FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD
June 24-25, 2015
Room 7C13
441 G Street NW
Washington, DC 20548

Wednesday, June 24, 2015

Administrative Matters

- **Attendance**

The following members were present throughout the meeting: Messrs. Allen, Granof, Showalter, Smith, and Steinberg. Mr. McCall attended on June 24th. Mr. Reger attended on June 24th and was represented by Ms. Kearney on June 25th. Mr. Dacey was represented by Mr. Gary Engel with the exception of the public-private partnership discussion on June 24th which he participated in by teleconference. Ms. Ho was represented by Ms. Ann Davis. The executive director, Ms. Payne, and general counsel, Mr. Marchand, were present throughout the meeting.

- **Approval of Minutes**

The minutes of the April meeting were approved in advance of the meeting.

Agenda Topics

- **Educational Session – Review Revenue Standards and Related Statements**

The Board discussed some of the complexities involved in reporting component level entity revenue. For instance, the Board developed explicit guidance on how to classify various revenue transactions and, although an agency may collect and report exchange revenue on the Statement of Net Cost, it may not have the authority to spend those collections. Legislation must provide the agency with the authority to spend the collections or the agency must deposit the funds in the general fund of the Treasury. Also, in all cases, the funds that components collect are subject to appropriation and the agency must apply budgetary reporting controls. As a result, the Statement of Budgetary Resources may report appropriation amounts even when the Statement of Changes in Net Position shows no appropriations used or unexpended. Board members acknowledged the need to make component level reporting less challenging for readers to understand and continued discussing the model during the Reporting Model session.

<u>Additional Matters Discussed During the Session</u>

Staff noted that the Board has primarily focused on reporting costs and staff believed that the Board should remain aware of the complexities of revenue reporting. Ms. Eileen Parlow of the Securities and Exchange Commission (SEC) was invited to provide an overview of how the SEC reports revenue.

The Board discussed the substance of the fees that the SEC charges and how they might be classified on the Statement of Net Cost and Ms. Parlow noted that FASAB explicitly mentions the SEC in the revenue guidance. Statement of Federal Financial Accounting Standards (SFFAS) 7, Accounting for Revenue and Other Financing Sources, paragraphs 3 and 282 provide that the fees collected by the SEC should be reported as exchange revenue. In addition, Statement of Federal Financial Accounting Concepts (SFFAC) 2, *Entity and Display*, paragraph 90, explains that the SEC should not attribute this exchange revenue to various programs, regardless of how they might be related to the revenue. The reason for this approach is that the revenue is intended to fund the SEC as an entity. Therefore, it should simply subtract the revenue from the costs for the entire organization rather than subtracting revenue from each specific program's costs.

Mr. Steinberg asked whether the Implementation Guide for SFFAS 7 and Office of Management and Budget (OMB) Circular A-136, both of which indicate that the Statement of Net Cost should present the exchange revenues for each responsibility segment rather than aggregated for the agency as a whole, are higher in the GAAP Hierarchy than a concepts statement. Board members noted that although the standards require reporting exchange revenue by responsibility segment, they do allow for cases where revenue cannot be attributed to a particular responsibility segment. Mr. Reger emphasized that, in some cases, the revenue a component collects may not be intended to offset the cost of specific programs.

Ms. Parlow noted that although the goal of the SEC's rate-setting is to fully fund the SEC, this can only be approximated, because the rates must be set in advance and the SEC also does not know in advance how much Congress will authorize the SEC to spend in upcoming years. However, the intent is to fund the entire SEC, so that the appropriated funding needed to be provided to the SEC is zero. She said that this is an indication of the substance of the fee revenues, that they are intended to fund the entire SEC organization.

Members agreed that readers likely have difficulty understanding the current component level reporting model. Mr. Showalter noted that while deliberating the reporting model, the Board should consider guidance that helps the reader better understand federal revenues. Mr. Steinberg noted that to facilitate comparability among the components we need to adopt the concept that, yes, there are many legal requirements, but generally accepted accounting principles should guide financial reporting.

In response to a request to explain how the SEC's revenues are reported on the Statement of Budgetary Resources, Ms. Parlow said that the fees allowed to be used by the SEC are reported as Offsetting Collections on the Statement of Budgetary Resources. She said that if it turns out that the fees were not set quite high enough, any appropriated funding provided is reported as Appropriations Received. She said that in a situation where more fees were collected than the SEC was authorized to use, all of the exchange revenue would be recognized in the Statement of Net Cost, but any collections in excess of what the SEC is authorized to use would not be recognized in the Statement of Budgetary Resources, because the excess collections would not be available as budgetary resources for the SEC.

Mr. Allen added that the accounting should be based on economic substance and context is needed. Currently, although the financial statements use standard financial reporting terminology, the economic substance is not what users normally consider when assessing an entity's financial position. Components are not always able to retain the funds collected and, in some instances, a significant net position may not be viewed favorably. The component may not be accomplishing its mission and using the resources to provide programs.

Mr. Smith noted that perhaps classifications are needed to inform readers about the resources that have been assigned to the entity; what resources are available to use; and what resources have been restricted.

Mr. Granof agreed that the component level financial statements needed improvement and noted that the Board should develop a model that a reasonably skilled citizen could understand.

Regarding next steps, Mr. Reger suggested that the Board decide on the purpose of the consolidated report and the purpose of the component report. Is the purpose of the component level statements to be pieces of the consolidated, or do they unto themselves have value to a reader, such as management? If so, what is that value?

Mr. Allen suggested a discussion on ideal component level reporting and noted that the value of component level reporting may be that they help demonstrate compliance. While financial statements may be needed for those entities with business-like operations, another model may be needed for most departments and agencies. Departments and agencies should inform users about how they operate; their sources of funds; their performance; and compliance. This information could be unique to each agency and could be presented as supplemental information rather than for the purposes of consolidation into a government-wide report.

The Board also discussed providing specific guidance in the concepts or in standards. Ms. Payne noted that staff has suggested that concepts are not very specific and do not lead to a change in practice. If the Board would like to change current practice, the Board would need to consider a standards effort. Mr. Allen added that one question to consider is whether there should be one set of standards for all entities that are required to issue financial statements. Mr. Steinberg noted that, if the Board developed standards, the Board would need to explain the relationship of the standard to the OMB form and content guidance. The OMB has responsibility and authority for form and content of financial statements.

