FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD
October 22-23, 2014
Room 7C13
441 G Street NW
Washington, DC 20548

Wednesday, October 22, 2014

Administrative Matters

- **Attendance**

The following members were present throughout the meeting: Mr. Allen, Messrs. Dacey, Granof, McCall, Showalter, Smith, Steinberg, and Ms. Ho. Mr. Reger was represented by Ms. Kearney. The executive director, Ms. Payne, and general counsel, Mr. Marchand, were present throughout the meeting.

- **Approval of Minutes**

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

- **Clippings and Other Matters**

Mr. Allen welcomed Christina Ho to the Board. Ms. Ho is the Deputy Assistant Secretary for Accounting Operations at the U. S. Department of the Treasury.

Mr. Dacey provided an update on the International Public Sector Accounting Standards Board (IPSASB). Key points included:

- The eight chapter conceptual framework was completed in September and will be issued later this year. The framework is significant because the IPSASB policy is to converge with standards issued by the International Accounting Standards Board (IASB) unless there is a reason to differ. The framework provides a basis for making decisions regarding differences.
- A recommended practice guide for reporting service performance information is being completed soon.
- The project on interests in other entities includes a wide range of other entities such as joint ventures. Final standards may be approved in December. A related project on public sector combinations is also underway.
- New projects include:
    - public sector specific financial instruments such as gold and seigniorage
    - social benefits
- Public consultation on the strategic plan has been completed and the plan should be finalized soon.

Mr. Granof provided an update on the Governmental Accounting Standards Board (GASB). Key points included:

- An exposure draft was approved regarding disclosures of tax abatements provided through an agreement with a specific entity.
- Public comment is being sought on a proposal regarding other post employment benefits.
- An ongoing project is addressing the definition of fiduciary funds.
- Comments have been received on an earlier proposal on how to compute fair market value.
- A preliminary views document on leasing is being reviewed and may be issued soon. It is not expected to be as controversial as other lease accounting proposals.

Ms. Ho provided an update on the DATA Act. Key points included:

- The Act requires public consultation on data standards and there are two components of data standards - the data element definition and the data exchange standard.
- A recent Federal Register notice sought public input on the data exchange standard and not the data element definition.

Regarding clippings and other items, members noted:

- The annual CFO survey discusses areas critical to the CFO community such as management and the Data Act. Copies were provided at the table and some suggested all members read it.
- The article linking government defaults to an absence of accrual accounting points to the importance of considering accrual information in the decision making process. This is especially important in a budget constrained environment. There are a number of reports suggesting more accrual like information be included in the budget decision process.

- An article on the limits of transparency has raised some issues, but they did not have a lot of substance behind the issues. More studies or more analysis on what people are doing with the information provided for transparency would be welcome.
- An article discussing how we get information out to citizens so they can get involved and understand it raises issues of trust. Studies show the further you are away from the citizen, the less trust there is. That is, there is usually more trust at the local government level, a little less trust at the state level, and less amount at federal levels. This emphasizes the importance of reports designed for the citizens such as the report issued by Treasury.

Agenda Topics

- **Agency Level Reporting**

FASAB discussed an ideal agency level reporting model with a panel of experts. Agency level financial reporting experts met with the Board and discussed their views on an ideal reporting model. They emphasized that the process of preparing financial statements and having them audited has improved internal controls over financial information and the reliability of the data that can be used for other reporting. However, financial statements are intended to present highly summarized departmental level information while users are seeking detailed information to answer questions about programs, such as the appropriation received, how it was used, and what benefits were derived. Technology can help users better understand financial information and guide them from highly summarized information (financial statements) to the detailed information provided through other sources. Also, disclosures could be minimized. In addition, the panel cautioned against simply expanding the existing model and suggested statements that could be removed or information that could be streamlined. Thus, the Board should consider the costs involved in preparing the statements and their usefulness as they revisit the model. The panel members:

- Gordon Alston, Director of Financial Reporting and Internal Controls, Department of Commerce
- Sheila Conley, Deputy Assistant Secretary for Finance and Deputy Chief Financial Officer, Department of Health and Human Services
- Donjette Gilmore, Director of Accounting and Finance Policy, Department of Defense
- Douglas Glenn, Deputy Chief Financial Officer, Department of Interior
- Katherine Palmer, Associate Deputy Assistant Secretary for Financial Policy, Department of Veterans Affairs

- Laurie Park, Deputy Assistant Secretary for Finance, Department of Veterans Affairs

Panel Member Remarks

Mr. Alston

Mr. Alston discussed that financial statements present highly summarized information and provide users with a level of comfort that his department has adequate internal controls and can account for items at a certain level. His department presents net cost by strategic goal which informs users what the department is trying to accomplish and is a level of aggregation appropriate for financial statements. However, strategic goals change and cost data is not necessarily collected by strategic goal. Also, different users are interested in different aspects of the department and it may not be possible to meet those needs with a financial statement. Financial statements do not provide the detail and different aspects of the department that users seek. Accordingly, other mechanisms such as USASpending.gov could provide that information.

Ms. Conley

Ms. Conley discussed that the Board should focus on a sustainable model and she expressed concern that the Board would add additional statements or requirements to the existing model. Her department is an enormous organization with over 70,000 employees and 11 operating divisions and has a broad audience. However, the existing reporting model is not particularly useful to them. The existing financial statements provide a high level base from which other reports can be developed. The same systems that produce the financial statements also produce managerial reports. The types of financial questions they receive:

- What was the amount of funding?
- How much is appropriated and obligated?
- What are the costs and what are the outlays?
- What is the department doing?

Since the passing of the CFO Act, the financial reporting community has made progress in accuracy, completeness, and timeliness of information, but needs to improve in utility, usefulness, and relevance. Disclosures are excessive and there is a high cost of producing financial statements and having them audited.

The reporting community should focus on a relevant reporting model that can be sustained over time. An ideal model today may not be the ideal reporting model in the future.

The balance sheet is helpful. It provides a snapshot at a point in time and a reference for going forward. However, the statement of net cost is not useful. Instead, the schedule of spending is starting to provide the information that the public is seeking. It is reported as other accompanying information and currently shows obligations by program and budget object class. Whether obligations should be the unit of measure can be discussed and, in the future, the schedule could include links so that users could select a program and drill-down to detailed information such as USASpending.gov. Auditing the statement would provide some assurance that the detail is reliable. Also, it may be a good idea to retain the statement of budgetary resources (SBR) because it provides a level of assurance on the budget data.

