Memorandum

Commitments

November 17, 2023

To: Members of the Board

From: Sherry L. Lee, Senior Analyst

Thru: Monica R. Valentine, Executive Director

Subject: **Commitments** (Topic E)

INTRODUCTION

In the August 2023 meeting, the Board reviewed the commitments pre-research during the technical agenda discussion and agreed to add the topic of commitments as a research topic to the Board's agenda. Staff researched and prepared the attached analysis and is seeking the Board's feedback on the questions.

REQUEST FOR FEEDBACK BY DECEMBER 7, 2023

Please review the attached Staff Analysis on commitments. Staff requests responses to the ensuing question in the Staff Analysis by **December 7, 2023**.

Please submit responses to Sherry L. Lee at LeeSL@fasab.gov with a cc to Monica Valentine at ValentineM@fasab.gov.

NEXT STEPS

Staff will continue the research on the topic of commitments.

ATTACHMENTS

Attachment 1: Staff Analysis

Staff Analysis

Topic E: **Commitments**

November 17, 2023

INTRODUCTION

Federal entities enter into binding agreements with other entities to support the organizations' missions. These agreements may result in current and future outflow of resources to the federal government. The Board provides general guidance on liability recognition and disclosure in Statement of Federal Financial Accounting Standards (SFFAS) 5, *Accounting for Liabilities of the Federal Government,* when the agreements meet the criteria for liability recognition. The Board also provides specific guidance on certain types of agreements such as public-private partnerships in SFFAS 49, *Public-Private Partnerships: Disclosure Requirements,* and leases in SFFAS 54, *Leases*. However, the Board has not fully addressed the reporting requirements for agreements that may not have a financial effect on current position but may have a financial effect on future position of the government. In the April 2023 meeting, the Board raised the question on the need for a standard on commitments. In the August 2023 meeting, the Board reviewed the pre-research material on commitments during the technical agenda review session and agreed to add the topic of commitments as a research project.

SUMMARY OF ANALYSIS AND RECOMMENDATION

Commitments are binding agreements as the result of current or past transactions. Some of these agreements are not required to be recognized on the Balance Sheet or disclosed in the notes to the financial statements according to current liability accounting standards because they do not meet the criteria for liability recognition or disclosure. However, their effect on future financial position of the federal government may be significant and failure to disclose commitments may be misleading to financial statement users. Commitments need to be accounted for to ensure future budgetary integrity and transparency about the federal government's financial condition. Staff recommends that the Board continues the research on the topic of commitments to develop accounting and reporting standards on commitments.

STAFF RESEARCH AND ANALYSIS

Federal entities enter into various agreements with other entities in the course of carrying out their missions. Some of these agreements may result in liabilities to the federal government in the period the agreements are entered into, while others may result in liabilities in future periods. Commitments are existing arrangements to enter into future transactions or events. Appendix A below lists and describes significant commitments of the federal government, including undelivered orders, international or other agreements in support of international economic development, and agreements supporting financial market stability.

Current Liability Concepts and Standards

Statement of Federal Financial Accounting Concepts (SFFAC) 5, *Definitions of Elements and Basic Recognition Criteria for Accrual-Basis Financial Statements* provides the definition and basic recognition criteria for liabilities related to these agreements.

In SFFAC 5, the Board defines a liability as follows:

- *"A liability is 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." (paragraph 39)*

SFFAC 5 describes the two essential characteristics of liabilities:

1. <u>Present obligation</u>

- *"As the term is used in this Statement, an obligation is a duty or responsibility to act in a certain way. To have a present obligation means that the obligation arose as a result of a past transaction or another event and has not yet been settled. Thus, a present obligation should be distinguished from a mere expression of future intent, such as the government's announcement that it intends to acquire equipment. A present obligation is incurred when the government takes a specific action or an event occurs that commits or binds the government." (paragraph 42)*

2. <u>Settlement of the obligation</u>

- *"The second essential characteristic of a liability is that either a law or an agreement or understanding between the government and another entity identifies conditions or events that will determine when the obligation will be settled. The timing of settlement often is expressed in contracts and other agreements as a specific or determinable date. However, in some cases the parties agree that settlement will be triggered by a specific event or by the demand of the recipient of the assets or services, the timing of which may be uncertain. If, at the reporting date, the government and the other entity do not have an agreement or understanding concerning settlement and the government is free to decide whether and when to settle its obligation, the obligation does not meet the definition of a liability." (paragraph 45)*