The Board continued discussing government-wide and component level reporting during the Reporting Model session.

- **Reporting Model**

The Board discussed a draft reporting model concepts statement. FASAB members deliberated a draft concepts statement that included discussions on the financial reporting objectives and FASAB’s priorities with respect to those objectives; reporting on financial condition at the government-wide level; the scope of financial reporting; financial statements and their relationship to other financial information sources; component entity reporting; and reporting budgetary information. The Board decided that the section discussing FASAB’s priorities was not needed because the Board’s priorities have been communicated in its Strategic Directions document and the priorities are subject to change. Also, Board members suggested that the concepts provide general, aspirational guidance and determined revisions. Staff will present a revised draft concepts statement at the August 2015 meeting. Details of the reporting model discussion follows.

Financial Condition at the Government-wide Reporting Level

The Board discussed the term financial condition and agreed that it is distinct from financial position. However, some Board members expressed concern that existing concepts explain financial condition too broadly. Statement of Federal Financial Accounting Concepts (SFFAC) 1, *Objectives of Federal Financial Reporting*, paragraphs 180 and 181, explain how financial condition is broader than financial position and notes that factors such as environmental degradation and the productivity of the U.S. economy affect judgments about the government's financial condition. Some Board members believe that such factors are beyond FASAB's scope while others believe that the concepts are aspirational and a general understanding of financial condition is needed because it cannot be measured simply by analyzing changes in a single number. The Board could develop standards to provide specific guidance for reporting financial condition.

Board members appeared to prefer the following discussion of financial condition noted in the draft concepts statement, although Mr. Steinberg stated he did not see the relevance of addressing financial condition vs. financial position in a concepts statement focusing on the component operating statement.:

51. Government-wide financial reporting should present the trends in the government's financial condition. In particular, financial statements and disclosures should:

    a. assist report users in understanding the government's financial condition at the end of the reporting period and how it changed from previous periods;

    b. assist report users in understanding the different sources of financing the cost of services now and in the future;

    c. assist report users in understanding the cost of services now and in the future; and

    d. provide links to information on the nation's economy.

52. The government-wide reporting level should assist readers in understanding that the federal government engages multiple organizations—including state and local governments, nonprofits, and private sector partners-in delivering services and the organizations frequently provide related services. The public is not always aware of the organizations involved in providing services and generally focuses on the services that impact them.

The Board believed that paragraph 51 should provide a framework. Accordingly, item 51.d. should be revised to state, "assist report users in finding relevant links to information on the nation's economy."

FASAB Priorities

The Board decided not to discuss its priorities in the concepts statement. FASAB's Strategic Directions document currently discusses the Board's priorities. Also, the Board's priorities can change.

Financial Reporting

The Board noted that the draft statement uses the term interoperability; however, the term needs to be defined and explained. Also, Board members discussed the broad nature of the term 'financial reporting' and the need for the Board to discuss its expectations for financial reports.

Mr. Allen noted that other sources may enhance GAAP reports and they are usually more detailed. Also, the Board's standards are based on accrual accounting and other sources use other measures.

Mr. Steinberg noted that the financial reporting section of the draft concepts statement should discuss more on new reporting mechanisms, such as checkbook reporting, in contrast to the financial statement approach and the different purposes of each. The Data Act definition of interoperability is broader than the criteria presented in the draft concepts. Interoperability refers to a widely-accepted, nonproprietary, searchable, platform-independent, computer-readable coding standard.

Mr. Reger noted that the Board should not mention specific legislation in the concepts because they are likely to change. He agreed that we have new reporting mechanisms that do not follow traditional accumulating reporting methodologies. However, is FASAB's definition of financial reports limited to GAAP reports? If mechanisms report federal financial information from the records used to generate financial statements should not that information be considered financial reports?

Mr. Engel suggested a diagram that shows the general purpose financial statements, general purpose financial reports which include financial statements and budget statements; and other reports. Also, explanations should be provided to facilitate the user's understanding.

Financial Statements

Mr. Allen discussed that paragraph 33 of the draft statement should explain why budgetary and accrual basis measurements and projections are used.

Also, members discussed paragraph 34 which concerns understandable relationships among financial statements. The Board discussed what should be the alternatives if the relationships and differences among the financial statements are not self-evident. Mr. Allen noted that articulation is an aspirational goal but may not be possible or appropriate in some circumstances. Mr. Engel noted that the differences among the various financial statements should be clear; however, he did not agree that the statements needed to articulate or be reconciled. The model may require accrual basis statements and projections such as the statements of social insurance and sustainability. Mr. Showalter suggested that the concepts be general and not restrain the Board. The Board may decide that, in some instances, the relationships among financial statements should be explained while in others a reconciliation is necessary.

Component Entity

The Board discussed whether the component level model should present different measurement bases and the terms that should be used in describing what information the components should present. Mr. Allen noted that the first sentence in paragraph 68 should state that component level reporting “may help” inform users rather than stating that component level reporting “should” inform users. Also, the terms used to describe outflows should be used consistently throughout the paragraph. For instance, cost should be used rather than expended.

Mr. Steinberg noted that users are interested in the amount of outlays or spending. Also, managers want to know the budget compared to spending rather than the budget compared to cost. Thus, it is important to have audited spending data and we need to explain the relationship between the audited cost and spending data. Mr. McCall noted that we should use cost when we are discussing operating performance but expenditure when we are discussing budgetary integrity. Ms. Payne noted that the paragraph addresses the reporting objectives which require different measurement bases. However, the different terms used could be confusing.

Mr. Allen expressed concern that the terms spending, expended, and cost, as used in the paragraph, would be setting up the component level model to present three different bases of accounting (cash, budget, and accrual). Mr. Steinberg noted that the Board would be presenting information in the manner in which users expect rather than different bases of accounting. We should use terms that users understand rather than technical terms.

Ms. Payne noted that accrual accounting recognizes that cash is an underlying part of the flow. We could restructure our budgetary information so that it better explains how we use budgetary resources, similar to the manner in which a company shows how it uses its cash resources. Ms. Payne also suggested general terminology be used to discuss outflows in the concepts statement rather than spend and expended. Consequently, the Board decided to revise paragraph 68 to be more general and aspirational.