Therefore, simplify and provide highly aggregated balance sheet, schedule of spending, and SBR and streamline the disclosures. Technology could be used to refer readers to information that is not subject to constant changes, such as the summary of significant accounting policies.

In addition, there is a concern that the ideal model project would simply result in adding additional statements or requirements to the existing model. This has been the trend and continuing this practice of adding to the model would be challenging because resources to prepare financial statements and meet reporting requirements are declining. Accordingly, the Board should consider the cost of preparing financial statements.

Ms. Gilmore

Ms. Gilmore noted that DoD has numerous stakeholders such as the citizens groups, the Inspector General, and the Government Accountability Office. They appear to be interested in the status of projects – whether they are ongoing or finished. She suggested a database that is segregated by project, rather than executive departments. After developing a definition of a project, the database should have all the cost accounting information and project outcomes to assess the success of the project.

While financial statements are high level, the Department tracks spending and performance by appropriation received. The current financial statements could be streamlined by eliminating the statement of changes in net position. This statement is loosely based on the statement of retained earnings in the private sector and profitability should not be a concern for the federal government. Also, there are differences in the Department of the Treasury and Office of Management and Budget reporting guidance regarding disclosures.

Mr. Glenn

Mr. Glenn noted that financial statements are not being used; however, they have driven data integrity and internal control improvements. In the federal government, there are different programs, different missions and a uniform set of static statements. However, users want to know what something costs and the benefits it provides. Ideally, this information should be provided at the program level, but agencies use different program definitions and are not able to provide consistent program level data today.

What if every expense transaction had a budget object class and a benefit class code? If that existed, we could produce costs and benefits for any transaction.

The community should be thinking about how we report, ways of presenting information so users can understand. An interactive report can provide multiple dimensions for analysis. For instance, users could click on a map that shows expenditure by state and click on an expenditure and view the amount by object class and vendor. Users could view summary level information and drill down to more detail. In addition, the Board should consider the costs that agencies incur to prepare financial statements.

Ms. Park

Ms. Park noted that we need to consider the purpose of financial statements. They help facilitate discipline and the balance sheet helps with understanding the assets and liabilities accumulated. However, the remaining statements do not offer value. It appears that a high level of complexity has been added and a high level of effort is required to prepare financial statements, but the information is not used. For instance, those interested in budgetary amounts will review the budget rather than the SBR. Potential users would want to answer questions such as:

- In my state, what benefit did the VA give me?
- Who received VA benefits in what county?
- How many people received them?
- What were we treating veterans for and at what hospitals?

We should consider a different model going forward because the departments and agencies receive a budget rather than seeking profits. Also, it may be beneficial if we can tie the information on a balance sheet to what will be produced in our transparency efforts.

Ms. Palmer

Ms. Palmer agreed with other comments indicating that the level of effort required to prepare financial statements is high in relation to their usefulness. The financial statements are being produced for the auditors, Inspectors General, Government Accountability Office, FASAB, OMB, and the Department of the Treasury. Also, if the new model is different from the statements provided in the private sector, the Board will need to consider that the audit community will need to be trained on the differences. The model should be basic and not very difficult to prepare and have audited.

Additional Topics Discussed

Regarding whether to abandon the existing model, there did not appear to be a consensus among the panel. Comments included:

- Abandon the model and consider the highest level of aggregation that can satisfy users. The HHS schedule of spending provides information by program and the programs are recognizable to many.

- The balance sheet provides some value.

- A significant amount of information is lost when aggregating at the department level. Providing financial statements with drilldown capability would be useful but a burden to prepare.

- We could abandon the existing model and permit auditors to audit trial balances. Agencies should have the flexibility to determine what their users need.

- Remove the statement of changes in net position.

- Remove the detail and focus on a few basic statements such as a balance sheet and another statement that agencies can determine based on their constituents.

Also, it was noted that the fundamental questions that agencies are trying to answer through the statements are: how much money did you get; what did you do with it; and what did we get for it? This information should be presented by program. Presenting information by strategic goal has several challenges including determining what items should be included in each broad goal. Those involved in performance reporting are still trying to determine what information should be reported externally.

With respect to government-wide reporting, the DoD accounts for about 50 percent of the federal government's net cost. However, the department is broad, composed of many sub-organizations, and collecting data is complex. It would be difficult to get to a clean opinion on the government-wide financial statements without DoD having a clean opinion.

Regarding executive use of financial statements, panel members noted:

- The statements are not used.

- Executives are briefed on the statements but not necessarily for decision-making purposes.

- The audit results are used to identify risks. However, budgetary information is used for decision-making.

Also, it was noted that financial statements are issued once a year; however, managers need information more timely for decision-making.

Members discussed web-based financial statements with drill-down capability. Mr. Dacey noted that it appears that the panel believes that financial statements present high-level information and if detail is needed, the detail should be presented outside of the basic statements. Also, the aggregation approach varies by agency. Mr. Granof added that the detail “evaporates” when information is aggregated at the department level. Financial statements should have drill-down and search capability so that users can access the detail.

With respect to performance information, panel members noted that performance reporting is challenging. Different constituents seek different performance measures but there is benefit in linking cost and performance.

- **Interior – Dashboard Demonstration**

Mr. Adam Crahen, systems accountant, Department of Interior, demonstrated how the department is using Tableau, data analytics software. The demonstration showed how a user can access and array financial data in a variety of ways. The software was highly interactive and offered flexibility, permitting a user to perform searches. Also, it used graphics to highlight key items of information and facilitated a dashboard presentation with drilldown capability.

Mr. Crahen noted that the primary purpose of the software is to present data in an understandable and useful manner. It will help answer questions such as: what do we do with the money received; where was it spent; and what do we get for it?

- **GPRA MA Implementation Update**

Ms. Elizabeth Curda, Assistant Director, Government Accountability Office (GAO) provided an overview of the GAO’s findings on Government Performance and Results (GPRA) Modernization Act of 2010 implementation. One observation was that GPRA requirements were on an agency-by-agency basis. This appeared to reinforce a siloed view of how performance occurs in the government. Although many outcomes involve multiple agencies, there was not an incentive for agencies to consider how they work together to solve common problems. Another major issue noted was that although there was a significant increase in the amount of performance information being generated, there was not a concomitant increase in the use of that information. Consequently, the GPRA Modernization Act included provisions to help address these concerns, such as the requirement for federal government (cross-agency) priority goals, agency priority goals, consultations with Congress, and electronic reporting.

