Federal Accounting Standards Advisory Board

December 3, 2010

Memorandum

To: Members of the Board

Wendy M. Payne

From: Wendy M. Payne, Executive Director

Subj: Review of Existing Standards: Statement of Federal Financial Accounting Standards (SFFAS) 27: *Identifying and Reporting Earmarked Funds* – **Tab H**[1]

MEETING OBJECTIVES

- To review and finalize draft language based on decisions made at the October meeting
- To discuss:
  - initial task force feedback on options considered in October
  - candidate terms to replace "earmarked funds"
  - initial staff research regarding options for excluding earmarked funds financed by exchange revenues and restricted for various uses

BRIEFING MATERIAL

This memorandum includes a discussion of the above issues, with questions for Board members.

Attachment 1 presents a draft exposure draft

BACKGROUND

At the August and October Board meetings, the Board decided that SFFAS 27 should be amended to:

a) clarify that the specifically-identified revenue or other financing source needs to be from a non-federal source

b) allow the preparer discretion in the placement of basic information for earmarked funds reporting at the component entity level (on the face of the financial statements or in a note)

[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.

c) permit presentation of combined or consolidated earmarked and all other fund amounts so long as amounts are properly labeled

At the October Board meeting, the Board asked staff to consider further whether:

d) funds should be classified based on the predominant source of funding

e) an exception to “classification based on predominant source of funds” should be required when a source other than the predominant source is material to the reporting entity

f) funds receiving exchange revenues restricted for certain types of activities should be excluded

g) a specific term to replace “earmarked fund” should be identified

The Board requested information regarding how options might impact practice.

Staff developed the draft exposure draft presented as Attachment 1 to facilitate review. It documents decisions made to date and offers a basis for conclusions. In addition, it includes text as place markers for future decisions of the board. This text is intended to demonstrate how issues not yet decided might be resolved and explained. Clarity of the text is important since the task force will be asked for feedback and possible field testing.

The task force has been asked for assistance and an initial round of comments provided. However, staff is not prepared to offer a recommendation regarding the exclusion of any funds financed by exchange revenues at this time.

DISCUSSION QUESTIONS

1. Finalizing amendments to the text of the standards and considering the basis for conclusions relating to decisions a through c above.

Attachment 1 provides a draft exposure draft including a basis for conclusions. Specifically paragraphs 4 (page 9), 6 and 8 (pages 11 through 14) provide amendments to accomplish decisions a through c identified above. The basis for conclusions discusses these changes (par. A4 through A22) and provides introductory material and preliminary explanation for pending decisions.

1. Questions for the Board:

a. Does the Board have any edits to suggest to the language amending the standards for decisions a through c above? (See par. 4, 6, and 8 in Attachment 1.)

b. Does the Board generally support the rationale offered for each decision? The rationales are summarized as follows:

Decision a (require an external source of funds) see par. A9:

- to ensure that only funds financed through collections from specific sources where there is a public expectation that the amounts collected will be used for their stated purpose are included as "earmarked" funds

Decision b (allow the preparer discretion in placing information in notes or on the face of the financial statements) see par. A16-A17:

- display on the face of statements adds complexity to already challenging financial presentations and may prevent display of comparable financial statements on a single page
- at the component entity level, it is not possible to assess the cumulative effect of intra-governmental borrowing that results from earmarked funds
- at the component entity level, meeting special accountability objectives requires information on individual funds which may or may not be feasible to display on the face of the financial statement

Decision c (permit presentation of combined or consolidated amounts) see par. A18-A22:

- existing guidance is unclear and practice varies
- at the component entity level, meeting special accountability objectives requires information on individual funds; whether amounts are combined or consolidated does not impact that objective
- there is need for broader study of the issue of combined or consolidated amounts for specific fund classes; until the study is conducted preparer discretion is acceptable

Specific edits can be offered directly to staff before or after the meeting. At the meeting, I hope that we can identify any rationale that the Board does not endorse or any new rationales that should be included.

2. Predominant Source of Funds (with potential exception where a material revenue is not the predominant source of funds)

At the August meeting, staff noted that preliminary research indicated that the funds with the largest negative net positions, such as deferred compensation funds, were funded predominantly by general fund appropriations and not by earmarked revenues. Staff noted that a potential filter for excluding such funds could be a requirement that earmarked funds should be funded predominantly by earmarked revenues. The Board decided that staff should develop this potential amendment for discussion at the October meeting.

At the October meeting, the Board considered a proposal that would have classified funds with mixed funding sources based on the predominant source of funds unless a fund had a source of revenue material to the government-wide report but which was not the predominant source. Members preferred to consider whether the revenue was material to the reporting entity and asked staff to explore this alternative. (Members also noted that this revised approach would not necessarily exclude all funds with large negative net positions. Further, they indicated that the focus should be on the characteristics of the fund rather than its net position.)

Staff drafted language regarding this option and asked task force members to respond. The request is presented below with a brief summary of the responses[6] to each question.

Dear Task Force Members,
…

The Board considered staff proposals at its October meeting and wishes to explore additional changes to the earmarked funds standards. Unfortunately, time does not permit another in-person meeting of the task force before the Board meets again December 16-17. I am hopeful that you will be able to assist me with a few questions. But first an update on the Board's decisions.

