What's New with Financial Reporting

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Functional Training Breakout Session 1

Session Overview

- Learn more about new/expected federal financial reporting requirements from Federal Accounting Standards Advisory Board (FASAB) significant to DOC, including planned DOC approaches, and FASAB statuses of expected requirements
  - Proposed Concepts for *Financial Reporting Model (*Exposure Draft, September 29, 2016), including:
    - DOC content from its FY 2016 Agency Financial report
    - Highlights of DOC financial data from FY 2016 Agency Financial Report
  - Standard 47, *Reporting Entity* (December 23, 2014)—Effective FY 2018
  - Standard 49, *Public-Private Partnerships Disclosure Requirements* (April 27, 2016)—Effective FY 2019 (Early Adoption Permitted; not Planned for DOC)

Session Overview (cont’d)

- Proposed Standard for New Reconciliation of a) Proprietary Net Cost of Operations to b) Budgetary Net Outlays (Exposure Draft, December 21, 2016)—Expected Implementation Requirement is FY 2019 (Early Adoption Permitted; not Planned for DOC)
- Proposed Standard for Leases Accounting and Disclosures (Exposure Draft, September 26, 2016)—Effective Date Proposed is FY 2019 (Early Adoption not Permitted)
- Questions/Answers/Discussion

Proposed Concepts for Financial Reporting Model

- Note: Concepts statements become effective immediately; however, concepts statements do not revise FASAB standards. Concepts statements help to guide FASAB in its development of standards, and are also included in GAAP hierarchy (included in Other Accounting Literature, which is after Categories A through D)
- Discusses concepts and relationships between a) Generally Accepted Accounting Principles (GAAP) reporting for federal government; and b) Other Reported Financial Information
  - GAAP (meets qualitative characteristics of financial reporting— understandability, reliability, relevance, timeliness, consistency, and comparability)
    - DOC content from its FY 2016 Agency Financial report (Word file pages 1-3)
    - Highlights of DOC financial data from FY 2016 Agency Financial Report (Word file pages 4-6)
  - Other Reported Financial Information (may not meet qualitative characteristics of financial reporting; may lack consistency with GAAP standards):
    - Information required by other bodies, by law, by directives, etc. or voluntarily presented, such as:
      - Performance information required by legislation and administrative directives
      - Information about the federal budget, economy, and management and performance challenges
      - Information presented on government sponsored websites

Proposed Concepts for Financial Reporting Model (cont'd)

- Per FASAB, proposed concepts would primarily assist FASAB in developing reporting models for government-wide and component reporting entities
- Concepts focus on:
  - Providing information to contribute to achievement of Operating Performance and Stewardship objectives of financial reporting and to support achieving Budgetary Integrity objective
  - Would also assist preparers and users in understanding purposes of information required by GAAP and how this information relates to Other Reported Financial Information
- FASAB's efforts have included:
  - Meeting with users, including citizens across U.S., and identifying needs and preferences for how information could best be presented
  - FASAB has feedback from citizens that citizens often want less text, more illustrations (e.g. charts, tables, maps), top-down, drill-down capability to lower-level information; and even video summary presentations
- Next steps: FASAB to develop illustrations of possible examples of financial reporting based on feedback received

Standard 47, *Reporting Entity*

- Implementation date is FY 2018; early adoption not permitted.
- Per SFFAS 47 Summary (page 1):
  - Provides for determining most appropriate means (consolidated financial statements (“consolidating entity”); or footnote) for agencies to include information about organizations for which an agency is accountable for:
    - Organizations budgeted for by elected officials of federal government;
    - Owned by federal government; or
    - Controlled by federal government with risk of loss or expectation of benefits
    - Additionally, include organization if it would be misleading to exclude it even though it does not meet one of above three inclusion principles.
  - When any of these conditions exist, information regarding organization is needed to provide accountability.

Standard 47, *Reporting Entity* (cont'd)

- Determining whether to report in consolidated financial statements or in a footnote, requires assessment of degree to which following characteristics are met:
  - Organization is financed by taxes or other non-exchange revenue;
  - Organization is governed by Congress and/or President;
  - Imposes or may impose risks and rewards on federal government; and/or
  - Provides goods and services on non-market basis.
- Note, however, not all characteristics are required to be met to same degree; classification is based on assessment as a whole.

Standard 47, *Reporting Entity* (cont'd)

- Also, federal government may have significant relationships with other parties ("related parties"). Standard requires disclosures if:
  - One party to an established relationship has ability to exercise significant influence over other party in making policy decisions; and
  - Relationship is of such significance that it would be misleading to exclude information about it.

Related party disclosures would provide:

- Information about nature of government's relationship with related party; and
- Other information to aid in understanding relationship, including exposures to risk of loss or potential gain as result of relationship.