Although the OMB has established a website for performance reporting and it provides the government and agency priority goals, users would need to access individual agency websites to review all the information that agencies report. In terms of the evolution of performance management, in the state and local governments, the trend has been toward active, real time collection and management of performance information. New York, Maryland, and Washington state are using this approach. In addition, there is commonality between the criteria for moving off the GAO high risk list and the kinds of requirements in the Modernization Act; leadership commitment, a plan based on what you are going to do, and monitoring.

Agencies are not always including all the relevant contributors in their cross-agency priority goals. Contributors can include grants, regulations, direct services, tax expenditures, and research and development. Any given outcome could have all these different kinds of tools of government working together. In addition, performance information is not being provided with respect to tax expenditures.

GAO surveyed managers regarding performance information and asked questions such as, are you using the information to inform a resource allocation; address program problems; or collaborate? Although about 50 to 60 percent express using the information, these results do not change. A factor that can enhance usage is the ability to disaggregate the information. For instance, can one determine where the outcomes are occurring and the demographics involved? Also, access to performance information, capacity to perform analysis, and clear communication are helpful as well.

GAO continues to observe issues with developing performance measures for different kinds of program types, such as grants, regulations, and research and development.

- **Reporting Model**

The Board reflected on the agency level reporting discussion and offered comments:

Mr. Showalter noted that it appears that little is known about users. Also, the Board has been discussing aggregated data, but such data are not going to be as useful as the data accessible through drilldowns. Can the Board think about a model that allows flexibility to accommodate the unique while covering some minimum requirements? Also, do we know what we want people to take away from financial statements? That is a data aggregation question that should be answered because there is only so much one can learn from highly aggregated data.

Mr. Smith noted that the Board has to define what we want financial statements to present because there are other ways of getting information. The process of producing financial statements instills discipline and ensures data integrity. These are important benefits that we need to keep in mind. Also, the information needed at the government-wide is different from the reporting needed at the agency level and an agency that receives user chargers appears to be a third reporting model that should be measured. Such agencies are not necessarily receiving appropriations. In addition, the Board should consider what information is really relevant and reduce the level of disclosures.

Mr. Dacey observed that there are many different users that seek different information. Consequently, it would be difficult to satisfy all of them. However, an “anchor” is needed. Audited financial statements help demonstrate accountability – the entity can prepare financial statements in accordance with generally accepted accounting principles and receive an unmodified opinion. The question is how can we improve the linkage between the existing model and other items of information, such as performance information? The existing model is designed to provide less detail in the consolidated financial statements and more detail at the agency level. Therefore, the Board should carefully consider the consequences of removing information from the agency level.

Ms. Kearney noted that preparers may be looking to the Board for relief because it appears that requirements are always being added. Also, the balance sheet appears to be a statement that should be retained but the statement of changes in net position was not useful. Other observations included: disclosures should be streamlined; the discipline has helped improve the reliability of information; and the Board should consider the basic “nuts and bolts” needed - remove graphics, pictures, and secretary messages and have links to dynamic displays.

Mr. Allen noted that managers are not using financial statements as indicated in the Board’s concepts. Also, although the existing model is designed so that the user goes from the government-wide to the agencies to obtain details, the panel noted that the agency level information is not useful, despite being more detailed than the government-wide. Users seek even more detailed information than that provided in agency level statements. In addition, strategic goals are used to present cost but goals change and systems may not be setup to capture costs in that manner.

Ms. Ho noted that the consolidated level is an economic entity and certain financial information should be presented at that level, such as assets and liabilities. However, each agency has a different mission and citizens want to know what goods and services they receive from agencies. Agencies need to be able to show how well they are achieving their mission and the associated costs. However, trying to show all that information at the government-wide level would be too much. Also, everyone appears to agree that the discipline involved in preparing financial statements needs to continue.

Mr. Steinberg observed that the panel discussed items of information that would be useful or approaches for helping users understand the information presented:

- The cost of the things that the department would like to do
- The cost of programs
- Disaggregated performance information
- Data visualization

Also, while the balance sheet was noted as useful, Mr. Steinberg noted that there is a common belief that government balance sheets are not that meaningful because they do not show the largest asset, the power to tax; and liabilities are not significant because the government has the power to print money. Consequently, we should focus on flow information.

Mr. McCall noted that agencies are driven by the appropriation process and would likely be satisfied using the cash basis. The Board should consider what agencies do that helps to provide accountability for the federal government. The agencies appear to be saying that too much time is being spent on financial statements rather than program cost and benefits. However, the discipline of preparing financial statements is improving internal controls so we can get to the program level data. Also, based on reviewing the financial statements, it appears that agencies may not know what success is for their organization. The statements of net cost reflect themes, goals, and various other items.

Mr. Granof observed the need to take advantage of electronic reporting. The panel members discussed the need to drill-down to detailed information. Also, the panel members noted the need to streamline information and remove statements such as the changes in net position. Although the statement may not be intelligible, we may continue to need the data. Thus, eliminating statements may not result in the cost savings they expect.

Mr. Simms discussed that different users expect different items of information and they will look to link or aggregate items in different ways. They may look for program information such as what was appropriated or budgeted, how much of the budget was used, where it was used, how much did it cost to provide the service, and what were the benefits. Consequently, a level of flexibility is needed along with the standard reporting because detail such as program locations may not be possible through financial statements. Basic financial statements can provide a level of assurance that financial data have integrity, and flexibility can be demonstrated by directing users to detailed information and data that can be aggregated in a variety of ways.

Ms. Payne noted that it was mentioned that the Board should consider the Data Act and integrate our project with the efforts to implement the Act. The Data Act is granular and financial statements are highly aggregated. There is an obligation to ensure that the two meet in the middle or a clear explanation of why they do not. Also, there is a cultural challenge to reporting performance information. Generally, the performance information is not linked with accounting and auditing. There is often no nexus between the discipline of providing cost information on the finance side with the data-driven decision-making envisioned in the Government Performance and Results Act.