The Board tentatively approved a proposal to eliminate the requirement for separate display of earmarked funds information on the face of component entity financial statements. Instead, the requirement to be proposed is that the information currently required by SFFAS 27 be disclosed (disclosure can be accomplished either on the face of the statements or in the notes). In addition, the Board tentatively approved allowing disclosure of combined or consolidated amounts so long as the amounts are labeled appropriately. The Board also plans to select a new name for these types of funds once classification issues described below have been resolved.

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[6] Five agencies responded – Commerce, RRB, SSA, Treasury, and USDA. Additional input will be sought following the December meeting and I may be able to update the Board.

Difficult decisions remain regarding changes to the criteria for classifying funds as earmarked. The Board tentatively approved a change that would require at least one external source of funds before a fund is classified as earmarked. The Board asked staff to explore further the following additional changes:

1. Classify funds based on the predominant source of funds unless a material external earmarked revenue source of funds also exists. Draft guidance would provide that -- In general, classification should be made at the level of an individual fund and each fund should be classified as earmarked or non-earmarked in accordance with its predominant source of funding. However, any fund receiving earmarked revenues or other financing sources material to the reporting entity as a whole should be classified as earmarked even if its predominant source of its funding is not earmarked. For example, as currently funded, Medicare Parts B and D should be subject to the earmarked fund reporting requirements even though they are supplemented by general fund appropriations that may exceed the amount of premiums collected from participants.

Question: Is the above draft language clear? Would it change current practice at your agency? If so, can you provide an example of a fund for which classification would change? What, if any, benefits or drawbacks can you identify regarding this option?

Two agencies responded that the language was clear and would not change practice.

Each of the remaining three agencies had difficulty interpreting the language. I believe the difficulty stems from focusing on the source of funding versus the fund as well as the introduction of the requirement for an external source of funding. You will see language in the draft ED that attempts to clarify how this requirement relates to the three criteria for an earmarked fund. In addition, stating the exception in a positive manner may further clarify the intent.

Aside from clarity, concerns about the approach identified so far include:

- Is there a definition of “predominantly” and should it be consistent across agencies?
- What happens if the mix of revenue changes from year to year?
- How would this change be implemented (e.g., prospectively or by restating prior amounts)?
- Will the result by as understandable to the users as the three criteria are now?

Question for the Board:

Staff proposed alternative wording for the exception and also believes the changes need to be presented in context with the revisions requiring an external source of funds. The revised language is included in par. 5 of the draft ED and is presented below for reference:

> Classification as earmarked or non-earmarked is made at the level of an individual fund. A fund should be classified as earmarked if its predominant sources of funding meet the paragraph 11.1 criterion and the fund meets the additional criteria in paragraphs 11.2 and 11.3. In addition, a fund should be classified as earmarked if a secondary source of funding that is material to the reporting entity meets the paragraph 11.1 criterion and the fund meets the additional criteria in paragraphs 11.2 and 11.3. For example, as currently funded, Medicare Parts B and D should be subject to the earmarked fund reporting requirements even though they are supplemented by general fund appropriations that may exceed the amount of premiums collected from participants.

Does the Board believe the above language clearly captures their intent?

Does the Board have any preliminary comments on the rationale drafted for this proposal at page 18, paragraphs A10 and A11?

3. Terminology: "Earmarked Funds"

While the Board agreed to defer discussion of this topic until tentative conclusions on how to limit the scope of this category of fund, it may be helpful to ensure that reasonable candidates are explored. In October, six candidates were presented by staff. An additional candidate – specific restricted funds – was recommended by OMB. Some members commented that the list was too long – staff has narrowed the list based on our judgment.

A revised list with pros and cons is presented below:

	Pro	*Con*
Funds from Dedicated Collections	• "Funds from Dedicated Collections" is a unique and descriptive term that will not be confused with other commonly used terms. • This term explicitly states the reason for separate reporting (dedicated collections).	• The term "dedicated collections" is not currently used in accounting literature. However, the term "dedicated collections was used in the past (prior to 2006) and included funds later categorized as earmarked funds and fiduciary activities.
Dedicated Funds	• "Dedicated funds" is a unique and descriptive term that will not be confused with other usages.	• This term might imply that appropriated funds financed by the general fund are not dedicated to specific purposes and/or may be used with greater management discretion than really exists.
Specific Restricted Funds	• Is unique, highlights the limitations on the use of the funds, and does not give more emphasis to restricted versus unrestricted funds	• This term may imply that "other funds" or "unrestricted funds" may be used with greater management discretion than really exists.

Funds from Restricted Collections	• "Funds from Restricted Collections" is a descriptive term that will not be confused with other commonly used terms. It explicitly states the reason for separate reporting (dedicated collections)	• This term may imply that "other funds" or "unrestricted funds" may be used with greater management discretion than really exists.

Question for the Board

Does the Board wish to add to or narrow the above list?

4. Exploring options for funds financed by exchange revenues

Time has not permitted extensive staff research in this area. The task force has provided an initial round of comments regarding the following three options:

Exclude from earmarked funds any funds:

1. financed predominantly by exchange revenues not set aside for the benefit of the general public

2. established to finance pension, other retirement or post-employment benefits for federal employees

3. financed predominantly by exchange revenue

Concerns raised so far include:

- conceptual questions regarding the justification for these types of conclusions (note that no basis for conclusions was offered to the task force)
- the need to review sources of revenue each year
- comparability if changes in the mix of exchange/non-exchange revenue occur over time

Staff also plans to explore an exclusion for funds financing insurance programs.

The draft exposure draft offers a preliminary rationale regarding funds financed by exchange revenue as well as the tentative conclusion that excluding all funds financed by exchange revenue would inappropriately exclude certain funds.