In addition to the guidance in SFFAC 5, SFFAS 5 defines the recognition points for liabilities associated with different types of events and transactions:

- *"A liability for federal accounting purposes is a probable future outflow or other sacrifice of resources as a result of past transactions or events. General purpose federal financial reports should recognize probable and measurable future outflows or other sacrifices of resources arising from (1) past exchange transactions, (2) government-related events, (3) government-acknowledged events, or (4) nonexchange transactions that, according to current law and applicable policy, are unpaid amounts due as of the reporting date." (paragraph 19)*

- ***"****An <u>exchange transaction</u> arises when each party to the transaction sacrifices value and receives value in return. There is a two-way flow of resources or of promises to provide resources. In an exchange transaction, a liability is recognized when one party receives goods or services in return for a promise to provide money or other resources in the future." (paragraph 22*)

- *"A <u>nonexchange transaction</u> arises when one party to a transaction receives value without directly giving or promising value in return. There is a one-way flow of resources or promises. For federal nonexchange transactions, a liability should be recognized for any unpaid amounts due as of the reporting date." (paragraph 24)*

SFFAS 5 also defines contingencies:

- *A contingency is an existing condition, situation, or set of circumstances involving uncertainty as to possible gain or loss to an entity. The uncertainty will ultimately be resolved when one or more future events occur or fail to occur. Resolution of the uncertainty may confirm a gain (i.e., acquisition of an asset or reduction of a liability) or a loss (i.e., loss or impairment of an asset or the incurrence of a liability). (paragraph 35)*

Analysis 1 – Do Commitments Meet the Definition of Liability in SFFAC 5?

I. Present Obligation

Commitments are existing binding agreements to enter into future transactions or events. The agreements do not obligate the federal government until the future transactions or events take place, at which point the federal government will be obligated to provide assets or services. Some commitments may not meet the definition of a liability. For example, under the government-sponsored enterprises (GSE) senior preferred stock purchase agreements, Treasury agrees to disburse funds to the GSE if, at the end of any quarter, the liabilities of the GSE exceed its assets, to maintain positive net worth. Treasury does not have an obligation to disburse funds to the GSE until the GSE's net worth is negative. Thus, Treasury does not have a "<u>present</u>

obligation" to provide funds to the GSEs until the condition associated with the agreements are met.

Another example is the Department of Agriculture's agreements to extend loan guarantees, which are binding agreements related to a loan guarantee, insurance, or other pledge with respect to the payment of all or a part of the principal or interest on any debt obligation of a non-federal borrower to a non-federal lender when specified conditions are fulfilled by the borrower, the lender, or any other party to the guarantee agreement. Until the conditions in the agreements are fulfilled, Agriculture does not have a "present obligation" to provide funds for the payments.

II. Settlement of Obligation

As commitments do not obligate the federal government until the conditions specified in the agreements are met, the federal government would not have an understanding of the timing of the settlement of the obligation as of the reporting date.

In conclusion, the federal government's commitments do not meet the definition of liability in SFFAC 5 because there is no present obligation and settlement of the obligation is unknown as of the reporting date.

Analysis 2 – Do commitments meet the liability recognition criteria in SFFAS 5?

Staff analyzed various federal government commitments and determined whether the transactions are exchange and non-exchange in the following table:

Examples of Commitments	Description of Agreement	Exchange/Non-Exchange
Undelivered Orders - Unpaid	Value of goods and services ordered that have not yet been received and that have not been prepaid	Exchange
Government-Sponsored Enterprises (GSE) Senior Preferred Stock Purchase Agreements	Treasury agrees to disburse funds to the GSE if, at the end of any quarter, the liabilities of either GSE exceed its assets, to maintain positive net worth, with a fixed maximum funding commitment amount available to each GSE under the agreement	Non-exchange
U.S. Participation in the International Monetary Fund	U.S. financial commitments to the IMF becomes binding when the U.S. consents to an increase in quota subscription or borrowing arrangement with the IMF and all other conditions to the increase have been met	Non-exchange