Budgetary Information

Board members agreed that the term ‘budget’ should be used consistently throughout the document and staff will propose revisions to the section given the following comments:

- Mr. Allen believed that the section should provide context - discuss what one can learn from reviewing budget data and what information budget data does not provide. Mr. Allen also noted that at the state and local government level, users wanted to know how well the state or locality estimated their budget rather than whether they complied with the budget. Mr. Reger added that the section should describe the difference between the budget and accrual bases.

- Mr. Showalter suggested that the staff paper discussing the complexities of budgetary reporting should be incorporated into the discussion. Also, it could discuss what information should be provided at the government-wide level versus the component level. In particular, paragraph 82 discusses what financial reports should include but does not say whether the discussion applies to the government-wide or component level or both.

- Ms. Payne noted that budgetary information is needed at both levels. While budgetary information is important for government-wide reporting, it is also important for components to demonstrate how they executed the appropriations laws. Currently, the government-wide reporting focuses on the annual deficit rather than total obligations.

- Mr. Granof noted that the model should have a comparison of budget to actual; however, presenting a comparison may be challenging. In the near term, improvements, such as distinguishing mandatory and discretionary spending can be made.

- Mr. Steinberg noted that the disclosures or MD&A should discuss what portion of the budget is mandatory and what is discretionary. Also, components are provided with budgetary resources that they cannot exceed. Those resources may be provided during the current period or remain available from prior periods.

- Mr. Reger raised the concern that presenting budget information would be difficult if what is meant by ‘budgetary resources’ is not clear. Mr. Engel added that most of the budget is mandatory; therefore, it requires a different presentation from simply stating how much was ‘budgeted’ or estimated upfront and presenting the actual amount.

Conclusions: Staff will present a revised draft concepts statement at the August 2015 meeting.

- **Public-Private Partnerships**

Mr. Savini began the session by asking Members to turn to TAB C where he provided a brief overview of the revised standards, subsequent member comments/edits conveyed by email regarding the TAB C materials, and an updated graphic illustration emphasizing the different filters contained in the revised standards.

Members generally agreed with all the edits contained in TAB C and summarized on page 3 of the transmittal memorandum. However, the following refinements were suggested:

- Par. 13 & 18 - Replace “significant risk” with “risk of loss”
- Par. 16 – Delete “material” in both parenthetical instances and in the second, replace the term with “ability to perform”
- Par. 17 – Delete entire paragraph
- Par. 18 – Delete entire last sentence beginning with “Unless risks…”
- Par. 19 & 20 – Delete columnar heading “Significant”
- Par. 19 – CC#1: refer to (private) partner as “private sector entities”

Additionally, subject to any conforming edits related to the above, members agreed with the email edits and/or comments as shown below:

Board Member EMAIL Changes other than Grammar/Syntax Correction	
TAB C, Attachment 1 Reference	**Content**
Page 1, Par. 13	• The absence of a transition from paragraphs 12 to 13 should be corrected. I suggest paragraph 13 should be rewritten to the following: “Some P3s can result in significant risk and therefore should be assessed against the conclusive and suggestive characteristics at paragraphs 19 and 20, respectively, to identify those that should be disclosed.”
Page 1, Par. 14b, footnote	• This (footnote reference) will not be true when someone reads those statements once the leasing standard is issued. I believe that it is sufficient to say "both capital and operating leases as defined under FASAB standards."
Page 3, Par. 18	• Is the phrase, “…. that provide evidence of significant risk in a P3 arrangement or transaction” needed? I suggest putting a period after the reference to paragraphs 19 and 20. Maybe remove ( )'s and add "in paragraphs in 19 and 20.
Page 3, Par. 18	• Suggest "insignificant" instead of "immaterial". • Is it possible to know if the risks are immaterial until they have been evaluated based on the specified risk characteristics? • This seems to be circular. How would the preparer know the risks are immaterial until he evaluates against

	the risk-based characteristics to determine whether the P3 possesses significant risk?

Staff also presented a revised updated graphic illustration to include subsequent email member comments received from Messrs. Showalter and Steinberg. Members generally agreed with both the updated illustration and subsequent member email revisions.

The following summarizes Board discussions concerning each of the questions presented on page 4 of the staff memo:

1. **Does the Board believe that the revised standards satisfactorily address content or technical concerns addressed at the February and April 2015 meetings? If not, please identify any pending concerns and what changes staff should consider making to better address them.**

   The Board generally agreed that the revised standards satisfactorily address previously identified content or technical concerns.

2. **Does the Board believe that the edits made to the revised standards so far also satisfy any remaining concerns related to remote risk disclosures? If not, why not and what additional staff research or outreach should staff consider, if any?**

   The Board generally agreed and no exceptions or comments were noted.

3. **Does the Board believe there are any remaining open content or technical concerns that should be addressed before staff begins finalizing the standards for the August meeting? If so, what additional staff research or outreach should staff consider, if any?**

   The Board generally agreed that the revised standards satisfactorily address previously identified content or technical concerns. Although Mr. Dacey reserved judgement, he stated that overall he felt good about the direction of the revisions noting that (1) the Basis for Conclusions should provide some clarity around materiality and (2) implications of the term “contractual” in paragraph 23d should be considered further. It appeared that most members generally agreed that the modifications to the standards addressed the issues raised in the alternative view and respondent comments.

Conclusions: Staff should work with Mr. Dacey to address his comments that (1) the Basis for Conclusions should provide some clarity around materiality and (2) implications of the term “contractual” in paragraph 23d should be considered further. Staff will prepare a complete Statement to include Introduction and Basis for Conclusions in accordance with the Board’s re-deliberations and submit it as a pre-ballot standard at the next meeting.

- **Steering Committee Meeting**

The steering committee discussed the budget for FY2016 and 2017. Members were supportive but final decisions will not be made until appropriations are finalized.

Adjournment

The Board meeting adjourned for the day at 4:30 PM.

Thursday, June 25, 2015

Agenda Topics

- **Risk Assumed-Insurance Programs**

Ms. Gilliam opened up the risk assumed-insurance program session and informed the Board that updated text based on pre-meeting feedback from members was circulated that morning (a copy of the updates is available in the risk assumed project page).