Questions for the Board:

Do members have any comments regarding the rationale or planned research?

Federal Accounting Standards Advisory Board

Comment: The title will be revised once a new term for "earmarked" is selected.

Revisions to Earmarked Funds Requirements:

Amending Statement of Federal Financial Accounting Standards 27

Statement of Federal Financial Accounting Standards

Exposure Draft

Written comments are requested by [date 90 days after issuance]

Month day, year

Working Draft – Comments Are Not Requested on This Draft

THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

The Secretary of the Treasury, the Director of the Office of Management and Budget (OMB), and the Comptroller General, established the Federal Accounting Standards Advisory Board (FASAB or "the Board) in October 1990. FASAB is responsible for promulgating accounting standards for the United States Government. These standards are recognized as generally accepted accounting principles (GAAP) for the Federal Government.

An accounting standard is typically formulated initially as a proposal after considering the financial and budgetary information needs of citizens (including the news media, state and local legislators, analysts from private firms, academe, and elsewhere), Congress, Federal executives, Federal program managers, and other users of Federal financial information. The proposed standards are published in an Exposure Draft for public comment. In some cases, a discussion memorandum, invitation for comment, or preliminary views document may be published before an exposure draft is published on a specific topic. A public hearing is sometimes held to receive oral comments in addition to written comments. The Board considers comments and decides whether to adopt the proposed standard with or without modification. After review by the three officials who sponsor FASAB, the Board publishes adopted standards in a Statement of Federal Financial Accounting Standards. The Board follows a similar process for Statements of Federal Financial Accounting Concepts, which guide the Board in developing accounting standards and formulating the framework for Federal accounting and reporting.

Additional background information is available from the FASAB or its website:

- "Memorandum of Understanding among the General Accounting Office, the Department of the Treasury, and the Office of Management and Budget, on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board."

- "Mission Statement: Federal Accounting Standards Advisory Board", Exposure drafts, Statements of Federal Financial Accounting Standards and Concepts, FASAB newsletters, and other items of interest are posted on FASAB's website at: www.fasab.gov.

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Federal Accounting Standards Advisory Board

ISSUE DATE

TO: ALL WHO USE, PREPARE, AND AUDIT FEDERAL FINANCIAL INFORMATION

The Federal Accounting Standards Advisory Board (FASAB or the Board) is requesting comments on the exposure draft of a proposed Statement of Federal Financial Accounting Standards entitled, TITLE. Specific questions for your consideration appear on page 7 but you are welcome to comment on any aspect of this proposal. If you do not agree with the proposed approach, your response would be more helpful to the Board if you explain the reasons for your position and any alternative you propose. Responses are requested by DUE DATE.

All comments received by the FASAB are considered public information. Those comments may be posted to the FASAB's website and will be included in the project's public record.

We have experienced delays in mail delivery due to increased screening procedures. Therefore, please provide your comments in electronic form. Responses in electronic form should be sent by e-mail to fasab@fasab.gov. If you are unable to provide electronic delivery, we urge you to fax the comments to (202) 512-7366. Please follow up by mailing your comments to:

Wendy M. Payne, Executive Director
Federal Accounting Standards Advisory Board
Mailstop 6K17V
441 G Street, NW, Suite 6814
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The Board's rules of procedure provide that it may hold one or more public hearings on any exposure draft. No hearing has yet been scheduled for this exposure draft.

Notice of the date and location of any public hearing on this document will be published in the *Federal Register* and in the FASAB's newsletter.

Tom L. Allen
Chairman

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Executive Summary

What is the Board proposing?

The Board is proposing to modify the definition of earmarked funds by clarifying that (1) at least one source of funds external to the federal government must exist for a fund to qualify as earmarked, and (2) for funds receiving both earmarked and non-earmarked sources of funding, classification should be based on the predominant source of funding unless the earmarked funding source is material to the entity. In addition, a specific exclusion is proposed for any funds that are: [under development as follows:

- Established to finance pension, other retirement or post-employment benefits for federal employees

- Financed predominantly by exchange revenue not set aside for the benefit of the general public]

The Board also is proposing to modify the reporting requirements at the component entity level by eliminating the requirement to separately display information about earmarked funds directly on the face of the financial statements. Instead, component entities would be required to disclose the information. In addition, component entities would be permitted to disclose either consolidated or combined information so long as it is adequately labeled.

The Board also proposes to change the term “earmarked” fund to “xxx:.”

How would this proposal improve federal financial reporting and contribute to meeting the federal financial reporting objectives?

The earmarked funds reporting requirements were intended to meet two goals—(1) highlighting the financing that will be needed by the government as a whole when earmarked funds use their accumulated revenues in the future, and (2) enhancing awareness of the restrictions on the use of earmarked revenues. Federal departments and agencies have classified over 500 funds as earmarked and provided detailed information on the most significant of these funds since reporting requirements were implemented in fiscal year 2006. This proposal improves federal financial reporting and contributes to meeting the earmarked funds reporting objectives by addressing the diverse characteristics within this group of funds, considering how those characteristics relate to the two goals of earmarked fund reporting and how meaningful the resulting reporting may be to users, and resolving implementation issues.

[The basis for each change will be summarized below once the Basis for Conclusions is drafted.]

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Questions for Respondents

The FASAB encourages you to become familiar with all proposals in the Statement before responding to the questions in this section. In addition to the questions below, the Board also would welcome your comments on other aspects of the proposed Statement.