Members discussed the nexus between the Data Act and financial statements. Mr. Dacey explained that the Data Act should facilitate consistency across agencies and rather than accessing a single, database, the system would access data residing at the agencies. If we assume that agencies can provide access to a rich set of data, the question becomes what is important at the financial statement level – should the agencies continue to have the flexibility that they have under existing guidance or should the reporting of cost be more standardized?

Mr. Allen expressed that if the Board assumes that agencies will be able to provide users with access to detail, the question becomes how simple can we make the financial statements? This would be a good goal but it would be a different approach than what most standards-setters use.

Ms. Ho clarified that the Data Act is not providing cost information. It is focused on spending information and it will help with providing more summary level information. There is a difference between the transparency initiative and financial reporting. The expectation for the transparency initiative is real-time information and it is not intended to replace financial statements and financial reporting. While it is good to discuss linkages, we need to be clear that the transparency data will not be subject to the same level of discipline as the financial statements.

Mr. Showalter added that although different users want different information, providing different information to different users is not the role of financial statements and we should be clear about what financial statements include. Financial statements should be as user-friendly as possible but users would need to go elsewhere for detail such as that envisioned by the transparency efforts. Also, Mr. Allen noted that materially, cash and accrual bases are the same. However, when users want to look at the net position of the government and how much it changed during the period, they would need accrual basis information. At the agency level, agencies only have the position that the government-wide assigns to them.

Concepts

The Board discussed broad concepts included in the working draft concepts statement and agreed that:

- The interrelationship among information presented in financial statements should be understandable. This may be self-evident or accomplished through narrative explanation.

- There are different levels of reporting, the government-wide and component levels, and they have different characteristics that should be discussed in the conceptual statement.

- The government-wide is the economic entity and components are not economically independent entities.

- The government-wide should help citizens and citizen intermediaries understand the major goods and services and other activities that the federal government provides and where they can obtain detailed information in components.

- The government-wide and components have different financing structures and focus.

- Although it may be challenging for external users to understand, the relationships and differences between the government-wide and component level, the financing should be explained.

Also, the Board believed that the concepts should acknowledge that the process of preparing financial statements instills discipline and a user could be an individual that relies on information that results from the discipline imposed. However, the individual may not necessarily use the financial statements.

Conclusion

The Board agreed with the concepts staff presented and, for the December 2014 meeting, the Board will: continue discussing ideal model concepts; and will have an educational session with experts on budgetary reporting.

- **Public-Private Partnerships**

Members considered three options for inclusion in the three-year plan concerning the P3 project's second phase addressing measurement and recognition. The first option was to proceed at a regular pace finalizing the measurement and recognition guidance in 2016, a second was to defer finalizing the measurement and recognition guidance to 2019, and the third was to proceed, but with a lengthened timeline finalizing the measurement and recognition guidance in 2018. The staff recommendation was to include the third option in the three-year plan.

The Board's discussion included the benefits as well as drawbacks of each option. Initially, no consensus existed as evidenced by each option receiving a fair amount of support among members. However, as discussions ensued, support for the deferral option gained momentum primarily due to its benefit of (1) allowing time to get entity results from the disclosure phase of the project and (2) reallocating staff resources to other critical work. In a formal vote, the majority of members agreed to present the P3 project under the deferral option in the three-year plan. Mr. McCall disagreed and voted for the third option and Ms. Ho abstained. Please refer to the *Annual Report and Three-Year Plan* section for related comments.

- **Annual Report and Three-Year Plan**

Ms. Payne noted that members were provided a revised copy of the report and plan at the table. Changes suggested by members before the meeting are included and marked. During the discussion, the following changes were agreed by members:

1. Consistent with the P3 discussion, the project timeline will be revised to allow for a deferral. Introductory text will be modified to encourage comments from respondents.

2. The summary of progress on the leases project (page 7) will not refer to concurrence with GASB decisions. In addition, the references to cost-beneficial options for extensive intragovernmental leasing activities will be deleted and the focus will be on federal intragovernmental leasing activities.

3. Repetition of points regarding steps that improved due process and efficiency will be streamlined (page 11 and prior text).

4. Restore the project on tax expenditures to the research agenda and remove dollar amounts from the description. Also, add a reference to the GPRA Modernization Act requirements relating to tax expenditures.

Members agreed to identify any purely editorial changes after the meeting. Ms. Payne indicated that she would circulate a revised report and plan for final review before it is issued in mid-November.

- **Steering Committee Meeting**

Ms. Payne provided an update on the recruitment efforts. She also noted that the reimbursable agreement for 2015 was completed.

Adjournment

The Board meeting adjourned for the day at 4:45 PM.

Thursday, October 23, 2014

Agenda Topics

- **Leases**

Ms. Valentine opened the lease discussion by stating that the objective for the current session is to review draft guidance for intragovernmental leases, which the Board has tentatively decided should be accounted for similar to current operating leases guidance. The proposed guidance includes definitions of relevant terms, as well as specific provisions that address features of leases and is based on the current FASB operating lease guidance. She also mentioned that she received some comments from Chairman Allen, Mr. Steinberg, Mr. Showalter, and Mr. McCall.

Intragovernmental Lease Definitions

Ms. Valentine presented seven lease-related definitions to the Board for discussion. The first three definitions were discussed and tentatively agreed to by the Board at previous meetings.

> ***Lease** : A contract or agreement that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration.*
>
> ***Intragovernmental**: Occurring within a consolidation entity or between two or more consolidation entities as defined under SFFAS 47 (Reporting Entity).*

Intragovernmental Lease Agreement*: A lease occurring within a consolidation entity or between two or more consolidation entities as defined under SFFAS 47 (Reporting Entity).*

Ms. Valentine noted that the lease task force asked for more information explaining "consolidation entities as defined under *SFFAS 47* (*Reporting Entity*)."

The remaining four lease-related definitions were adapted from FASB's existing operating lease guidance.

Intragovernmental Lease Inception

The date of the lease agreement or commitment, if earlier. For purposes of this definition, a commitment should be in writing, signed by the intragovernmental parties in interest to the transaction, and should specifically set forth the principal provisions of the transaction. If any of the principal provisions are yet to be negotiated, such a preliminary agreement or commitment does not qualify for purposes of this definition. [Adapted: ASC 840-20-20 Glossary]

Mr. Smith asked about the use of "commitment" in the definition of lease inception and how binding is a commitment. Mr. Dacey asked staff how "lease inception" was going to be used in the context of the standard. He also noted that the definition does not need to be complicated for intragovernmental leases, we just need to decide at what point the agreement will be binding with limited judgment involved.