Standard 47, *Reporting Entity* (cont'd)

- Fiscal Service has led the government-wide implementation of SFFAS 47, and the following organization has been agreed to, between DOC and Fiscal Service, to continue to be included in the DOC consolidated financial statements as a "consolidating entity:"

NIST's National Cybersecurity Center of Excellence

- Funded through NIST's Information Technology Laboratory operating unit
- A Federally Funded Research and Development Center (FFRDC):
  - Paragraph 47 discusses quasi-governmental and/or financially independent organizations:
    - Quasi-governmental and/or financially independent entities have relationships with the federal government that are not temporary. Such relationships may be considered long term, or even permanent in some cases, when compared to other types of disclosure entities. Quasi-governmental and financially independent entities have different governance and financial arrangements.
    - Paragraph 50 of SFFAS No. 47 references FFRDCs as organizations that could be quasi-governmental and/or financially independent

Standard 49, *Public-Private Partnership Disclosure Requirements*

- Implementation date is FY 2019; early adoption is permitted (not planned for DOC)
- Per SFFAS 49, Introduction Section (page 5)
  - To meet challenges such as those brought about by limited budgetary resources, governments are increasingly establishing risk-sharing arrangements or transactions with private sector. Some of these arrangements or transactions may also involve private financing and enable governmental agencies to fulfill their missions to their constituents that would otherwise not be possible without such arrangements or transactions.
  - These risk-sharing arrangements or transactions are commonly referred to as **Public-Private Partnerships (P3s)** but may also be referred to as Alternative Financing Arrangements, or Privatization Initiatives, some of which are extremely complex.
  - For example, P3s may involve use of appropriated funds, non-appropriated funds, third-party financing, or significant amounts of private capital or investment. Furthermore, P3s can:

    (1) Be so long-term in nature that costs along with accompanying benefits may not be distributed equitably across generations;

    (2) Exclude contractual protections afforded government by Federal Acquisition Regulation (FAR) such as, but not limited to: termination rights and obligations, contract by negotiation, cost accounting administration, and contract cost allowability; and

    (3) require Government to provide resources or absorb losses greater than other alternative procurement methods or competing in-house performance

    Lastly, P3s may involve transfer of government assets, including intellectual property, into private hands for extended periods of time

Standard 49, *Public-Private Partnership Disclosure Requirements* (cont'd)

- Helps make P3s more understandable to public, and P3 information is important because government is accountable to citizens for proper administration of its resources
- Moreover, because P3s are a form of investment, P3s should be adequately disclosed in order to assist report users in determining:
  - Important assets of U.S. government; and how effectively they are being managed; and
  - Identification of risks.
- The term P3s refer to a wide variety of service, management, operating, and R&D arrangements or transactions meeting definition of P3s (paragraphs 16 through 19)
- May include contracts, grants, reimbursable agreements, alternative financing arrangements, privatization initiatives, and other arrangements or transactions
- Some P3s can result in risk of loss and therefore ***should be assessed against risk based (conclusive and suggestive) characteristics (paragraphs 20 and 21) to identify those that should be disclosed***

Standard 49, *Public-Private Partnership Disclosure Requirements* (cont'd)

- P3 definition (paragraphs 16 through 19):
  - Paragraph 16 states:
    - "federal public-private partnerships (P3s) are risk-sharing9 arrangements or transactions with expected lives greater than five years between public and private sector entities. Such arrangements or transactions provide a service or an asset for government and/or general public use where in addition to the sharing of resources, each party shares in the risks and rewards of said arrangements or transactions."
    - [9] Risk-sharing can be either structural or transactional. P3 Structural Arrangements are external to the government entity's operations and often involve the creation of a Special Purpose Vehicle (SPV), Trust, or Limited Partnership (LP); for example, military base housing. P3 Transactional Arrangements are internal to the government entity's operations; for example, work-share programs not involving the creation of a SPV, Trust, or LP.

Standard 49, *Public-Private Partnership Disclosure Requirements* (cont'd)

- Exempts certain arrangements or transactions from P3 disclosure requirements. (Such exempt arrangements or transactions are subject to existing disclosure requirements in other SFFASs):
  - ***Non-lease acquisitions of PP&E that are subject to Federal Acquisition Regulations (FAR)*** and private entity is not directly financing, operating, or maintaining the PP&E as part of an overall risk-sharing arrangement or transaction
  - ***Leases that are not bundled and are entered into using GSA-delegated authority***
  - ***Acquisition of supplies and services***, including construction, R&D, and commercial items, ***made pursuant to FAR Simplified Acquisition Procedures (FAR Part 13)***
  - Formal and informal ***arrangements or transactions that do not share risks or rewards and are solely designed to foster goodwill, encourage economic development, promote research and innovation, or coordinate and integrate strategic initiatives***
  - ***Grants*** to state, local, and Indian tribal governments and other public institutions and arrangements or transactions with foreign governments
  - Arrangements or transactions in which private entities voluntarily contribute nominal resources or provide incidental resources without expectation of compensation or government indemnification for any possible risk of loss