<u>The following was discussed in relation to which option the Board preferred in relation to estimating losses on remaining coverage</u>:

> Ms. Gilliam referred the Board to Options 1 and 2 on page 4 of the June Memo, and Option 2A which was provided in the updated handout as a result of the briefing with Mr. Allen.
>
> Mr. Allen explained that he wanted to be consistent with the FASB language—provided on page 3 of the memo—which starts with expected value and notes it should be used in most circumstances. He further explained that over the past year, we worked under the assumption that we should only use the expected value. However, Mr. Dacey requested that we also include the most likely amount.
>
> Mr. Steinberg asked what the difference is between option 2 and 2A. Mr. Allen explained that 2 provides an either or option and 2A requires expected value first, and then the most likely amount when the circumstances do not support an

expected value calculation. Ms. Gilliam also noted that 2A provides more descriptive information.

Mr. Steinberg said that he still did not understand what “the sum of probability-weighted amounts” means. Staff noted that this was the FASB definition and was under the impression that Mr. Steinberg wanted to know how to do expected value and therefore would address that in a technical release. He clarified that he just wanted to add a couple of sentences to better define it and that a technical release was not necessary.

Ms. Payne suggested wording such as, “The preparer selects a number of possible cash flow scenarios and assigns probabilities to each for use as weights in arriving at a weighted average amount.” Mr. Steinberg agreed with adding such language.

Mr. Granof asked under what circumstances we would use a most likely amount and not the expected value. He was concerned that the language in option 2A allowed insurance programs to use any method. He preferred the expected value as originally presented at the April 2015 Board meeting.

In relation to the most likely amount, Ms. Payne noted that Crop uses a regression method. During the April 2015 Board meeting, Mr. Dacey said that as an auditor he would not accept a regression model if an expected value were required. Therefore, staff was instructed to include the most likely amount, which can be achieved by using a regression model.

Mr. Showalter also did not agree with option 2A that allows either model and asked if there is another option that requires expected value unless it is inappropriate and then use the most likely amount. That would give Mr. Dacey the ability to audit a regression model.

Members were also concerned about the wording “The most likely amount may be an appropriate estimate of the amount to settle claims during the remaining open contract period if 1) the contract has only two possible outcomes (for example, an entity must either settle a claim or not)…”

Ms. Payne asked the Board to think about the following rare example—OPIC writes one contract for a company going into business in a third world country, and the contract either pays or it is zero. Would you want that contract to report an expected value if, for example, it is 80% likely that it is zero and 20% likely that it will pay $1 Million in claims, with the expected value somewhere between a million and zero? This wording allows OPIC to determine which of these two possible outcomes should be recognized as the most likely amount.

The Board approved the wording in option 2A with the expected value first and then the most likely amount if circumstances do not support calculating an expected value. The Board also requested that the wording be more affirmative and expand on the definition for both expected value and most likely amount, including a reference to a regression model being appropriate.

All members approved this update, except Mr. Engel who was sitting in for Mr. Dacey. He noted that Mr. Dacey would like most likely to remain the first option. The Board noted that the updated wording should address Mr. Dacey's auditing concern.

The following was discussed in relation to updated wording for subsequent events:

Ms. Gilliam noted that the next update to discuss was the subsequent events wording. Mr. Allen noted that the original write up in Attachment 1, page 6, par. 24, was technically correct, but it was confusing with no connection from the estimate discussion.

Mr. Steinberg requested that on the fifth line down, after the words with the brackets that we add "do not require adjustment but may require disclosure…" Mr. Allen noted that this is explained in the second paragraph, but agreed that including it helps with the transition from the discussion on estimates and gives more clarity and guidance. Staff will update.

Ms. Gilliam asked if placing the subsequent event guidance first, before the estimate guidance would help with the transition. Mr. Showalter noted that from his experience, most develop the estimate first and then adjust for subsequent events. Therefore, the current order is sufficient.

The Board approved the updated verbiage with the one change suggested by Mr. Steinberg.

Ms. Gilliam introduced the three proposed categories: 1) exchange revenue insurance programs other than life insurance, 2) nonexchange insurance programs, and 3) life insurance programs.

The following was discussed in relation to the exchange revenue insurance programs other than life insurance category:

Ms. Gilliam explained that exchange revenue insurance programs collect revenue through contracts/agreements that are authorized by law for certain durations and/or assessment periods. She pointed the Board to the examples provided on page 6 of the memo.

She continued to explain that it is not necessary to have separate categories for short- and long-duration contracts because the proposed standards require exchange revenue programs to break out their liability disclosures by portfolio. Therefore, agencies are expected to include short- and long-duration contracts in separate portfolios according to their similar characteristics.

She also noted that staff did not want to define the length of short- and long-duration because it is subjective within each agency and the portfolio break out should capture and disclose it. For example, Flood has some three year contracts. Some agencies might consider those long-duration and others short-duration.

Another reason for breaking into revenue type is to avoid duplicating the standards by repeating the same thing for short- and long-duration contracts.

Mr. Allen noted that these transactions are really “exchange-like” transactions because of the appropriations that might also fund them. He also noted that a traditional exchange transaction is normally an arm’s length transaction that someone chooses or does not choose to participate in based on value and cost. These insurance programs are exchange-like because they do not follow this traditional formula; instead the government says you will participate in these programs and pay a certain amount and what is not covered we will supplement with appropriations.

Mr. Steinberg agreed that there are two different types of support, one being the exchange revenue collected under contract/agreement, and the other being appropriations provided from tax payer money.

Ms. Gilliam directed the Board to disclosure schedules starting on page 5 of the additional handout and stated that most of the exchange programs are hybrids because they can utilize appropriations or borrowing to fund losses. However, these insurance programs belong in an exchange revenue category because they predominantly collect revenue that is collected through contracts/agreements. She noted that the staff strongly recommends the disclosure schedules, which will clearly disclose the specific types of revenues collected.

Mr. Steinberg asked to turn to page 6 to understand what nonexchange revenue is captured in the exchange revenue schedule. Ms. Gilliam explained that those are fees and fines for any punitive action outside of the contract/agreement revenue collected. Staff will add this wording to the disclosure and schedule illustration.

Mr. Smith asked if they wanted to split these into two different programs. Mr. Steinberg and Mr. Allen said no, that calling this category exchange revenue was fine.