The Board asked staff to simplify the definition of Intragovernmental Lease Inception and test it with the task force.

Intragovernmental Minimum Lease Payments

- *For a* ***lessee****, minimum lease payments comprise the payments that the lessee is obligated to make or can be required to make in connection with the leased property* <u>*excluding*</u> *both of the following:*

  a. Contingent rentals

  b. The lessee's obligation to pay distinguishable executory costs (such as insurance, maintenance, and taxes in connection with the leased property) separately or as a component of the rental payments. [Adapted: ASC 840-10-25-5]

- *For a* ***lessor****, minimum lease payments comprise the payments that the lessee is obligated to make or can be required to make in connection with the leased property, including any guarantee of the residual value, but* <u>*excluding*</u> *both of the following:*

  a. Contingent rentals

  b. The lessee's obligation to pay distinguishable executory costs (such as insurance, maintenance, and taxes in connection with the leased property) *separately or a component of the rental payments. [Adapted: ASC 840-10-25-7]*

Mr. Steinberg noted that the definition of "executory costs" should be included if we are using it in the definition. Ms. Valentine noted that FASB has a definition of "executory costs" that we could use. Mr. Steinberg also asked about the types of executory costs applicable in intragovernmental leases (i.e., taxes, maintenance, insurance, and utilities) and are they normally separate from the pure space costs. Mr. Showalter added that FASB separates the costs to identify operating costs. Mr. Dacey noted that the executory costs may not always be distinguishable in order to separately account for them. Ms. Valentine noted that GSA does identify those costs in most of their agreements. Ms. Payne asked if it was the Board's intention to require the disclosure of the rent costs alone.

Mr. Smith asked why it matters if the executory costs are included or not; the Board should make the accounting less complicated. Ms. Ho agreed with Mr. Smith because simplification will help with the intragovernmental eliminations. Ms. Payne added that "cash basis" is the most simplified method.

The Board agreed that the lease payment would be defined as whatever the rental payment is including "executory costs."

Intragovernmental Noncancelable Lease Term

The period during which a lessee has a noncancelable right to use an underlying asset. [Adapted: GASB's Tentative Decisions on Lease Project]

Mr. Dacey recommended that the definition of "lease term" be discussed in the context of the accounting for non-level rents. The Board agreed.

Intragovernmental Sublease

A transaction in which a leased property is re-leased by the original lessee to another lessee within the same or another consolidation entity, and the intragovernmental lease agreement between the two original parties remains in effect. [Adapted: ASC 840-20-20 Glossary]

There were no Board objections to staff's proposed definition of "intragovernmental sublease."
Staff then presented proposed recognition and disclosure lessee guidance for intragovernmental lease arrangements.

General Lessee Recognition Guidance

The following general guidance was proposed by staff.

Intragovernmental rent should be charged to expense by lessees over the intragovernmental noncancelable lease term. If rental payments (i.e., minimum *lease payments) are not made on a straight-line basis, rental expense should be recognized on a straight-line basis unless another systematic and rational basis is more representative of the time pattern in which use benefit is derived from the leased property, in which case that basis should be used. [Adapted: ASC 840-20-25-1]*

The Board discussed the noncancelable lease period as it relates to intragovernmental leases and how short that period is in many intragovernmental leases – for example, many GSA occupancy agreements are cancelable after the first 16 months.

The Board decided that the general guidance for the intragovernmental lessee would be to recognize lease payments as they are made and the specific provisions would address those instances when the "due and payable" is not applicable.

Specific Provisions – Lessee Recognition Guidance

The following specific provision lessee guidance was proposed by staff.

Nonlevel Rents
Lease Incentives
Rent Holidays
Build-to-Suit Leases
Rent Expense During Construction
Subleases
Amortization of Leasehold Improvements
Lease Modifications
Renewals and Extensions

Mr. Steinberg stated that nonlevel rents that are based on scheduled rent increases should not be recognized on a straight-line basis, but recognized as they are due. Mr. Granof noted that if the rent increases are for inflation purposes, expensing when occurred would be appropriate, but if the rent increases are used to avoid expense in the early years, then straight-line would be a better recognition option.

Mr. Smith noted that rent holidays and other lease incentives should be straight-lined. Ms. Payne noted that the Board might also consider the recognition of inter-entity cost as it relates to intragovernmental leases.

Mr. Dacey stressed that the standard should clearly explain those instances when straight-line recognition should apply.

The Board agreed that certain scheduled rent increases, rent holidays, and lease incentives should be recognized on a straight-line – possibly using the proposed language used for the amortization of leasehold improvements, including the "reasonably assured" language use by FASB.

Mr. Granof noted that FASAB has not used “reasonably assured” in the past and asked how would it be defined. Chairman Allen suggested using “expected” instead. Ms. Payne suggested using “more likely than not” since it is defined in the FASAB standards. Mr. Dacey suggested staff look into the FASB language used (reasonably assured).

Mr. Steinberg asked staff what are the differences between the “build to suit” guidance and the “rent expense during construction” guidance. Staff noted that FASB provided this type of guidance to distinguish between those instances when the lessee has access to the property before construction is completed and those when the lessee does not have access to the property before construction is completed.

The Board asked staff to discuss with the task force the need for any “build to suit” or “rent expense during construction” guidance.

Ms. Valentine suggested as a general rule for intragovernmental lease modifications, the standards should require a simple prospective recognition approach. There were no Board objections to staff’s suggestion.

Ms. Valentine noted that for the recognition of contingent rentals, FASB’s current operating lease guidance states that the lessee recognize the contingent rent when the contingent event is probable and the lessor recognize the contingent rent when the contingent event occurs – the FASB approach is not symmetrical. Mr. Dacey recommended that, for symmetry purposes, both the lessee and lessor recognize contingent rentals when the amounts are due and payable.

The Board agreed with Mr. Dacey’s recommendation and asked staff to talk with the GSA and the task force about the frequency of contingent rentals in intragovernmental leases.

Ms. Valentine asked the Board about the proposed definition and recognition of the renewal or extension of an intragovernmental lease. Mr. Granof and Mr. Dacey recommended simplifying the proposed definition and recognition of the renewal or extension of an intragovernmental lease, because the FASB guidance was used to differentiate between capital and operating leases. Since we do not have that situation, the language should be simplified. The Board agreed with the recommendation.

