 30, 2012, with earlier implementation encouraged?

Broad Issue 3: Other Comments

3 a) Suggested edits to the definition

1. One respondent (KPMG LLP) noted that the placement of the phrase clarifying that the fund is financed by non-federal sources is not consistent between paragraphs 11, 11.1, 13.1 and 13.2. In paragraph 11, the phrase only identifies revenue as the non-federal source of financing; however, the other two paragraphs refer to revenue and other financing sources. We recommend paragraph 11 be modified as follow for consistency, taking into consideration other recommended changes presented in other parts of this letter:

> "[11.] Funds from dedicated collections are financed by specifically identified revenues and other financing sources, provided to the government by non-federal sources, often supplemented by other financing sources provided by the federal government…"

2. KPMG also suggested the following changes to the proposed amendment to paragraph 11 to be consistent with the proposed amendment to paragraph 11.1:

> "Funds from dedicated collections are financed by specifically identified revenues, originally provided to the federal government by non-federal sources, often supplemented by other financing sources."

3. KPMG also suggested the following changes to the proposed amendment to paragraph 11.3

> "A requirement to account for and report on the receipt, use, and retention of the revenues and/or other financing sources of ~~that distinguishes~~ the fund separately from the federal g~~G~~overnment's general revenues."

4. KPMG also recommended the following edits to paragraphs 11 and 13 in responding to Question 6 on funds with mixed sources of funding:

> "[11.] Funds from dedicated collections are financed by specifically identified revenues, provided to the government by non-federal sources and may be~~, often~~ supplemented by other financing sources~~, which remain available over time. These specifically identified revenues and other financing sources are required by statute to be used for designated activities, benefits or purposes, and must be accounted for separately from the Government's general revenues~~. The determination of whether a fund should be classified as a fund from dedicated collections is done at the individual fund level. The three required criteria for a fund from dedicated collections are:
>
> 1. A statute committing the Federal Government to use specifically identified revenues and/or other financing sources that are originally provided to the federal government by a non-federal source only for designated activities, benefits or purposes;
>
> 2. Explicit authority for the fund to retain revenues and/or other financing sources not used in the current period for future use to finance the designated activities, benefits, or purposes; and
>
> 3. A requirement to account for and report on the receipt, use, and retention of the revenues and/or other financing sources that distinguishes the fund from the Government's general revenues.
>
> In certain circumstances, a fund may be financed by a combination of both federal and non-federal sources. Such a fund should be classified as a fund from dedicated collections if the fund meets the above three criteria and
>
> – Its predominant sources of revenue and other financing sources are non-federal sources, or
>
> – its non-federal sources of revenue and other financing sources are material to the reporting entity.
>
> For example, as currently funded, Medicare Parts B and D meet the first three criteria. Medicare Parts B and D's predominant sources of revenue and other financing sources are federal sources. However, Medicare Parts B and D have non-federal revenue and other financing sources that are material to the reporting entity. Therefore, Medicare Parts B and D should be classified as funds from dedicated collections.
>
> [13] **Fund** in this statement's definition of funds from dedicated collections refers to a "fiscal and accounting entity with a self-balancing set of accounts recording cash and other financial resources, together with all related liabilities and residual equities or balances, and changes therein, which are segregated for the purpose of carrying on

> specific activities or attaining certain objectives in accordance with special regulations, restrictions, or limitations." ~~Classification and reporting should be made at the level of an individual fund. A fund should be classified as a "fund from dedicated collections" if it meets the criteria in paragraphs 11.2 and 11.3 and either:~~
>
> ~~1. its predominant sources of revenue and other financing sources are nonfederal sources meeting the paragraph 11.1 criterion, or~~
>
> ~~2. it has non-federal sources of revenue and other financing sources meeting the paragraph 11.1 criterion 5a that are material to the reporting entity.~~
>
> ~~For example, as currently funded, Medicare Parts B and D do not have nonfederal sources as described in paragraph 11 as their predominant revenue and other financing sources. However, Medicare Parts B and D do have revenue and other financing sources material to the reporting entity that meet the criteria in paragraph 11. Therefore, Medicare Parts B and D should be classified as funds from dedicated collections.~~"

<u>Staff analysis and recommendation:</u>

1. Staff believes that the issue identified in item 1 above could be addressed by inserting the word "generally" at the beginning of paragraph 11, as follows:

> <u>Generally,</u> funds from dedicated collections are financed by specifically identified revenues, provided to the government by non-federal sources, often supplemented by other financing sources.