The Board believes that this proposal would improve Federal financial reporting and contribute to meeting the Federal financial reporting objectives. The Board has considered the perceived costs associated with this proposal. In responding, please consider the expected benefits and perceived costs and communicate any concerns that you may have in regard to implementing this proposal.

Because the proposals may be modified before a final Statement is issued, it is important that you comment on proposals that you favor as well as any that you do not favor. Comments that include the reasons for your views will be especially appreciated.

The questions in this section are available in a Word file for your use at www.fasab.gov/exposure.html. Your responses should be sent by e-mail to fasab@fasab.gov. If you are unable to respond electronically, please fax your responses to (202) 512-7366 and follow up by mailing your responses to:

Wendy M. Payne, Executive Director
Federal Accounting Standards Advisory Board
Mailstop 6K17V
441 G Street, NW, Suite 6814
Washington, DC 20548

All responses are requested by [insert date].

Q1. A summary of the issue (one paragraph) should be presented followed by a question. If multiple questions follow one issue summary, use letters to distinguish them.

Q2.

Q3. Why

Introduction

Purpose

1. The Board is evaluating existing standards to identify areas for improvement. SFFAS 27, *Identifying and Reporting Earmarked Funds*, has been in effect since FY2006. The review considered the results of the reporting requirements as well as the challenges inherent in presenting understandable information.

Materiality

2. The provisions of this Statement need not be applied to immaterial items. The determination of whether an item is material depends on the degree to which omitting or misstating information about the item makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or the misstatement.

Proposed Standard

Scope

3. The Statement amends Statement of Federal Financial Accounting Standard (SFFAS) 27, *Identifying and Reporting Earmarked Funds*.

Amendments

4. SFFAS 27, paragraph 11 is amended to provide that a non-federal source of revenue or other financing source must exist if a fund is to be classified as earmarked. Changes to paragraph 11 are:

[11.] Earmarked funds 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. 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 three required criteria for an earmarked fund 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[3a] only for designated activities, benefits or purposes;

2. Explicit authority for the ~~earmarked~~ fund to retain revenues and 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[4] on the receipt, use, and retention of the revenues and other financing sources that distinguishes the ~~earmarked~~ fund from the Government's general revenues.

Footnote 3a: In some cases, specifically identified revenues or other financing sources are collected from a non-federal source by one agency and transferred or appropriated to another. For example, Social Security taxes are collected from non-federal entities (employees and employers) by the Internal Revenue Service. Those amounts are subsequently appropriated and transferred to the Social Security Administration. This internal process does not change the nature of the revenue or other financing source (i.e., specifically identified revenues or other financing sources originally collected from a non-federal source).

Footnote 4: A "report" may be something other than stand-alone financial statements for the earmarked fund.

5. SFFAS 27, paragraph 13 is amended to clarify that generally classification occurs at the fund level based on the fund's predominant source of funding. An exception is made if material earmarked revenue is a secondary source of funding. In this case, the entire fund should be classified as earmarked. Changes to paragraph 13 are:

[13] **Fund** in this statement's definition of earmarked funds 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."[5] Classification as earmarked or non-earmarked is made at the level of an individual fund. A fund should be classified as earmarked if its predominant sources of funding meet the paragraph 11.1 criterion and the fund meets the additional criteria in paragraphs 11.2 and 11.3. In addition, a fund should be classified as earmarked if a secondary source of funding that is material to the reporting entity meets the paragraph 11.1 criterion and the fund meets the additional criteria in paragraphs 11.2 and 11.3. For example, as currently funded, Medicare Parts B and D should be subject to the earmarked fund reporting requirements even though they are supplemented by general fund appropriations that may exceed the amount of premiums collected from participants.

Footnote 5: National Council on Governmental Accounting Statement 1, par. 16.

6. SFFAS 27, paragraph 14 is amended for clarity.

[14] Whereas earmarked funds are financed by specifically identified revenues and other financing sources, the general fund is financed by receipts not earmarked by law for a specific purpose and the proceeds of general borrowing. Although there are exceptions, funding decisions regarding activity financed from general receipts usually govern one fiscal year and are made as part of the process of enacting one of the annual appropriations acts. In contrast, legislation establishing earmarked funds reflects a longer (if not indefinite) Government commitment to collect, hold and spend identified revenues for a designated activity, benefit or purpose. Earmarked funds may ~~have~~ be given authority to make outlays by means of a permanent indefinite appropriation, often enacted by authorizing legislation. If not, an appropriation provided in annual appropriation acts is necessary to make expenditures. Whether the ~~appropriation~~ budget authority is provided by authorizing legislation or annual appropriations acts, the

~~cumulative results of operations~~ accumulated resources arising from earmarked funds ~~is~~ are reserved or restricted to the designated activity, benefit or purpose.

7. SFFAS 27, paragraph 18 is amended to exclude pension, other retirement benefit, and other post-employment benefit funds from earmarked funds. Changes to paragraph 18 are:

[18.] Certain categories of funds are excluded from the reporting requirements of this standard. Intragovernmental funds are excluded because they are revolving funds that conduct business primarily within and between Government agencies. Credit financing accounts are also excluded. Credit financing accounts are nonbudgetary funds that do not accumulate results of operations; they primarily serve as clearing accounts for cash activity relating to Federal credit programs. Fiduciary funds, which are not Government-owned, are also excluded. [Additional exception are still being researched – options under consideration are: (1) Funds established to account for pensions, other retirement benefits, and other post-employment benefits provided to federal employees should not be classified as earmarked funds. or (2) Funds for which the predominant source of funding is exchange revenue unless the exchange revenue is set aside for the benefit of the general public rather than simply as reimbursement for goods or services provided to the purchaser.]