Standard 49, *Public-Private Partnership Disclosure Requirements* (cont'd)

- Arrangements or transactions meeting P3 definition are then evaluated against four risk-based "Conclusive Characteristics" (paragraph 20). **If any one of following is met, P3 arrangement or transaction should be disclosed:**
  - Conveyance or creation of a long-lived asset or long-term financing liability
  - Federal entity participates in, helps sponsor, or is party to a Special Purpose Vehicle, partnership, trust, and other such arrangements
  - Covers a significant portion of economic life of a project or asset
  - Principal arrangement or transaction is exempt from:
    - If a contract, the FAR; or
    - If a grant, OMB requirements (2 C.F.R. Title 2, Part 200)

Standard 49, *Public-Private Partnership Disclosure Requirements* (cont'd)

- Should arrangement or transaction **not meet** any one of the four Conclusive Characteristics required for disclosure, arrangement or transaction should then be evaluated (considered in aggregate) against five "Suggestive Characteristics" (paragraph 21) before concluding whether disclosure is required
  - A Value for Money (VIM) analysis is performed
  - Consideration of items given up in an arrangement/transaction or their value is not readily apparent
  - Significant work force duties, activities, or knowledge are cross-shared between public and private sector P3 parties
  - Focus is more on collaboration and informal, real-time, resolution processes than on formal, contractual, administrative processes
  - Government relies on either private sector partner's or a third party's determination of a P3's performance or return on investment/equity without performing its own verification of performance or return on investment/equity

Standard 49, *Public-Private Partnership Disclosure Requirements* (cont'd)

- Disclosure requirements for reporting entities' (paragraphs 22 through 24) comprise quantitative and qualitative information to assist users in understanding nature of P3s such as:
  - Relative benefits/revenues being received in exchange for government's consideration
  - Contractual terms governing payments to and from government
  - Related risks including those deemed remote
  - Disclosures can be provided by individual P3 or summarized; for example, by an entity's strategic objectives, departmental or bureau categorizations, or program budget classifications
- DOC will be participating in FASAB's upcoming Implementation Workgroup. OFM will shortly be issuing a data call request to <u>all</u> Bureau CFOs to begin the implementation process

Proposed Standard for New Reconciliation of a) Proprietary Net Cost of Operations to b) Budgetary Net Outlays

- Appears, based on April 2017 FASAB meeting, that implementation date will be FY 2019; and that comparative FY 2018 will not be required to be restated in new reconciliation format. Early adoption permitted (not planned for DOC)
- Replaces current Reconciliation of a) [Budgetary Net Obligations Incurred + Other Nonbudgetary Resources] to b) Proprietary Net Cost of Operations, which is a footnote
- May be required as statement or footnote (appears that OMB may be decision-maker)
- Categories of reconciling items:
  - Components of Net Cost of Operations that are not Part of Net Outlays
  - Components of Net Outlays that are not Part of Net Cost of Operations
  - Other Temporary Timing Differences (e.g. Prior Period Adjustment due to Corrections of Errors)
- Intended to be easier and more understandable
- Brief narrative also required

Proposed Standard for New Reconciliation of a) Proprietary Net Cost of Operations to b) Budgetary Net Outlays (cont'd)

- ***However, DOC strongly disagrees that reconciliation will be easier:***
  - ***Breakdown of reconciliation between Intragovernmental and With the Public is required (two additional columns) to support U.S. Government reconciliation of Budget Deficit to Net Operating Cost (there is a GAO recommendation to Fiscal Service that this breakdown be included in agencies' audited footnotes)***:
    - While Net Cost of Operations is broken down by Intragovernmental and With the Public, ***Net Outlays is not broken down this way***
    - ***Really is a requirement for <u>two reconciliations</u> due to required breakdown***
    - Only 4 of 26 applicable U.S. Standard General Ledger (USSGL) accounts have this breakdown required for trial balance submissions to Treasury (GTAS)
    - Agencies may have to devise their own methodologies to breakdown Net Outlays this way so that reconciliations by Intragovernmental and With the Public breakdowns are accurate
    - Treasury has recently provided agencies a revised draft USSGL crosswalk with required breakdown between Intragovernmental and With the Public

Proposed Standard for New Reconciliation of a) Proprietary Net Cost of Operations to b) Budgetary Net Outlays (cont'd)

- FASAB convened a Task Force for new reconciliation, and 13 agencies piloted new format (however, without Intragovernmental and With the Public breakdown). DOC and Treasury's Bureau of the Fiscal Service presented their views at April 2017 FASAB meeting.
- Selected agencies, including DOC, are currently piloting new reconciliation using FY 2016 data with required breakdown between Intragovernmental and With the Public. FASAB to consider this information prior to finalizing new Standard. OFM will likely need significant assistance from bureaus during this piloting of new reconciliation using FY 2016 data.