The Board approved the exchange revenue insurance programs other than life insurance category.

The following was discussed in relation to the nonexchange revenue insurance programs category:

Ms. Gilliam explained that the nonexchange category collects money demanded by the government. She referred to the two examples in the memo: 1) the national vaccine injury protection program, which collects excise taxes, and 2) the terrorism risk insurance act, which collects surcharges from the insured through their commercial contract if Treasury has to pay for terrorism damage over a certain threshold ($100 million).

Mr. Steinberg noted that the vaccine program collects dedicated taxes which are nonexchange revenue, but that the Terrorism risk program is other financing because it appears to be a loan and must be paid back.

Ms. Payne noted that the surcharges paid back to the Terrorism Risk program are regulatory fees to cover any outlays paid after a loss has incurred; the risk assumed is managed as a timing issue and, therefore, should not be classified as a loan under other financing sources.

She cited FDIC as an example of when they increased the assessment to banks to cover the losses of so many failed banks during the financial crisis. This was not a loan because FDIC was covering losses that already existed. Mr. Steinberg agreed that the Terrorism, like FDIC, was not a loan, but instead regulatory fees to cover money that the government was provided for an insurance loss.

Ms. Kearney asked if the liability recognition categories in SFFAS 5—*Accounting for Liabilities of The Federal Government*, follows the associated revenue categories that are governed by SFFAS 7—*Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting.*

Ms. Payne explained that SFFAS 7 provides the definition for exchange and nonexchange revenue. She noted that SFFAS 7 and SFFAS 5 are in synch. Therefore, an exchange transaction on the revenue side is also an exchange transaction on the liability side. For nonexchange, SFFAS 7 will do revenue timing and recognition issues and SFFAS 5 will govern when the associated loss becomes a liability.

Mr. Allen noted that there will not be that many liabilities in the nonexchange category. Ms. Gilliam agreed that only unpaid claims are liabilities for losses that have occurred. Because there are no contracts for nonexchange transactions, losses are only recognized when they occur and, therefore, there will be no liability for losses on remaining coverage.

Ms. Gilliam reminded the Board that staff split the categories between exchange and nonexchange in order to account for the different liabilities and related guidance.

Mr. Engel noted that Mr. Dacey wanted to know if there are any long-duration exchange contracts with subsidy components.

Ms. Payne noted that for duration we are only looking at the existing contract, even if a policyholder is required; for example under Flood insurance, to carry that insurance for a long-duration, the standard only requires disclosure of the remaining coverage on the current contract.

Ms. Gilliam noted that Flood, as another example, would disclose their three year contracts that include a subsidy component, in a separate portfolio, and the disclosure statement will outline the amount of exchange revenue and appropriations used.

The Board approved the nonexchange revenue insurance program category.

<u>The following was discussed in relation to a life insurance category:</u>

Ms. Gilliam discussed that life insurance was separated out because: 1) life insurance has a different risk profile—death always occurs resulting in a payout, whereas an adverse event might not have occurred, 2) SFFAS 5 already separates it out, and 3) there will be a liability on future benefits, similar to the liability for losses on remaining coverage.

The Board approved the life insurance category.

<u>The following was discussed in relation to the disclosure schedules:</u>

Ms. Gilliam directed the Board to the updated flow disclosure schedules for exchange and nonexchange categories. Staff will work up one for life insurance for the next Board meeting.

Mr. Granof requested that staff include numbers instead of “Xs.” Mr. Allen agreed, but did not want to create a lot of work for the staff.

The Board deferred approval until staff includes the one for life insurance programs.

<u>The following was discussed in relation to the government-wide (GW) financial report:</u>

Mr. Allen asked if these schedules are required at the GW level. Ms. Gilliam said that no, she did recommend including these at the GW level. Only certain pieces will be included.

Ms. Davis noted that we can only require information at the GW level that is required at the component level.

Ms. Gilliam noted that staff still needs more time to work on the GW once the standards for all of the categories have been addressed.

Conclusions: Staff will revise the draft standards per the Board's decisions. Draft standards regarding life insurance will be provided at the August meeting.

- **Department of Defense Request**

Ms. Loughan explained the objective of the session is to consider options regarding baseline estimates of general property, plant, and equipment (GPP&E.) She explained that the agenda item resulted from a request from DoD to clarify whether capital improvements are included when estimating the historical cost of GPP&E. Ms. Loughan explained that at the April 2015 meeting, staff presented the Board with a staff draft interpretation, *Accounting for Property, Plant, and Equipment as amended by SFFAS 35, Estimating the Historical Cost of General Property, Plant, and Equipment: Amending Statements of Federal Financial Accounting Standards 6 and 23.* In short, the draft interpretation provided that the estimated current cost of similar assets may include all capital improvements. The draft explained that separately estimating the cost of capital improvements is permitted but not necessary and such costs may be included in a single estimate deflated to the original in-service date.

Ms. Loughan explained that the Board directed staff to move towards issuing the draft. However, shortly after the meeting, a member raised concerns regarding capital improvements made in recent years as well as future capital improvements. After sharing this concern with the Board, several members suggested that the Board should discuss the matter further.

Ms. Loughan explained Mr. Dacey's concern is that because the underlying standard is applicable to future capital improvements, the draft interpretation would also apply to future capital improvements. Therefore, new capital improvements to fully or substantially depreciated assets could be similarly deflated to the original in-service year, effectively writing them off. His concerns were that the proposal would allow an entity to understate the depreciated costs of material capital improvements made in recent years as well as future capital improvements by allowing the entity to deflate the cost of the capital improvement(s) to the estimated original in-service year or actual original year of acquisition of the G-PP&E item itself.

Ms. Loughan explained that originally staff hoped to accomplish the DoD request through the issuance of an Interpretation because staff believed "reasonable estimates" as provided in SFFAS 35 that were subject to audit with the professional judgment of auditors and preparers would lead to amounts that are fairly presented. Thus, judgment would safeguard against the member's concerns. However, feedback from the Board was that language should be added to ensure that entities are only allowed to apply the deflation method inclusive of capital improvements once to explicitly safeguard against unintended consequences. Staff believes the only way to accomplish this is to restrict the estimations rather than permit continuous estimation as currently allowed under SFFAS 6 as amended by SFFAS 35.