8. SFFAS 27, paragraphs 19 through 26 and related headings are amended to (a) permit but not require disclosure of information on the face of the financial statements for **component entities**, (b) remove existing requirements including requirements for eliminations and provide that either combined or consolidated amounts may be presented so long as amounts are appropriately labeled, and (c) related conforming changes for clarity. Changes are:

~~Financial Statement Presentation and~~ Disclosures for Component Entities

~~Financial Statement Presentation~~

[19.] ~~Earmarked non-exchange revenue and other financing sources, including appropriations, and net cost of operations should be shown separately on the Statement of Changes in Net Position. Also, the portion of cumulative results of operations attributable to earmarked funds should be shown separately on both the Statement of Changes in Net Position and the Balance Sheet. This standard does not require earmarked funds to be separately shown on the Statement of Net Cost. (See Appendix C: Pro Forma Illustrations for examples of accounting entries and financial reporting.)~~

[20.] Most earmarked revenues and other financing sources are in the basic financial statements of the entity carrying out the program and responsible for administration of the fund. If more than one component entity is responsible for carrying out the program financed with earmarked revenues and other financing sources, and the separate portions of the program can be clearly identified with a responsible component entity, then each component entity should report its portion in accordance with the requirements of this standard. If separate portions cannot be identified, the component entity with program management responsibility should report the fund.[7]

Footnote 7: To determine program management/accounting responsibility, agencies should consider the legislation authorizing the program; the Memorandum of Understanding that establishes responsibilities; and the provisions of SFFAC 2, *Entity and Display,* as amended by this standard.

~~Disclosure~~

[21.] A component entity should disclose[8] the portions of beginning and ending net position, non-exchange revenue and other financing sources, including appropriations, and net costs of operations attributable to earmarked funds and to all other funds. Entities may present combined or consolidated amounts but must appropriately label the amounts. In addition, a component entity should disclose all earmarked funds for which it has program management responsibility by either a list, by official title, or a statement indicating where the information can be obtained. An earmarked fund should not be characterized as a “trust” in general purpose external financial reports of Federal entities. (The use of the term “trust fund” is acceptable only in the fund’s official title.)

Footnote 8: Disclosure is reporting information in notes or narrative regarded as an integral part of the basic financial statements.

[22.] ~~The following~~ Information should be disclosed for each individual earmarked fund~~s~~. An exception is provided for component entities having numerous individual earmarked funds. Paragraph 24 discusses criteria to consider in selecting individual funds for disaggregated disclosure. Entities may present combined or consolidated amounts but must appropriately label the amounts. The following information should be disclosed for selected individual earmarked funds, ~~and~~ in aggregate for all remaining earmarked funds, and in total for all the entity’s earmarked funds:

1. Condensed information about assets and liabilities showing investments in Treasury securities, other assets, liabilities due and payable, other liabilities, cumulative results of operations and net position.

2. Condensed information on gross cost, exchange revenue, net cost, nonexchange revenues and other financing sources, and change in net position.

~~The information required by this paragraph for earmarked funds may be presented separately on the face of the entity's basic financial statements or disclosed in the accompanying notes. Information for funds not presented individually may be aggregated, but must be provided even if the aggregate total is immaterial. The total cumulative results of operations shown in the note disclosure should agree with the cumulative results of operations for earmarked funds shown on the face of the component entity's basic financial statements.[9] (See Appendix D: Examples of Note Disclosure of Summary Financial Information for an illustration of the disclosure required by this paragraph.)~~

~~Footnote 9: For the U.S. Treasury and any other component entity where earmarked fund investments are eliminated within the component entity, the note disclosure should include eliminations, similar to the note disclosure provided by the U.S. Government-wide financial statements as described in paragraph 30.~~

[23.] The following information should be disclosed for each individually reported earmarked fund, or portion thereof, for which a component entity has program management responsibility (see paragraph 24.).

1. A description of each fund's purpose, how the entity accounts for and reports the fund, and its authority to use those revenues and other financing sources.

2. The sources of revenue or other financing for the period and an explanation of the extent to which they are inflows of resources to the Government or the result of intragovernmental flows.

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.

[24.] Selecting earmarked funds to be presented individually requires judgment. The preparer should consider both quantitative and qualitative criteria. Acceptable criteria include but are not limited to: quantitative factors such as the percentage of the reporting entity's earmarked revenues or cumulative results of operations from earmarked funds; and qualitative factors such as whether an earmarked fund is of immediate concern to constituents of the fund, whether it is politically sensitive or controversial, whether it is accumulating large balances, or whether the information provided in the financial statements would be the primary source of financial information for the public.

~~[25.] The total cumulative results of operations of all earmarked funds shown in the note disclosure should agree with the cumulative results of operations of earmarked funds shown on the face of the component entity's Balance Sheet and the Statement of Changes in Net Position.~~

[26.] In accordance with the provisions of paragraph 20, if a component entity reports a different portion of an earmarked fund than it reported in prior years, it should not restate its prior year financial statements. It should disclose the change in a note. This applies if a component entity does not report an earmarked fund, or portion thereof, that it reported in the previous year. It also applies if a component entity does report an earmarked fund, or portion thereof, that it did not report in the previous year.