2. Staff believes that that both of the suggested edits to par. 11.1 would improve the document editorially. Staff recommends that these edits be incorporated into the draft SFFAS.

3. Staff believes that two of the above edits to par. 11.3 (insert "federal" and change "Government" to lower case) would improve the document editorially. Staff recommends that these edits be incorporated into the draft SFFAS.

Staff does not believe that striking out "that distinguishes" and inserting "separately" improve the document editorially and does not recommend that those edits be incorporated into the draft SFFAS.

4. Staff recommends no change re the edits to paragraphs 11 and 13 regarding funds with mixed sources of funding. Staff believes that these edits constitute a substantial rewrite of two critical paragraphs that were well understood by other respondents. Paragraph 11 provides a general definition and specific criteria while paragraph 13 defines a fund and explains how to apply the criteria to a fund. Staff worked closely with the task force to develop the wording in the exposure draft and responses generally show that the proposed wording is well understood.

Question for the Board:

Does the Board agree with staff recommendation for the above editorial changes to paragraphs 11, 11.1, and 11.3?

3 b) Suggested addition to the criteria

One respondent (AGA FMSB) suggested that the criteria should explicitly address the circumstance where the level of spending from the fund may be a function of the revenues collected from the non-federal sources. The respondent suggested that criteria number 1 might be modified to incorporate this concept as follows, "… benefits or purposes<u>; or at levels commensurate with the amount of identified revenues."</u>

<u>Staff analysis and recommendation:</u>

Staff recommends no changes to the Board's proposal. Staff believes that variations in authorized levels of spending are unrelated to the Board's principle-based criteria for inclusion in the category of earmarked funds/dedicated collections.

3 c) Suggested additions to the Basis for Conclusions

1. Discussion of reasons for new term

One respondent (GWSCPA FISC) suggested that:

> the Board should consider further discussing its decision to return to the term "dedicated collections," why the term "earmarked funds" was preferred in SFFAS 27, and what has changed to return to the term "funds from dedicated collections" in the ED.

<u>Staff analysis and recommendation:</u>

Staff believes that the following discussion from paragraphs A7 - A8 in the Basis for Conclusions of the ED provides a clear explanation of why the Board proposed changing the term, and recommends that these two paragraphs should be carried forward into the Basis for Conclusions of the final SFFAS:

[A7.] The Board believes that the term "earmarked funds" has become confusing to readers because of the increasing focus on a similar term, "earmarking," which refers to earmarked spending. Earmarking occurs when congressional direction (provided in legislation, report language or other communication) designates appropriations for a specific purpose. In contrast, the reporting requirements of SFFAS 27 are focused on collections that are distinct from the government's general revenues and are dedicated for a specific purpose.

[A8.] The Board believes that the proposed new term, “funds from dedicated collections,” is a unique and descriptive term that will not be confused with other commonly used terms. In addition, it explicitly states the reason for separate reporting (dedicated collections).

> ***Question for the Board:***
>
> **Does the Board agree with staff recommendation to carry forward paragraphs A7-A8 of the ED into the Basis for Conclusions of the final SFFAS?**

2. Suggested addition to the Basis for Conclusions
One respondent (GWSCPA FISC) recommended that paragraphs A-13 and A-14 of the ED’s Basis for Conclusions, other examples, in addition to Medicare Parts B and D, be provided to inform readers of the Board’s intent in these two paragraphs.

<u>Staff analysis and recommendation:</u>

Staff recommends no change. The purpose of the exception discussed in paragraphs A-13 and A-14 (displayed below) was to offer a clearly material example. Additional examples would not be appropriate since their materiality would not be immediately apparent.

> [A13.] In implementing SFFAS 27, agencies classified numerous funds primarily funded by general fund appropriations as earmarked funds. The Board believes that guidance is needed for funds with mixed sources of funding (that is, a combination of (a) revenues and other financing sources that meet the criteria in paragraph 11 of SFFAS 27 ("non-federal") and (b) general fund appropriations ("federal")). In some such cases, the funding from non-federal sources is insignificant both to the component entity and the government as a whole. The Board believes that because a “fund” (usually associated with a Treasury account fund symbol) is the smallest accounting unit in the federal government, a fund with mixed sources of funding including earmarked receipts presents special challenges in meeting the objectives of SFFAS 27. Conceptually, the earmarked portion should be separately identified. In the Board’s view, separately accounting for the earmarked portion of these funds would impose reporting burdens in excess of any benefits. However, classifying both earmarked receipts and general fund appropriations as “earmarked revenues” would overstate restricted revenue in component entity reports.
>
> [A14.] To avoid such overstatements while minimizing reporting burdens, the Board believes that to be classified as an earmarked fund, a fund should be predominantly funded by revenues from non-federal sources. However, if the non-federal revenues supporting the fund are material to the reporting entity, the Board believes that the fund should be classified as earmarked even if the non-federal revenues are not the predominant source of inflows of the fund for which they are collected. The Board believes that this approach will result in a cost-effective solution. Material non-federal revenues that meet the definition and criteria in paragraph 11 of SFFAS 27 will be disclosed and costs will not be incurred to provide special accountability for immaterial amounts of non-federal revenue that meet the criteria but are commingled with other