Staff noted that paragraph 9 of SFFAS 35 revised SFFAS 6 to allow the use of reasonable estimates upon initial capitalization as entities implement G-PP&E accounting for the first time, as well as by those entities who previously implemented G-PP&E accounting. In effect, it allowed reasonable estimates to be applied on an ongoing basis and expressly eliminated a timeframe based limitation to existing property. Consequently, it is inconsistent to interpret the standard to impose any sort of timeframe-based limitation related to capital additions. Staff explained a proposed standard is the best vehicle to resolve the member concerns because it would require a Statement of Federal Financial Accounting Standards that amends certain provisions of SFFAS 6, 23 and 35.

As detailed in the staff analysis, the real property environment at DoD cannot provide the necessary information for the previous periods and they wish to establish an initial baseline of related property assets for the balance sheets. For example, DoD has approximately 440,000 separate real property (RP) assets and capital improvement projects related to RP assets that have not been reliably tracked in systems.

Staff explained three options were presented for the Board's consideration:

1. **One-time Use** - Allow one-time application of current cost deflated to the original in-service date to establish an initial baseline. This option provides a clear cutoff for deflating capital improvements to the original in-service date of the asset and may more easily facilitate establishing a one-time threshold for recognizing existing capital improvements.

2. **One-time Use but Identify Recent Material Improvements** - Allow one-time application of current cost deflated to the original in-service date but require consideration of recent material improvements that may need to be estimated separately to establish an initial baseline.

3. **One-time Use but Identify Significant Added Space or Functions** - Allow deflation of current cost to the original in-service date if improvements did not (1) significantly expand the capacity of an asset (for example, expand the square footage) or (2) otherwise upgrade it to serve needs different from, or significantly greater than, it's current use or add significant new capabilities to establish an initial baseline.

Ms. Loughan explained that several Board members had provided feedback and had generally concurred with option 1 but also liked certain provisions of option 2. Staff opened the floor for Board member comments and questions. Ms. Loughan explained that Mr. McCall was not present but he had shared his thoughts via email and conveyed that he liked the "pros" relating to the clear cutoff, line in the sand, in option 1 and that future improvements would not be deflated. However, he liked that recent material capital improvements would be reviewed and separately estimated in option 2 and considered if option one might accomplish this as recent material improvement consideration is permissive.

Ms. Loughan explained that Mr. Showalter also preferred option 1 with some of the aspects of option 2. She explained that Mr. Steinberg conveyed he preferred option 1 because it had the most pros with it but he wanted additional explanation in the basis for conclusions. Mr. Granof had also agreed with option 1.

Mr. Engels (substituting for Mr. Dacey as the GAO representative) explained that Mr. Dacey had noted he preferred option 2 with the caveat that only recent material capital improvements or additions that would need to be reviewed would be those that the undepreciated cost at time of implementation is more than the capitalization threshold.

Mr. Showalter explained his comment relates to practicality and that the Board's preference should be explained. Specifically, if the information exists for the material capital improvements, it should be used but if it does not then it would be exempt. Ms. Payne asked how one would prove that information does not exist. Mr. Showalter explained that standard would not have to require that, it would be more of an assertion that they have the information or do not have it. Otherwise, he believes option 1 could be read that even if they have the information they can still not use it. Staff noted that with the permissive language, one would hope they would use the information when it was available.

Ms. Loughan explained that as far as the one time application it would be a similar approach compared to the Opening Balances exposure draft and they would only be permitted to assert one time and this would be expected when they are prepared to assert that they can present the amounts fairly in accordance with GAAP and do so on a go forward basis.

Ms. Payne suggested polling the Board members for more information on what they would envision as there does not appear to be an overwhelming support for one option and it may be something in the middle.

Mr. Showalter explained his position is in the middle as it allows a one-time application of current cost deflated to original in-service date but if they have information – they should separately estimate capital improvements. Staff requested clarification because option 1 does not prohibit or preclude. Mr. Showalter explained this would require them to be estimated separately if the information is available. However, if DoD states they do not have records then they would not necessarily be reviewing any.

Ms. Kearney (substituting for Mr. Reger as the OMB representative) explained she understood Mr. Showalter's point but she would like to know if that would result in additional cost and she would like to have a better understanding of the cost of option 2.

Mr. Smith explained that originally he was comfortable with option 2 but then he realized that with discounting back to the original in-service date, we would be losing pretty much all of the costs. He explained if cost is the issue, it might be reasonable to depreciate the additions going forward. Mr. Allen explained that he was supportive of such an approach.

Ms. Loughan explained that the challenge with that is that DoD has explained that they cannot separate the additions nor provide the documentation for the additions and that is why the request has come forth. Now, if the Board is considering a certain time period, staff is not certain how much effort or cost that would require. Staff was working from the Plant Replacement Value (PRV) because that is something that DoD is required to maintain for the Federal Real Property Council database and information they believed they could support.

Mr. Smith explained his focus is on the depreciation cost and determining a reasonable estimation. He stated that if you believe 50% of the estimated life is remaining for the properties and/or that half the capital improvements were made recently and have useful life remaining, then it is something to start with and depreciate prospectively. He explained that we know we are not getting something exact, but if we develop a methodology that will get a reasonable estimate then it should be accepted.

The Board acknowledged Ms. Jenkins, Director of the Financial Improvement and Audit Readiness from DoD's Office of the Under Secretary of Defense (Comptroller) and Mr. Steve Chad, consultant working with DoD. Ms. Jenkins shared that DoD recommends option 1 because the records and documentation are not there to support the capital improvements. She explained that most facilities have had multiple improvements and there is no consistent way to go back and capture the information. Ms. Jenkins explained it would be nearly impossible to prove the completeness by determining which ones there was information for and which ones there was not.

Mr. Smith suggested not expensing more than 50% of the usable life at the time of adoption. For example, if a building has a 50 year life and it has had significant additions, then you would depreciate 25 years going forward. He explained there is a practical way to get started, while we accept it will not be perfect.

Mr. Allen asked what the DoD capitalization threshold is and considering most of the buildings are older, would not that limit the population under consideration. He explained that many of these may be at a net book value of zero. With the ones that are remaining, then you could apply a little bit more effort in determining the value of those.