Callable Capital Subscriptions for Multilateral Development Banks (MDB)	Treasury subscribes to shares of certain MDB that are callable under certain limited circumstances to provide supplemental resources that can be used by the MDBs to obtain favorable financing terms when borrowing from international capital market	Non-exchange
Fuel, Power, or Other Purchase Obligations	Agencies enter into binding agreements to purchase fuel, power, or others to comply with various laws and regulations or to share costs.	Exchange
Commitments to Extend Loan Guarantees	Loan guarantee commitments are binding agreements by the Department of Agriculture to make a loan guarantee, insurance, or other pledge with respect to the payment of all or a part of the principal or interest on any debt obligation of a non-federal borrower to a non-federal lender when specified conditions are fulfilled by the borrower, the lender, or any other party to the guarantee agreement	Non-exchange
Grant Programs – Airport Improvement Program	Airport Improvement Program grant agreements that provide grants for the planning and development of public-use airports	Non-exchange

Commitments do not meet the criteria for liability recognition according to SFFAS 5 because:

1. For exchange type commitments, good or services have not been received or goods or services will be provided in the future, and
2. For non-exchange type commitments, there is no unpaid amount due as of the reporting date.

In addition, commitments and contingencies are similar. Both are related to the obligations of the federal government to provide resource. However, the concepts are different. Commitments are binding agreements that will become obligations of the federal government to provide resources when conditions specified in the agreements are met, whereas contingencies may or may not become obligations for the government to provide resources, depending on the occurrence or nonoccurrence of the future events. Commitments do not become liabilities of the federal government until conditions specified in the agreements are met, but liabilities for contingencies may be reasonably estimated if the likelihood of occurrence or nonoccurrence of the future event is probable.

Why report commitments?

Although commitments do not meet the liability definition in SFFAC 5 and the liability recognition criteria in SFFAS 5, commitments are the result of existing arrangements that may have significant effect on future financial position of the government and should be reported for purposes of accountability, transparency, and sustainability. In

2022 and 2021, commitments were approximately $2.36 trillion and $2.23 trillion, respectively.

In Statement of Federal Financial Accounting Concepts (SFFAC) 1, *Objectives of Federal Financial Reporting,* the Board established four objectives of federal financial reporting, including (1) budgetary integrity, (2) operating performance, (3) stewardship, and (4) systems and controls. Specifically, objective 1, *budgetary integrity,* states that

- *"Federal financial reporting should assist in fulfilling the government's duty to be publicly accountable for monies raised through taxes and other means and for their expenditure in accordance with the appropriations laws that establish the government's budget for a particular fiscal year and related laws and regulations. Federal financial reporting should provide information that helps the reader to determine:*

    - *how budgetary resources have been obtained and used and whether their acquisition and use were in accordance with the legal authorization,*
    - *the status of budgetary resources, and*
    - *how information on the use of budgetary resources relates to information on the costs of programs operations and whether information on the status of budgetary resources is consistent with other accounting information on assets and liabilities." (paragraph 13)*

In addition, objective 3, *stewardship,* states that

- *"Federal financial reporting should assist report users in assessing the impact on the country of the government's operations and investments for the period and how, as a result, the government's and the nation's financial conditions have changed and may change in the future." (paragraph 15)*

- *Federal financial reporting should provide information that helps the reader to determine whether:*

    - *the government's financial position improved or deteriorated over the period,*
    - *future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due, and*
    - *government operations have contributed to the nation's current and future well-being." (paragraph 16)*

Commitments may not meet the liability recognition criteria for the current periods, but they are the actions of past transactions that will obligate the government when conditions or criteria specified in the agreement are met. Commitments may not result in costs to current operation but may incur significant future costs to the government which will affect the government's future financial position. Therefore, staff believes the Board should develop guidance for reporting commitments so users are informed about the costs of the government's operation and may evaluate how current actions impact future budgetary resources, and whether the government can sustain the agreements as currently constructed to ensure sufficient resources will be available to support the government programs. Failure to report commitments may potentially be misleading to users about the future of the government's financial condition.