Proposed Standard for Leases Accounting and Disclosures

- Implementation proposed for FY 2019; early adoption not permitted
- ***Replaces accounting for leases as either an operating lease or capital lease***, which was based on Financial Accounting Standards Board (FASB) standards effective at that time (for private sector). New FASB lease standards took effect February 2016, based on a joint project between FASB and International Accounting Standards Board (IASB).
- FASAB collaborated with Governmental Accounting Standards Board (GASB), which establishes standards for state and local governments
- ***Leases include contracts or agreements that, although not explicitly stated as leases, meet definition of a lease***
- Does not apply to leases of federal natural resources
- A lease that transfers ownership of asset to lessee at or before end of lease, and does not contain termination options, should be treated as purchase of that asset
- ***A lease creates an asset consisting of "right to use" an asset for a period of time, and a liability consisting of obligation to pay for the right to use an asset***
- ***A lessee will recognize a lease liability and a leased asset (e.g. Property, Plant, and Equipment) at the beginning of the lease (a lessor will recognize a lease receivable and deferred revenue), unless:***
    - ***It is an intragovernmental lease***
    - ***It is a short-term lease***

Proposed Standard for Leases Accounting and Disclosures (cont'd)

- Intragovernmental leases and short-term leases will be expensed by lessee similar to current accounting treatment of operating leases
- A short-term lease is defined as a lease that, at beginning of lease, has maximum possible term under agreement of 24 months or less, including any options to extend, regardless of its probability of option being exercised
- Lease term is the period during which a lessee has a noncancelable right to use an asset (referred to as noncancelable period—further defined in proposed standard) plus each option period if it is probable that lessee will exercise that option
- Lease term should be reassessed if lessee does either of following:
  - Elects to exercise an option
  - Does not elect to exercise an option

Proposed Standard for Leases Accounting and Disclosures (cont'd)

- Lease liability will be measured initially at present value of payments to be made for lease term. Includes several types of payments that might be required by lease (e.g. fixed, certain variable payments, probable purchase options)
  - Discount rate will be rate that lessor charges lessee, which may be implicit in lease (and may not be stated or known)
  - If above discount rate cannot be reasonably estimated by lessee, lessee's incremental borrowing rate should be used—this would be Treasury's borrowing rate for securities of similar maturity to term of lease (assuming bureau does not have its own borrowing authority)
- Lessee should remeasure lease liability at subsequent financial reporting dates if certain changes (any of five situations indicated on page 15 of exposure draft) have occurred and are expected to significantly affect amount of lease liability. Leased asset would also be adjusted by same amount. If remeasurement occurs, discount rate should also be updated if any of two situations indicated on page 15 of exposure draft occurs, and are expected to significantly affect amount of lease liability.

Proposed Standard for Leases Accounting and Disclosures (cont'd)

- Leased asset should be initially recorded as total of:
  - Amount of initial measurement of lease liability
  - Lease payments made to lessor at or before beginning of lease, less any lease incentives received from lessor
  - Initial direct costs—costs directly attributable to negotiating and arranging a lease or portfolio of leases and would not have been incurred without entering into lease
- Leases unexpired at beginning of FY 2019 (October 1, 2018) will be initially recognized and measured using facts and circumstances that exist at October 1, 2018:
  - Lease term for an existing unexpired lease at October 1, 2018 would be initially determined assuming that the lease term began on October 1, 2018
  - Lease liability and leased asset should initially be measured based on remaining lease term at October 1, 2018
  - Effects of implementing this standard for unexpired leases at October 1, 2018 will be recorded prospectively (i.e. not recorded as a Prior Period Adjustment, and prior period financial statements will not be restated)

Proposed Standard for Leases Accounting and Disclosures (cont'd)

- Disclosure Requirements for Lessees (Groupings can be made):
  - General description of leasing arrangements including information about:
    - How variable payments not included in lease liability are determined
    - Residual value guarantees provided by lessee
  - Total amount of lease assets, and related accumulated amortization
  - Amount of lease expense recognized for period for variable lease payments not included in lease liability
  - Principal and interest requirements to maturity, presented separately, for lease liability for each of five subsequent years, and in five-year increments thereafter
  - Amount of annual lease expense and discount rate used to calculate lease liability
  - For significant intragovernmental leases activity, a broad summary of:
    - Existence of intragovernmental leases and annual expense
    - General lease terms with specific intragovernmental requirements (groupings can be made)
    - Annual lease expense by major leased asset category
- FASAB in its April 2017 heard comments from selected agencies that strongly disagreed with Exposure Draft, and will consider those comments before finalizing standard. Edits to Standard are expected based on April 2017 FASAB meeting.