Ms. Payne noted that developing two sets of definitions – one for the intragovernmental leases and one for the non-intragovernmental leases – may lead to confusion unless the terms are clearly distinguished.

- **Risk Assumed**

In relation to Question I—does the board approve requiring a reference to the disclosure for borrowing authority, borrowing, and interest expense from the insurance notes? — Ms. Gilliam reminded the Board that they agreed during the August 2014 meeting to disclose insurance related borrowing but requested additional information. She informed them that current standards provide for good guidance on disclosing borrowing authority, borrowing and the related interest expense, and as a result, the disclosures are clear and concise. Staff recommended that insurance programs refer to the borrowing disclosures instead of repeating the information in the insurance notes. This would not add an extra reporting burden to the agencies, which she noted was a concern during the reporting model discussion.

Ms. Ho noted the difference between insurance and non-insurance for borrowing and the timing in the request for the borrowing. She asked if the measurements of the risks are harder for insurance programs. Would that difference have an impact on the disclosure?

Ms. Gilliam responded that significant uncertain events do have an impact on why the insurance programs borrow which is disclosed in their borrowing notes. For example, flood insurance did reference the losses from Sandy as the reason they needed to borrow a significant amount. Balances were disclosed, as well as their inability to pay.

Mr. Showalter asked if we would be that prescriptive regarding location of information. He was concerned about precedence set by saying that we have to reference these notes. Agencies may want to structure the notes differently and that should be their call.

Mr. Allen said more common language was “here is the requirement and it can be fulfilled in various ways.” Mr. Showalter agreed.

Mr. Dacey also agreed and noted that disclosure of borrowing authority for unanticipated losses is helpful regarding understanding the cash flow rather than the cost. That understanding is important. Mr. Steinberg request that for the borrowing disclosures, we include inability to repay.

Ms. Gilliam restated that the members agreed to use the existing standards and recommended that in our interpretation of the borrowing standards that we also include a requirement to disclose the inability to pay and narrative about any material changes without being prescriptive.

The following was discussed in relation to Question II—Does SFFAS 7, paragraphs

36 -37 provide enough guidance to allow a reference from the insurance standards for unearned revenue? Does the board think this reference to unearned revenue provides enough guidance to allow a reference from the insurance standards?

Mr. Showalter found SFFAS 7 clearer for unearned premiums, but not earned premiums. Mr. Steinberg and Mr. Dacey agreed that SFFAS 7 is not adequate to just refer to for insurance premiums. Mr. Steinberg and Mr. Showalter interpreted the current standards to recognize revenue when services were performed.

Ms. Payne pointed out that SFFAS 7, item 36 (d) provides that revenue be recognized level over the time period of a policy. Item 36 (a) addresses that, if the risk is unlevel over a period of time, revenue would be recognized according to when services are performed.

Ms. Gilliam informed the Board that the new FASB revenue standards are by contract type. For current insurance it was by short term and long term policies. The updated standard for long term contracts have been broken out specifically and staff might use some of that for our insurance contracts. Our insurance contracts seem to be a hybrid and if we decide to do a premium deficiency, this break out for revenue recognition will support that. We want to be clear about how to recognize our unearned revenue to correctly post them against the expected losses for the same period.

Ms. Payne noted that while the FASB standards might be clearer directly related to insurance, they are not inconsistent with SFFAS 7. Mr. Showalter agreed but noted that it probably was not obvious to some readers.

Mr. Dacey agreed saying that we are taking on equal risk throughout the policy period because generally there are no differential insurance risk throughout the policy. Ms. Payne asks if rainy season for flood insurance is considered a differential insurance risk. Mr. Dacey said the coverage is the same whether or not there is a predictable event.

Mr. Dacey noted that 36(d) will not intuitively lead a preparer or the auditor to the right answer. The recommendation is not to establish new principles but to apply the existing principles in SFFAS 7 and to make it clear and consistent by building on the ones we have with an interpretation of how it applies to earned and unearned revenue for insurance contracts. He emphasized that both the revenue and unearned revenue side should be very clear to the preparer and the auditor.

Mr. Showalter agreed to an interpretation of SFFAS 7 for insurance.

Mr. Allen was concerned that the portion of 36(d) determined whether interest earned on investments is exchange or non-exchange revenue based on whether the source of funding is exchange or non-exchange revenue.

Ms. Payne noted that earning interest appears to be revenue exchanged for depositing funds; however, the federal statements are structured to show the net cost financed by taxpayers on the statement of net costs. If all interest earned were reported as exchange revenue it would appear to reduce the cost borne by taxpayers.

Per SFFAS 7, exchange revenue that is deposited at Treasury and earns interest goes on the statement of net cost. A tax that is deposited and earns interest revenue goes on the statement of changes in net position. The result is not a true classification of the interest earning process as exchange or non-exchange; instead interest classification is driven by placement of the deposited funds within the statements when they were first earned.

Mr. Steinberg asked how do we know if the source of money borrowed from Treasury is exchange or non- exchange. Mr. Dacey noted that premium revenue is exchange and only the first part of 36(d) needs to be referenced for the insurance standards.

Ms. Payne requested that we defer this discussion since it is a broad concern beyond the risk assumed- insurance project. Mr. Allen agreed.

Ms. Gilliam summarized that the Board requests staff to draft the proposed standards to align with SFFAS 7 but provide an interpretation for insurance contracts.

The following was discussed in relation to Question III—Does the Board approve including claim adjustment expenses (CAE) in insurance program liabilities?

Mr. Dacey asked if any of the entities recognize that today. Ms. Payne noted that crop and flood are recognizing CAE. She referenced Note 20, on page 13 for Flood insurance which reads "the insurance liability for unpaid losses and related loss adjustment expenses."

Ms. Kearney asked if this is a significant, cost, a hole in the guidance, or is it something FASB is doing that we are considering.

Ms. Payne stated that it is a legitimate conceptual issue that FASAB considered when developing the credit reform standards. In credit reform there was a decision on the budget side to exclude expenses to administer a direct loan, in determining a subsidy or to process the loan guarantee. The Board deliberated and decided to also exclude it on the proprietary accounting side in order to maintain symmetry. Staff is seeking an explicit decision so guidance in the insurance standards is clear.

Ms. Kearney asked what does flood look like if the claim adjustment expenses are not included. Ms. Payne said she did not know since it is not broken out. Therefore, the question is does the Board want to be symmetrical with SFFAS 2 or do you want the full settlement cost of insurance?