> financing sources provided through general fund appropriations. The Board has accordingly proposed an exception to the "predominant source of funds" principle in cases where the revenue that meets the criteria of paragraph 11 of SFFAS 27 is material to the reporting entity. In such cases, such as Medicare Parts B and D, the entire fund should be included.

Question for the Board:
Does the Board agree with staff recommendation for no change?

3 d) Suggested edits to the reporting requirements

1. One respondent (DoD) commented that:

> Paragraph 26, states that components are not required to restate when there is a change in the treatment of a fund previously deemed Earmarked and vice versa. However, under the Implementation Guidance paragraph on page 19, components are required to restate prior period amounts displayed on the face of the financial statements and notes.

<u>Staff analysis and recommendation:</u>
Staff recommends no change. The requirement on in paragraph 26 governs cases when an agency reports a different portion of a fund or program in different years. Restatement of prior year amounts would be inappropriate in such cases because the original amounts would best reflect operations for the prior year. Paragraph 15 on page 19 governs implementation of the new definition, and restatement is necessary to present consistent information.

2. One respondent (Dept. of Labor) recommended that:

> With regard to paragraph 15 on page 19, we noted that the implementation guidance would require changes in the financial statements and the notes. In the implementation guidance, the Board may wish to include required supplementary information and required supplementary stewardship information as well

<u>Staff analysis and recommendation:</u>

Staff recommends no change. Staff does not believe that the proposed amendments impact RSI or RSSI

3. One respondent (KPMG) recommended "updating the summary section and appendices of SFFAS No. 27 to reflect the proposed changes in this ED."

<u>Staff analysis and recommendation:</u>

Staff recommends no change. Only the authoritative portions of standards are subject to amendment. The summary and appendices of SFFAS 27 are non-authoritative.

4. One respondent (C. Johnson) commented that:

> I am wondering whether it would be possible to add to the standard a requirement that the government-wide financial report include a footnote that explains the non-earmarked funds (or non-dedicated collections) total on the balance sheet. I think this might help the lay reader understand the significance of what is currently the largest negative number on the balance sheet.
> I am thinking that it might be nice to explain what the number represents both mathematically and conceptually. Maybe the footnote could say something along the following lines. "The non-earmarked funds [non-dedicated collections] balance is the Government's net position less the balances of funds that receive dedicated collections. It represents the cumulative results of operations plus future program commitments for certain/all [whichever word is accurate] non-exchange programs that receive dedicated collections."

<u>Staff analysis and recommendation:</u>

Staff recommends no change. Staff believes that substantive deliberation on wording would be needed and re-exposure would be necessary if wording is offered or required. However, this suggestion could be considered within the context of another project, such as the reporting model project.

5. One respondent (Treasury Dept.) commented:

Possible misconnect when looking at Appendix B: Text of SFFAS Accounting Standards with Proposed Amendments

Paragraph 11 (page 29)

> Funds from dedicated collections are financed by specifically identified revenues, provided to the government by non-federal sources, often supplemented by other financing sources, which remain available over time.

Paragraph 19 (page 32)

> Non-exchange revenue and other financing sources, including appropriations, and net cost of operations for funds from dedicated collections should be shown separately on the Statement of Changes in Net Position.

Misconnect – Paragraph 11 says revenues and paragraph 19 says non-exchange revenue. Are current earmarked funds that receive their revenue from exchange revenue now considered not earmarked funds?

<u>Staff analysis and recommendation:</u>
Staff recommends no change. Exchange revenue is a component of "net cost of operations." Non-exchange revenue and other financing sources such as

appropriations are not included in net cost of operations and accordingly those items are listed separately in paragraph 19. Accordingly, staff believes that there is no disconnect between paragraph 11 and paragraph 19.

NEXT STEPS

If the Board reaches a consensus on the above issues, staff will prepare a preballot draft SFFAS on or before the December 2011 Board meeting.