Characteristics of Commitments

Staff analyzed various federal government commitments and noted the following characteristics[1]:

- The agreements are existing arrangements.
- The agreements are binding.
- The agreements may result in exchange or non-exchange transactions.
- The conditions specified in the agreement need to be met before the government is obligated to provide resources.
- When conditions are met, the government is obligated to provide resources to the other entity to the agreement.

Question for the Board:

1. Do members have any comments or questions regarding staff's research on the topic of commitments?

NEXT STEPS

Depending on the Board's decision during the December 2023 meeting, staff will continue the research on the topic of commitments.

[1] Refer to Appendix A for descriptions of various commitments.

Appendix A: Significant Federal Government Commitments

The following are descriptions of significant federal government commitments:

- Congress established Fannie Mae and Freddie Mac as government-sponsored enterprises (GSEs) to provide stability and increase liquidity in the secondary mortgage market and to promote access to mortgage credit in the United States by purchasing and packaging mortgages into securities and sell to investors. In 2008, in response to the financial crisis that threatened the housing market, Congress passed the Housing and Economic Recovery Act (HERA), which provided the Treasury Secretary with certain authorities to ensure the financial stability of the GSEs. Treasury enters into Senior Preferred Stock Purchase Agreement (SPSPA) with each GSE. The SPSPAs, which has no expiration date, requires Treasury to disburse funds to the GSE if, at the end of any quarter, the liabilities of either GSE exceed its assets, to maintain positive net worth, with a fixed maximum funding commitment amount available to each GSE under the agreement.[2]

  The maximum remaining contractual commitment to the GSEs for the remaining life of the SPSPAs totaled $284 billion and $254 billion as of September 30, 2022 and 2021, respectively.[3]

- Treasury, on behalf of the U.S. government, participates in the International Monetary Fund (IMF) through a quota subscription and a borrowing arrangement that supplements IMF resources. U.S. financial commitments to the IMF becomes binding when the U.S. consents to an increase in its participation as an IMF member country and all other conditions to the increase have been met.

  - The outstanding financial commitment in the U.S. quota changes when the IMF draws upon or repays funding it obtained pursuant to a letter of credit established by the U.S. to make domestic currency available to the IMF as needed.

  - The outstanding financial commitment in the supplemental borrowing arrangement changes when the IMF borrows and repays loans under the related supplemental funding arrangement.

  The financial commitment under the U.S. quota and borrowing arrangements totaled $146.4 billion and $162.6 billion as of September 30, 2022, and September 30, 2021, respectively.

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[2] Source: Agency Financial Report | U.S. Department of the Treasury .

[3] Source: Financial Report of the United States Government - Financial Statements of the United States Government for the Fiscal Years Ended September 30, 2021, and 2020 (treasury.gov).

- Treasury, on behalf of the U.S. government, subscribes to shares of certain multilateral development banks (MDB), which are international financial institutions that finance economic and social development projects in developing countries. Some shares represent capital commitments that are callable under certain limited circumstances to meet the obligations of the respective MDB. Callable capital in the MDBs provide supplemental resources that can be used by the MDBs to obtain favorable financing terms when borrowing from international capital market. There has never been a call and none is anticipated. As of September 30, 2022, callable capital in MDBs totaled approximately $128 billion.

- Fuel purchase obligations

    - Tennessee Valley Authority has fuel purchase obligations which includes commitments to purchase nuclear fuel, coal, and natural gas, as well as related transportation and storage services. As of September 30, 2022, TVA has fuel purchase obligations totaled $5.1 billion ($5,148 million).[4]

- Power Purchase Obligations

    - TVA also has power purchase obligations, which includes commitments for energy and/or capacity under power purchase agreements from coal-fired, hydroelectric, diesel, renewable, and gas-fired facilities, as well as transmission service agreements to support purchase of power from the market. As of September 30, 2022, TVA's total power purchase obligations were $2.6 billion ($2,536 million)[5].