Mr. Steinberg said that SFFAS 2 is probably symmetrical because the cost to administer the long term loan programs comes out of several salary and expense (S&E) budget accounts. If we are talking about a liability we want to show our total liability even if immaterial. Claim adjustment expenses are part of the liability of the insurance program, because they do incur expenses to determine the expenses of the program.

Ms. Payne noted that for insurance programs there are third parties providing claim adjustment services. For example, Crop claims are largely administered by private sector insurers with the government back filling. Conceptually, it may have always been part of the settlements paid.

Mr. Dacey said that with credit reform you have 10, 20, or 30 years of servicing that loan and do we really want to have that estimate? Conceptually for short duration contracts—on average 6 months— we could estimate the ratio of CAE to actual payments and then apply that to the claim liability. For example, if on an average it costs 2% to settle claims then we could add 2% onto the claim liability that we estimate.

The real question is what period to do you recognize that cost? Do you recognize it in the period that the entity actually paid it or do you recognize it when accruing that liability?

Ms. Kearney asked two questions: 1) do we think it is material, and 2) do we think we will get great benefits out of it. One of OMB's charges is to weigh cost and benefits. If it this looks like it is something that is going to be extraordinary for agencies to collect and to report on, and it is immaterial then we probably want to reconsider including it in the liability. If this is something easy for agencies to include then, conceptually we should include it.

Mr. Allen said yes, conceptually if should be included in the liability, but how difficult is it to obtain? Some programs know and some do not. In looking at insurance and other phases of risk assumed who knows what the administrative cost will be and therefore suggested we use the word "estimatable" since we should not burden the agencies unnecessarily.

Mr. Dacey noted if agencies are not having any problems accruing it today, then we may not want to say do not do it now.

Mr. Steinberg agreed that we do need more information about what the insurance programs are doing now. So in relation to the 2% reference, it might be based on history, so it may not be difficult to add in. And, they have to come up with some type of number for their budget request. But a more important issue is, when would you recognize it?

Mr. Dacey noted that from a budget point, it is probably when they incur the cost to settle the claim. Mr. Steinberg said that the liability should be reported when the cost is incurred.

Mr. Dacey asked if we are going to deal with deferred acquisition costs. Ms. Payne noted that the Board made a prior decision not to require deferral of the acquisition costs at the April or June 2014 meeting. Ms. Gilliam reminded them that the task force did not support breaking acquisition costs out.

The Board requested information on the following questions:

- What effort are they expending and how difficult is it to estimate or identify CAE?
- What is the materiality of the CAE in relation to the liability for claims?
- How do they calculate CAE for third parties and/or federal staff?
- Are the auditors having problems with it?

Ms. Gilliam noted that the staff will take these questions to the Nov 20th task force meeting.

The following was discussed in relation to Question IV: Does the Board agree with (1) separating the liability now required by SFFAS 5 into two components—liability for unpaid claims and liability for premium deficiency….

Ms. Gilliam noted that staff followed up with the Board's request to better understand the term Premium Deficiency Reserves. Staff determined that programs are using the term "reserves" to refer to a liability, yet they do not have an asset that is a reserve for their liability. Staff wants to get away from using the term "reserves" without actually stating "do not use that term."

We recommend breaking out the liability for premium deficiency to build on and clarify SFFAS 5, Table 9, in order to show amounts that need to be financed by taxpayers above and beyond premiums.

The goal for commercial insurance is to make a profit; the government's goal is to cover our losses with premiums. If premiums do not cover losses are we at risk to borrow or use appropriations?

If we do not have a premium deficiency, are we collecting too much money in premiums? These programs have actuarial staffs that constantly monitor their risks, events, and assumptions so they can address adjusting premiums. Therefore, the liability for premium deficiency is an important piece for risk assumed.

Ms. Ho asked whether a reader's interpretation for the risk related to liability for unpaid claims and liability for premium deficiency will be different.

Ms. Gilliam stated that the liability for unpaid claims is related to an event that has already occurred by September 30th. The liability is for claims that have been received but not yet paid, and incurred but have not yet been reported (IBNR).

The liability for premium deficiency is related to the risk for future claims on events that have not occurred in relation to the unearned revenue collected for the remaining policy period beyond September 30th.

Ms. Ho asked if it has already been included in the reserve calculation because it sounds like expected loss. Ms. Gilliam explained that IBNR are included in the liability for unpaid claims, but expected losses on future events are not. Mr. Granof asked how to discount probable losses in the future back to the present for short term and long term policies.

Mr. Dacey answered that it is not necessary to discount for short term policies since the projected losses are based on the policy term covered by unearned revenue.

Ms. Payne said that we were getting a little ahead of ourselves in relation to measurement. There will be things that are not measureable, for example, Flood talks about the catastrophic but low frequency events and they give you an average annual loss but they explain that there is never an average year. So there would be an effort to provide guidance for such cases.

Mr. Granof thanked staff for explaining a key point. Another question relates to estimates at the balance sheet date made using only “information that theoretically exists?” What is information that theoretically exists?

Ms. Payne noted that “theoretically,” the national weather service has a lot of weather data available at year end but does not have data that indicates precisely when a hurricane will occur. She agreed use of the word is a little odd, but the notion that appears to be that it is knowable at year end.

Some members agreed that the statements need to provide clarity.

Mr. Dacey raised the issue that for programs where the government is intentionally subsidizing the premiums, should the future subsidy for the remainder of the policy period be recognized in the current period or next period ? A number of members agreed that this was very difficult to understand.

Mr. Steinberg said that if you have potential losses that are more than the assets to pay them, then you have a negative net position that will be eliminated in one of two ways: either you are going to borrow (have a liability) or get an appropriation (have non-exchange revenue). We should look at incurred claims one way and decide if we want to pick up potential claims. Then we have to get into the measurement disclosure.

Mr. Dacey noted that it could be financed through future premiums, however, because borrowing is on a cash flow basis, future premiums would not reduce the negative net position. Mr. Steinberg said that you have to separate the cash flow from the accrual position.

Ms. Payne noted that the key question is when to recognize expected losses for a losing contract that spans reporting periods - do you wait until each adverse event actually happens (recognizing incurred claims) or accrue the full expected loss when you first expect the contract to be a losing one?