9. In addition to the above changes, the term "earmarked funds" is being changed to "XX." To facilitate review, the entire amended text is presented in Appendix B without strikeouts and deletions.

Implementation Guidance

10. In the year this standard becomes effective, entities should restate prior period amounts displayed on the face of the financial statements and disclosed in notes.

Effective Date

11. These standards are effective for periods beginning after September 30, ___. Earlier implementation is encouraged.

12.

The provisions of this Statement need not be applied to immaterial items.

Appendix A: Basis for Conclusions

This appendix discusses some factors considered significant by Board members in reaching the conclusions in this Statement. It includes the reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others. The standards enunciated in this Statement–not the material in this appendix–should govern the accounting for specific transactions, events, or conditions.

Project Background

A1. SFFAS 27 was established to distinguish between earmarked funds and all other funds. Earmarked funds have characteristics that justify special accountability. An explicit commitment associated with the statutory establishment of earmarked funds is created that raises an expectation on the part of the public that the Government will use the amounts collected from specific sources and accumulated in earmarked funds for their stated purpose. There is often a direct link between the source of fund revenues and designated activities, benefits, or purposes in an effort to charge beneficiaries or users for benefits received. Resource inflow is accounted for separately from general tax receipts, allowing the program's status to be more easily examined.

A2. SFFAS 27 became effective in fiscal year 2006. It required each component entity to display nonexchange revenue and other financing sources, and net cost of operations attributed to earmarked and all other funds separately on the Statement of Changes in Net Position. The component entity also displays the portions of cumulative results of operations attributable to earmarked funds and all other funds separately on the Statement of Changes in Net Position and on the Balance Sheet. The government-wide financial statements display revenue, other financing sources and net cost of operations attributed to earmarked and all other funds separately on the U.S. Government Statement of Operations and Changes in Net Position. The U.S. Government Balance Sheet displays separately the portions of net position attributable to earmarked and all other funds.

A3. The Board is reviewing SFFAS 27 to determine if the intended objectives have been achieved. Following an initial review by staff, a task force that included representatives from 23 federal agencies was formed. The task force assisted the Board by identifying concerns, testing alternatives, and reviewing proposals.

Outcome of Task Force Evaluation

A4. The following four major issues were identified by FASAB staff and the Task Force:

a. **Appropriateness of Classifications** – the appropriateness of certain types of funds being classified as earmarked funds was questioned for the following reasons:

i. no non-federal (external) source of funding exists for some funds

ii. classification of funds with mixed sources of funding where the predominant source is general fund appropriations may be misleading

iii. more funds conducting business-like activities were classified as earmarked than anticipated

iv. funds supporting deferred compensation programs are among the largest and do not have significant external revenues that are reserved for specific future uses

b. **Understandability** – whether presenting earmarked funds information on the face of component-level financial statements is understandable to financial statement readers

c. **Eliminations** – confusion over whether and how to perform and disclose eliminations at the component entity level

d. **Term "Earmarked"** – confusion caused by competing meanings of the term "earmarked"

A5. These issues are discussed in more detail in the sections that follow.

Appropriateness of Classifications

A6. A primary objective of SFFAS 27 was that "under this standard the financial statements would thus present – in a transparent manner – the cumulative financing provided by earmarked funds to the general fund that will need to be repaid in order to use earmarked funds for the designated activities, purposes or benefits."[1] The need for greater transparency was explained as follows:

> …the consolidated net position of the Federal Government reported on the U.S. Government-wide financial statements does not include the effect of the claim on the U.S. Treasury that the various funds hold, just as the consolidated net position does not include the effect of other intragovernmental claims. Instead, the U.S. Government-wide financial statements include the cumulative results of operations of earmarked funds – currently a large positive balance – as an offset against the cumulative results of operations of the general fund – currently a large negative balance. The result is that the financing provided by earmarked fund operations to general fund operations – which would otherwise be financed through the issuance of debt to the public, tax increases or other financing sources – is not shown on the face of the U.S. Government Balance Sheet.[2]

A7. By providing separate presentation of the cumulative results of operations attributable to earmarked funds, the commitment to restrict the use of net position, or "net assets," accumulated in earmarked funds would be apparent. In developing SFFAS 27, the Board noted that a 2001 report "identified three hundred and ninety-two possible earmarked funds. Annual revenues and other financing sources for those earmarked funds range from negligible amounts to over half a trillion dollars. Accumulated balances range from zero to over a trillion dollars."[3] However, upon implementation in 2006, five of the sixteen largest earmarked funds reported a negative net position.

A8. Not previously having been aware of earmarked funds with negative net positions, staff questioned whether these funds are appropriately included as earmarked funds. Further research showed that some of the funds with negative net positions did not receive any non-federal sources

[1] SFFAS 27, Basis for Conclusions, par. 63.

[2] SFFAS 27, Basis for Conclusions, par. 62.

[3] SFFAS 27, Basis for Conclusions, Paragraph 3.

of funds. For example, the Medicare Eligible Retiree Health Care Fund receives income from three sources: an annual Treasury payment made on behalf of the Services at the beginning of the year based on average budgeted force strengths, annual payments from the Treasury to amortize the unfunded liability, and investment income on Treasury securities.