Ms. Jenkins explained that they have determined from past audits and reviews that they cannot rely on the acquisition cost that is in the database. DoD's plan was to establish a baseline for the 440,000 real properties based on the PRV. The PRV looks at the property today, inclusive of additions and improvements, based on its location, square footage, capacity, etc. and that comes with a value. That would be deflated to the original in-service date and those amounts would be applied against the capitalization thresholds. She explained to break out the capital improvements separately, it would be very difficult as that information is in different systems considering the magnitude of the assets and systems involved.

Mr. Allen noted that the PRV is an overstated amount and if that is depreciated back, then it might actually be close. However, they are deflating it back to the original in-service date so that would make it near zero. Thereby doing this, would not many of them be removed from consideration?

Mr. Smith explained that if a building still has remaining life, then it seems reasonable to have 50% going forward for a certain number of years.

Ms. Payne suggested that looking forward may be a good alternative when you consider looking at the remaining useful life to the overall useful life and book what is left; that is, have no deflation.

Ms. Payne explained that we are not going for a precise number so it is a choice one has to make, do we want DoD staff working to get a more accurate number for the older stuff or work on an improved system to capture the improvements going forward. She believed the focus should be on the go forward.

Mr. Allen agreed but he explained there should be a manner to narrow the population that DoD review whether by their capitalization threshold or some other manner. He explained that certain members are bothered by the fact that it may result in a known understated number.

Mr. Granof noted that while it's a large number on the balance sheet, there is little decision making or management usefulness of the depreciated historical cost of an asset that no one uses that information for decision making. Mr. Allen explained it is a necessary cost of service.

Mr. Allen explained he would accept deemed cost or something similar to the GASB approach – a reasonable estimate and disclose the method and then go forward. Mr. Smith explained that it appears DoD has a method, they want a standard to say it is acceptable and perhaps we should consider a starting point for the depreciation they should take against that asset. Another option would be to provide a cap on how far back they could deflate the property. He explained the estimated PRV is too high and the deflated number to the original in service date would be too low, so it is something in between.

Mr. Chad explained that he understood all the views, but the reality at DoD is that one must consider things prospectively. Anything retroactive, even if looking back one year, will make the DoD unauditable because they do not have systems the auditor can get satisfied about completeness and they cannot produce the documentation. He explained they will not be able to pass an auditor's test for anything like that. Mr. Allen asked how they would prove the in-service date. He explained they have a service date or range for when property was placed in service. Ms. Jenkins explained the support for the in-service date for the asset itself is easier to prove than for the capital improvements.

Ms. Jenkins explained the PRV model and calculations a bit further. She explained that no one is actually walking through the building. While inspections and inventories are performed, they are not done on 100% of the properties. It is a model based on the cost factors. There are approximately 4,000 different types of assets that are classified and assigned separate useful lives. Mr. Allen asked if there was a way to group those assets in certain ways to stratify for capitalization and depreciation. Mr. Chad explained that one must consider that it is not just the DoD-wide audit, but there are component level audits and based on their analysis it is $250,000.

Mr. Granof asked if this issue exists with other PP&E. Ms. Jenkins explained there are issues with the military equipment and capital improvements. She explained the capitalization threshold for that area is $1 million. She explained the issue is the items in the past, they understand going forward they will be compliant. Mr. Allen suggested applying a threshold to the replacement cost and focus on those—there is a difference between those that must be recognized and depreciated for financial statements versus accountability.

Mr. Steinberg explained that DoD attempting to correct the past deficiencies will cost them money and that does not seem practical. He explained that a good example is the Pentagon improvements, if those are fully depreciated, would that be a huge misstatement in the financial statements? It is best to recognize reality and move forward. Mr. Allen explained his issue is if we are trying to help them develop a system going forward, then let's help them with a system that is manageable. Ms. Jenkins explained that she understood that but she stated she needs the baseline first before she can apply the capitalization threshold.

Mr. Granof explained that the DoD is not in a position to get an audit opinion and it is the Board's task to give them license to do something else. He believes those particular numbers are not useful so the Board should try to accomplish this goal in the simplest and most cost effective manner possible for the DoD and focus on the future.

Mr. Showalter agreed with Mr. Granof. He asked Ms. Jenkins if they have had discussions with their auditor about this and if they have enough support to support option 1 as presented. Ms. Jenkins explained that there are elements of their model that would need to be validated. She explained that they have a model and she can calculate the PRV. She explained that they can determine a range of placed in service date but they have to validate the cost factors that go into the model. She understands that it is not without work and needs to be validated as well as a level of work that continues on. DoD is requesting the pressure regarding the past documentation to be relieved. They have not had any feedback from the DoD IG as of yet, but there is not a standard in place that this could be compared against. Mr. Allen explained he also believes that after further discussion with the auditors it may be determined there is another approach they would prefer or that is more appropriate. Mr. Allen agreed that working with the auditors may be an advisable step in the process.

Mr. Steinberg asked if option 1 would be accepted by the auditors. Mr. Showalter explained his concern was if DoD was in a position to have what was necessary to complete option 1 as well as the auditors views. Ms. Jenkins explained that without a standard she did not believe the auditors would support their current approach using the PRV deflated back.

Mr. Engels explained that GAO would still be concerned about the recent material capital improvements. Ms. Jenkins explained that if those need to be reviewed that would require people visiting every property and a much more detailed review than envisioned and she did not believe they would be able to accomplish that. Mr. Steinberg asked whether Mr. Engels' response was in his role as auditor or as Board member because while Option 2 might be his preference, he wonders if the Board issues a standard with option 1, would he be able to audit against it. Mr. Engels stated he would be able to audit against the standard. However, he does not know if DoD would be able to support it. Mr. Allen asked why the Board would want them to go through an effort that we know would produce an understated number.

Ms. Payne asked the Board if their goal is historical cost or an estimate of today's cost. She explained that if we simply want an estimate, then SFFAS 6 provides the path for that already. Mr. Allen explained he believes they should focus on the largest assets and whether they had information on any recent material capital improvements. If they do, for those make an estimate on the average estimated useful life estimate based on replacement cost.