Mr. Allen clarified that incurred claims equal a liability for an event that has happened. Premium deficiency is when the insurance coverage goes forward and we have to estimate what our loss is going to be during that period even though an event has not occurred yet.

Mr. Dacey added that conceptually unearned revenue is the liability for the premiums collected to cover future losses related to the open policy term. If unearned revenue is sufficient to cover the future losses during the policy term, then there are no future losses or contingencies. If the future losses exceed the unearned premium then there is a premium deficiency for which we will have to book an additional liability to the balance sheet.

Ms. Ho asked the following questions: Is un-incurred for short term policies not included in the reserve because it does not meet the probably threshold? Why is the expected loss of an event that has not happened for short term not already included in the loss estimation reserve?

Mr. Dacey explained that if you have an accident before September 30th then the insurer has an obligation to pay the damage as of September 30th. If it happens in October after the year ended you would not recognize that claim liability as of September 30th because you did not have an incurred loss.

In relation to the premium deficiency, you ask whether there is enough unearned premiums to cover all of those auto accidents that will happen after September 30th? If the answer is no, then you have a probable loss for that difference. To accrue that loss you recognize the loss at September 30th and a liability related to the premium deficiency.

Mr. Allen gave another example. Actuaries make projections based on what they estimate losses to be over the next five years and determine that this is the premium to be charged. However, Congress determines to cap premiums based on constituent complaints. Therefore, premiums will not be charged for the full estimated cost over this period of time. This builds in a subsidy through appropriations or borrowing to cover the estimated loss. This is the premium deficiency for this period that we are insuring based on what the actuaries tell us the losses will cost and what Congress has capped.

Mr. Granof asked if the loss can occur in a future year for a policy written in a previous year. Mr. Dacey said that for the insurance there is a period of coverage and what has happened during that period of coverage would be covered. For example, if a loss occurred but was not reported for two years, then in theory they are included in the liability which should capture incurred but not reported (IBNR).

Mr. Showalter explained that we write policies that cover financial statement opinions this year on anything issued, but it may be two or three years later until someone actually sues you.

Mr. Smith clarified that the triggering event is the accident which is the IBNR claim. Mr. Granof agreed that therefore they have to estimate IBNR.

Mr. Steinberg noted that while most insurance policies will insure an event that occurs only during the period of time the policy covers, the government does have some insurance policies for which there is no ending date such as the FDIC which could be considered in perpetuity. Mr. Dacey said that banks need to keep paying the FDIC based on assessments or they will not be covered. Mr. Steinberg asked if PBGC is in perpetuity once they take over the pension plan. Mr. Dacey said he believes that for plans they take over, they recognize the liability (that is, the liability for covered benefits to plan participants net of estimated recoveries and the assets of the plan).

The following was discussed in relation to Question IV: Does the Board agree … (2) more clearly addressing recognition of contingent liabilities by expanding federal GAAP for federal insurance programs.

In relation to expanding GAAP, Ms. Kearney asked if staff meant applying existing guidance for contingent liabilities or coming up with new requirements for insurance programs. And, would we change the recognition period and remove reasonably possible and probable?

Mr. Dacey said that we need to refer to and elaborate on the existing contingency standards.

Ms. Gilliam agreed, stating that we will rescind the insurance guidance in SFFAS 5 and develop a new standard, but the general discussion on contingency liabilities in SFFAS 5 will not be removed. Instead we will interpret them in the new standard.

Mr. Allen requested an education session prior to the next discussion with actuaries to help understand this issue.

The following was discussed in relation to Question V: Does the board approve the wording of the proposed standards?

Ms. Gilliam noted that staff received comments on the criteria for insurance programs from Treasury. Staff determined that we will move the criteria to basis for a conclusion because it does not add any additional information to the definition.

The discussion moved to combining paragraph 19 (a) and 19 (c):

> 19 (a)—the balance of liabilities for unpaid insurance claims at the beginning and end of each reporting period and an explanation for any event(s) that caused a material change.
>
> 19 (c) A— schedule to show the significant components of the change in the liability for unpaid insurance claims. Information in the schedule should provide:…

Members agreed that staff would combine the two and insure that there is a narrative identification of events that caused material changes that are presented in the chart.

In relation to 19 (a), Ms. Payne noted that some members asked about: ”major insurance program and collectively for all other insurance programs.” The question for the Board is, do we want reporting entities to break out certain insurance programs or aggregate all their insurance programs?

Members agreed that programs with similar risks and transactions should be grouped together.

Mr. Steinberg asked how this would be addressed in the CFR. Ms. Payne noted that staff has not written the CFR section yet. Normally the requirements provide that the CFR show an aggregated disclosure for insurance programs and identify the agencies readers can look to for information on significant insurance programs.

The discussion moved to 19 (g)—Information regarding premium pricing policies as required by SFFAS 7, paragraphs 46.a. and 46.b., or a reference to another disclosure providing this information; and 19 (h)—Appropriations used to settle claims and an explanation for event(s) that caused material changes.

Mr. Showalter noted that (g) and (h) are related to premium deficiency and noted that he wants to see how the pricing contributes to the risk of the government.

Mr. Steinberg agreed and noted that he wants to see how the insurance premium prices are determined by law or actuarial method. And do premiums cover cash needs for losses?

Mr. Allen asked if we are trying to capture the differences in pricing from the full cost or market and only require those who did have a premium deficiency.

While Ms. Payne agreed, she noted that it would be clearer if we relate the premium pricing to the premium deficiency number and talked about, why it exists and is it expected to continue over the life of the program.

Mr. Dacey agreed and noted that the requirement needs to be more generic than is presented in SFFAS 7 paragraphs 46 (a) and (b) to show how a premium deficiency occurred and why there is a subsidy.

The discussion turned to 19 (i)—Transfers out to Treasury and an explanation for the transfer.

Ms. Gilliam noted that Treasury requested examples to explain the purpose of why money is “transferred” to Treasury which could indicate a negative premium deficiency and the risk of receiving too much appropriation. Ms. Ho noted that if the intent is based on an indicator of risk then we need to provide a disclosure that will help people understand what that really means. Mr. Allen noted that the terminology ”transfers to Treasury” is not commonly understood. Ms. Gilliam explained that the task force preferred the word “transfers” to the word “returned” but staff would reword based on the Board’s preference.

Adjournment

The meeting adjourned at 12:00 PM.