    - The Department of Energy enters into long-term agreements to purchase power for future delivery to cover a potential shortage when the Power Marketing Administrations[6] (PMAs) forecast a resource shortage. The future power purchase obligations or commitments as of September 30, 2022, totaled $645 million.[7]

- Commitments to extend loan guarantees

  Loan guarantee commitments are binding agreements by a federal agency to make a loan guarantee, insurance, or other pledge with respect to the payment of all or a part of the principal or interest on any debt obligation of a non-federal borrower to a non-federal lender when specified conditions are fulfilled by the

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[4] Source: [TVA - Financial Information - SEC Filings - Document Details (q4ir.com)]

[5] Source: [TVA - Financial Information - SEC Filings - Document Details (q4ir.com)]

[6] There are four Power Marketing Administrations in the United States, including Bonneville Power Administration (BPA), Western Area Power Administration (WAPA), Southeastern Power Administration, and Southwestern Power Administration that operate electric systems and sell the electrical output of federally owned and operated hydroelectric dams in 34 states.

[7] Source: [FY 2022 DOE Agency Financial Report | Department of Energy]

borrower, the lender, or any other party to the guarantee agreement.[8] Beginning with fiscal year 1992, the planned level of loan guarantee commitments associated with each appropriation request is included in the president's budget. The authority to incur new loan guarantee commitments or modify outstanding loan guarantee commitments constitutes new budget authority in the fiscal year in which definite authority becomes available or indefinite authority is used.

The Department of Agriculture's commitments to extend loan guarantees are estimated to be $4.6 billion (or $4,605 million) and $5.6 billion (or $5,600 million) in FY 2022 and FY 2021, respectively.[9]

- Grants programs – Airport Improvement Program

  The Department of Transportation's Federal Aviation Administration (FAA) issues letter of intent to enter into annual Airport Improvement Program grant agreements that provide grants for the planning and development of public-use airports that are included in the National Plan of Integrated Airport System. As of September 30, 2022, and 2021, the FAA has letters of intent totaled $260 million and $200 million, respectively.[10]

- Other purchase obligations – USPS, Energy, TVA, DHS,

  - USPS has capital commitments to purchase of equipment, building improvements and vehicles. As of September 30, 2022, USPS has capital commitments totaled $5,613 billion.[11]

  - DOE's WAPA and BPA are required by law to make cash distributions to the Treasury for the portion of BOR's original capital construction costs allocated to irrigation purposes, which were determined by the Secretary of the Interior to be beyond the ability of the irrigation customers to pay. Statutory provisions guide the assumptions related to the amount and timing of the distributions. Future irrigation assistance payments are scheduled for BPA to total $247 million over a maximum of 66 years from the time the irrigation facilities were completed and place in service.

  - To comply with the Northwest Power Act, BPA enters into long-term agreements to protect, mitigate, and enhance fish and wildlife and their habitats to the extent they are affected by the Federal hydroelectric projects on the Columbia River and its tributaries from which BPA markets power. In addition, BPA enters into long-term agreements for power

[8] Federal Credit Reform Act of 1990, Section 502.

[9] Source: Agency Financial Reports (AFR) | USDA at https://www.usda.gov/ocfo/plans-reports/agency-financial-reports.

[10] Source: DOT FY 2022 Agency Financial Report | US Department of Transportation at https://www.transportation.gov/mission/budget/dot-fy-2022-agency-financial-report.

[11]Source: Form 10-K FY 2022 at Financials - What we do - About.usps.com at https://about.usps.com/what/financials/10k-reports/fy2022.pdf

purchases to comply with the Endangered Species Act. As of September 30, 2023, BPA has long-term fish and wildlife agreements with estimated contractual commitments of $373 million.

- Tennessee Valley Authority's other purchase obligations primarily include long-term service contracts, contracts that contain minimum purchase levels for the purchase of limestone along with related storage and transportation, and contractual obligations related to TVA's load control program. As of September 30, 2022, TVA's other purchase obligations totaled $406 million.

- DHS maintains one letter of intent for modifications to airport facilities in which TSA uses cost-sharing agreements with the airports to modify the facilities for checked baggage screen projects. As of September 30, 2022, TSA received documentation for costs incurred totaling $58 million for unpaid invoices. [12]

[12] Source: https://www.dhs.gov/publication/dhs-fiscal-year-2022-performance-accountability-reports.