A9. The intent of SFFAS 27 was that the specifically identified revenues and other financing sources required to meet the criteria for an earmarked fund should be from a source that is non-federal – that is, a source that is external to the federal government. Evidence of that intent is found in the SFFAS 27 explanation that earmarked funding "raises an expectation on the part of the public that the Government will use the amounts collected from specific sources and accumulated in earmarked funds for their stated purpose."[4] However, SFFAS 27 did not explicitly state that a non-federal source of funds was required and current reporting practices vary. To ensure that earmarked funds are those where such a public expectation exists, the Board is proposing amendments to explicitly state that the source of the specifically identified revenues or other financing source must be external to the federal government, and clarify the distinction between earmarked funds and the general fund.

A10. In implementing SFFAS 27, agencies classified numerous funds primarily funded by general fund appropriations as earmarked funds. In some such cases, the funding from external 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.

A11. To avoid such overstatements while minimizing reporting burdens, the Board believes that to be classified as an earmarked fund, a fund should

[4] SFFAS 27, Basis for Conclusions, Paragraph 54.

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 fund should be classified as earmarked even if these 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 are earmarked will be disclosed and costs will not be incurred to provide special accountability for immaterial amounts of non-federal revenue that are earmarked but commingled with other financing sources provided through general fund appropriations.

A12. The Board also noted funds arising from exchange transactions were classified as earmarked and questioned this result given the nature of such funds. For example, some funds collect fees, premiums, or other exchange revenue from ongoing business-like activities such as insurance programs while others collect contributions from employees to offset the cost of benefits. Generally, when an exchange occurs there is an expectation that the individual providing the revenue received the good or service purchased and no longer expects “special accountability” after the transaction is completed. If revenue was provided but the associated good or service has not yet been provided, a liability is recognized and provides any needed accountability for unmet obligations to the individual. In these cases, additional reporting as earmarked would be unnecessary.

A13. There are, however, exceptions to this general rule regarding exchange transactions. The federal government often sets aside exchange revenue for the benefit of the general public rather than simply treating it as reimbursement for goods or services provided to the purchaser. For example, this type of scenario may occur when public lands are used to generate revenue through user fees or sales of the land and the natural resources contained within. The Department of Interior (DOI) reports several funds that earn exchange revenue and commit it to solving a related public problem or providing a benefit to the general public. The DOI FY2009 financial report described one such fund as follows:

> ***Southern Nevada Public Land Management Fund (SNPLMF).*** The Southern Nevada Public Land Management Act, enacted in October 1998, authorizes BLM to sell public land tracts that are interspersed with or adjacent to private land in the Las Vegas Valley. BLM is authorized to deposit the proceeds as follows: 85 percent in the SNPLMF, 10 percent to the Southern Nevada Water Authority, and 5 percent to the State of Nevada’s Education Fund. The revenues generated from the land sales are required to be used by BLM and other government entities to acquire environmentally sensitive lands and build

or maintain trails, day use areas, campgrounds, etc., to benefit public land visitors. The funds are considered inflows of resources to the government. (Part II, page 88.)

A14. The Board believes the public should expect special accountability for funds committed to such purposes whether they are derived from exchange or non-exchange activities. Because of the variety of exchange revenues earmarked for specific purposes, the Board considered whether there were classes of exchange transactions that do not require the level of special accountability afforded to earmarked funds.

A15. [Options being considered by staff now include:

- Exclude funds for which the predominant source of funding is exchange revenue unless the exchange revenue is set aside for the benefit of the general public rather than simply as reimbursement for goods or services provided to the purchaser. Generally, when an exchange occurs there is an expectation that the individual providing the revenue received the good or service purchased and no longer expects “special accountability” after the transaction is completed. If revenue was provided but the associated good or service has not yet been provided, a liability is recognized and provides any needed accountability for unmet obligations to the individual. In these cases, additional reporting as earmarked would be unnecessary. However, where public goods – such as land – are sold and the exchange revenue committed to addressing specific public problems, special accountability is warranted.

- Deferred compensation funds have neither accumulated balances that may be used to finance future activities nor significant external sources of revenue. Employee contributions offset the overall cost of future benefits and are routinely withheld from employee pay. Ultimately, accountability runs to the total accumulated liability for deferred compensation and includes amounts covered by contributions from employees. Thus, the liability provides the needed accountability information for employee contributions. Further, employee contributions are a means of cost sharing between employer and employee rather than an externally generated revenue source.

STAFF AND THE TASK FORCE ARE CONTINUING TO CONSIDER THESE ALTERNATIVES. INPUT FROM THE BOARD WILL BE SOUGHT BUT NO DECISION REGARDING EXCHANGE REVENUE FINANCED FUNDS IS REQUESTED UNTIL THE FEBRUARY MEETING.]

Understandability

A16. Members of the task force expressed concerns regarding the understandability of financial statements displaying separate amounts for earmarked and all other funds. They believed users would find the display cluttered and confusing. Appendix B, Example Statement of Changes in Net Position, shows that four columns may be needed to convey information as required. This adds complexity to an already challenging financial presentation. Further, it prevents display of comparative financial statements on the same page.

A17. The Board believes that component entity financial statements need not display earmarked and all other fund totals separately. Instead, such information can be provided through disclosures. Component entity financial statements must be read with the understanding that they provide information about a single component of the federal government. Each component acts as an agent of that government and restrictions are placed on the use of most funds available to agencies whether earmarked or not. While special accountability for the use of funds can be conveyed through component entity reports by presenting information on significant individual funds, the cumulative financial implications of total earmarked funds are best understood from the government-wide perspective since the focus is on intra-governmental borrowing.

Component Entity Required Eliminations

A18. 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. Practice has varied as a result. The proposed amendments eliminate the confusing guidance and instead provide that combined or consolidated totals are permitted so long as they are properly labeled.