Ms. Payne explained that SFFAS 6 is not silent on the issue:

> 41. Accumulated depreciation/amortization shall be recorded based on the estimated cost and the number of years the PP&E has been in use relative to its estimated useful life. Alternatively, the PP&E may be recorded at its estimated net remaining cost and depreciation/amortization charged over the remaining life based on that net remaining cost.
>
> 42. For general PP&E that would be substantially depreciated/amortized had it been recorded upon acquisition based on these standards, materiality and cost-benefit should be weighed heavily in determining estimates. Consideration should be given to:
>
> • recording only improvements made during the period beyond the initial expected useful life of general PP&E, and
>
> • making an aggregate entry for whole classes of PP&E (e.g., entire facilities rather than a building by building estimate).

FASAB staff member, Mr. Savini, suggested the Board also consider information related to condition assessment and deferred maintenance because if one considers the PRV and take out DMR, then deflates it back, it may provide a more realistic value. He believes some of the data may be there in the system; it just may need to be analyzed a bit further.

Mr. Smith suggested another alternative; that any building placed in service more than 40 years ago would not be placed on the books. He explained that would reduce the amount of work. Mr. Allen explained that would not address recent improvements for older buildings. Mr. Smith explained we are trying to come up with something practical and reasonable. He believes DoD should take all the points that have been made and come back with what they believe is feasible.

Ms. Kearney explained that asking DoD to come back with a best estimate based on another model or different method may cost them and that fact should be considered. She explained that we have an opportunity to draw a line in the sand and move forward. She believes the Board should do that without spending resources. Mr. Allen asked if that meant starting with zero. Ms. Kearney explained that option 1 was an alternative. Mr. Allen explained that he feared that may require work and expense on their part for an inaccurate number. Ms. Kearney explained that based on what she has heard, they have most of that information based on existing requirements with real property council.

Mr. Smith asked what presently supports what is on their financial statements. Ms. Jenkins explained it is whatever is in the system but she really does not know. He asked if she could say for the past five years. She said it has not been consistent so she could not say. She said there have been many issues over the years and it differs across agencies.

Ms. Payne explained the Board has not liked the discounted PRV because it is understated, she asked if they would rather consider the PRV which would be overstated as the starting point.

Mr. Smith suggested taking the PRV and if there was a way to determine the estimated life for those and put that on the books at a certain percentage, such as 50%. Ms. Jenkins explained they are doing engineering studies at buildings for budget purposes. The community accepts the PRV as that is used for sustainment and other purposes. Mr. Allen explained if that number is widely accepted then a percentage of that should be depreciated going forward.

Mr. Allen said he believes whatever approach is selected that the auditor will have to validate and there will be associated cost. Therefore, he would accept something such as a deemed cost approach. He said that 50% may be too high, and that 30% may be sufficient and accept what is in the system and disclose what has been done.

Mr. Smith asked DoD to come back with options. Mr. Allen suggested that the Board must provide certain provisions in the standard that provides relief from certain assertions that otherwise would need to be meet- existence, completeness, valuation, etc. or it will not pass the auditor’s test. Ms. Jenkins explained there is respect for the auditors’ judgment but one must realize it does not matter if DoD spends resources they do not have, the question may be will they ever get the professional to the point of where they may think they need to be to pass the audit based on the current standards. Mr. Smith explained that is why he would like DoD to come back with something that they believe is reasonable and something that they can support. From there, the Board can consider and develop a transition standard.

Mr. Engels explained it would have to be reasonable because it would be material at the components, DoD and government-wide statements. Therefore, it would have to be grounded in a reasonable methodology. Mr. Smith explained he believes it would be reasonable if you could recalculate how they got there. He elaborated that it is not going to follow the present GAAP standards. It will be reasonable in that they are explaining how it was estimated and it represents somewhere between zero and replacement cost as the starting point. Mr. Allen explained another option is to just say start with zero as a starting point as well.

Mr. Allen explained that is seems the Board has discussed several options for staff to work with DoD. FASAB staff will meet with DoD as well as their auditors to discuss the approaches further. The Board would like to engage the auditor to ensure it addresses the problem and does not create another problem. Ms. Payne explained that staff will continue working but due process would prohibit staff from circulating too much information and gathering feedback from members on the options between meetings.

Staff noted the issue came up in the context of real property, but when staff addressed it we made it consistent with the standards and it applied to all property. A question is how to address going forward. It does appear there are issues with all property, but whether those issues will be the same may require more time. Ms. Jenkins explained that with military equipment there are issues but they are handling these differently and that requires pulling all the modifications related to contracts. Ms. Jenkins said that there is also issue with land. Mr. Allen believes that the materiality should be considered further as DoD approaches this.

Ms. Payne explained that a lot of good points had been discussed in the session. She understands the member views and they recognize the DoD request for a cost effective go forward approach. She wanted to make everyone mindful that it appears it will result in a Statement so that will have to sit before Congress and that typically takes 9 months to a year and if that flips to another session of Congress the clock starts over. She also stated that it may take several Board meetings to work through the language since it will cover all the PP&E areas, so this will not be a Statement that can be issued quickly.

Conclusions: The Board agreed that issuing a Statement and making the appropriate amendments to standards should be done to provide a cost effective go forward approach for DoD. While the Board did not decide on a particular approach, many good points and options regarding baseline estimates of general property, plant, and equipment (GPP&E) were discussed such as:

- not expensing more than 50% of the usable life at the time of adoption
- accept deemed cost or something similar to the GASB approach – reasonable estimate and disclose method and then go forward
- provide a cap on how far back they could deflate the property
- take the PRV and put 50% of the estimated life on the books
- developing an estimation method where one looks prospective, looking forward may be a good alternative when you consider looking at the remaining useful life to the overall useful life and book what’s left, no deflation
- allow one-time application of current cost deflated to original in-service data but depreciated only at half the usual approach AND if they have the information – they should separately estimate capital improvements.

- a reasonable recalculation test that is between zero and the replacement cost as the starting point
- consider information related to condition assessment and deferred maintenance
- allow one-time application of current cost deflated to the original in-service date to establish an initial baseline
- Plant Replacement Value

The Board suggested that DoD come back with what they believe the best approach is. It was agreed that FASAB staff would work with DoD and facilitate meetings to gather input from their auditors to discuss the approaches further. Staff will also consider the issues related to all general property plant and equipment, including real property, military equipment and land so all items could be addressed in one Statement.

Adjournment

The meeting adjourned at 11:30 AM.