A19. The primary objective of SFFAS 27 relates to intra-governmental borrowing/investing:

> Under this standard the financial statements would thus present- in a transparent manner- the cumulative financing provided by earmarked funds to the general fund that will need to be repaid in order to use earmarked funds for the designated activities, purposes or benefits.[5]

A20. Another objective of SFFAS 27 relates to special accountability:

> All earmarked funds have characteristics that justify special accountability. While many Government programs raise implied commitments for the future, there is a more explicit commitment associated with the statutory establishment of earmarked funds. The Government raises an expectation on the part of the public that the Government will use the amounts collected from specific sources and accumulated in earmarked funds for their stated purpose.[6]

A21. The above objectives of SFFAS 27 focus primarily on the accumulated net position of earmarked funds. Because net position is not affected by eliminations, presentation of eliminations at the component entity level is not necessary to meet the objectives of SFFAS 27. In addition, because the focus of special accountability is necessarily on individual funds (or programs) – members question whether the consolidated total is useful for assessing the status of earmarked funds available for the individual purposes established in law.

A22. Members believe that a broader study of fund reporting is needed. Specifically, a fund reporting project would address the question of whether consolidated or combined amounts are more useful when reporting on a specific class of funds. Until such a study is completed, the Board believes it is acceptable to report either consolidated or combined amounts so long as the amount is appropriately labeled.

Term “Earmarked”

A23. Further discussion of term “earmarked” issue?

A24. To be developed

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[5] SFFAS 27, Basis for Conclusions, Paragraph 63.

[6] SFFAS 27, Basis for Conclusions, Paragraph 54.

Alternative Views

A25. Individual members sometimes choose to express an alternative view when they disagree with the Board's majority position on one or more points in a Statement. The alternative view would discuss the precise point or points of disagreement with the majority position and the reasons therefore. The ideas, opinions, and statements presented in the alternative view are those of the individual member alone. However, the individual member's view may contain general or other statements that may not conflict with the majority position, and in fact may be shared by other members. The material following was prepared by [insert name or names] and is presented as an alternative view.

A26.

Appendix B: Example Statement of Changes in Net Position

Statement of Changes In Net Position
For the Year Ended September 30, 20XX
(In dollars/thousands/millions)

FY 20XX **(CY)**

	Earmarked Funds	All Other Funds	Eliminations	Consolidated Total
Cumulative Results Of Operations:				
1. Beginning Balances	$ xxx	$ xxx	$ xxx	$ xxx
2. Adjustments:				
2A. Changes in accounting principles	xxx	xxx	xxx	xxx
2B. Corrections of errors	xxx	xxx	xxx	xxx
3. Beginning balance, as adjusted	xxx	xxx	xxx	xxx
Budgetary Financing Sources:				
4. Other adjustments	xxx	xxx	xxx	xxx
5. Appropriations used	xxx	xxx	xxx	xxx
6. Non-exchange revenue	xxx	xxx	xxx	xxx
7. Donations and forfeitures of cash and cash equivalents	xxx	xxx	xxx	xxx
8. Transfers in/out without reimbursement	xxx	xxx	xxx	xxx
9. Other	xxx	xxx	xxx	xxx
Other Financing Sources (Non-Exchange):				
10. Donations and forfeitures of property	xxx	xxx	xxx	xxx
11. Transfers in/out without reimbursement	xxx	xxx	xxx	xxx
12. Imputed financing	xxx	xxx	xxx	xxx
13. Other	xxx	xxx	xxx	xxx
14. Total Financing Sources	xxx	xxx	xxx	xxx
15. Net Cost of Operations	xxx	xxx	xxx	xxx
16. Net Change	xxx	xxx	xxx	xxx
17. Cumulative Results of Operations	**xxx**	**xxx**	**xxx**	**xxx**
Unexpended Appropriations:				
18. Beginning Balance	xxx	xxx	xxx	xxx
19. Adjustments:	xxx	xxx	xxx	xxx
19A. Changes in accounting principles	xxx	xxx	xxx	xxx
19B. Corrections of errors	xxx	xxx	xxx	xxx
20. Beginning Balance, as adjusted	xxx	xxx	xxx	xxx
Budgetary Financing Sources:				
21. Appropriations received	xxx	xxx	xxx	xxx
22. Appropriations transferred in/out	xxx	xxx	xxx	xxx
23. Other adjustments	xxx	xxx	xxx	xxx
24. Appropriations used	xxx	xxx	xxx	xxx
25. Total Budgetary Financing Sources	xxx	xxx	xxx	xxx
26. Total Unexpended Appropriations	xxx	xxx	xxx	xxx
27. Net Position	xxx	xxx	xxx	xxx

The accompanying notes are an integral part of these statements.

Appendix B: Illustration 254

Appendix C: Abbreviations 265

Appendix C: Abbreviations

Appendix D: Glossary

Component entities - The term "component entity" is used to distinguish between the U.S. federal government and its components. The U.S. federal government as a whole is composed of organizations that manage resources and are responsible for operations, i.e., delivering services. These include major departments and independent agencies, which are generally divided into suborganizations, i.e., smaller organizational units with a wide variety of titles, including bureaus, administrations, agencies, and corporations. (SFFAC No. 2, Entity and Display, pars. 11-12). Use of "component entity" in this standard is only intended to distinguish between the U.S. federal government's consolidated financial statements and financial statements of its components.

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