Date

August 7, 2013

To

Chief Financial Officer

From

Inspector General

Subject:

Audit Report–Financial Accounting: Volatility of the Federal Employee's Compensation Act (FECA) Actuarial Liability Estimate

Report Number 13-14

Enclosed please find the subject final report. Please refer to the "Results in Brief" for the overall audit results. Our evaluation of your response has been incorporated into the body of the report. We consider management's comments responsive to the recommendation. The recommendation is resolved and will remain open for reporting purposes pending completion of the proposed actions.

If you have any questions or comments about this report, please do not hesitate to contact me at (202) 512-0039.

Michael A Raponi

MICHAEL A. RAPONI
Inspector General

Enclosure

cc:
Public Printer
Assistant Public Printer, Operations
General Counsel

U.S. GOVERNMENT PRINTING OFFICE
OFFICE OF INSPECTOR GENERAL

AUDIT REPORT
13-14

Financial Accounting: Volatility of the Federal Employees' Compensation Act Actuarial Liability Estimate

August 7, 2013

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Office of Inspector General

Report Number 13-14 **June 21, 2013**

Financial Accounting: Volatility of the Federal Employees' Compensation Act Actuarial Liability Estimate

Introduction

This report presents the results of our review of GPO's workers' compensation actuarial liability estimate, focusing on the discount rate model used to estimate the liability. Our objective was to determine whether opportunities existed to address the volatility[1] associated with accounting for the Federal Employees' Compensation Act (FECA) actuarial liability estimate.

The FECA program provides workers' compensation coverage to approximately 193 GPO employees for work-related injuries and illnesses. In fiscal year (FY) 2012, the FECA program paid approximately $7 million to claimants who lost wages due to work-related injuries or illness. As of the end of Fiscal Year (FY) 2012, estimates for future actuarial liabilities for compensation payments totaled more than $70 million.

The Department of Labor (DOL) determines actuarial liabilities of agencies for future workers' compensation benefits for civilian Federal employees, as FECA mandates. The actuarial liability for future workers' compensation includes the expected liability for death, disability, medical and miscellaneous costs for approved cases as well as an estimate for cases incurred but not reported. DOL follows accounting standards promulgated by the Federal Accounting Standards Advisory Board (FASAB). Since October 1999, FASAB has been recognized as the standard-setting body for Federal Governmental entities. Those standards are also referred to as Federal Generally Accepted Accounting Principles (GAAP) or Federal GAAP.

GPO's Office of Finance and Administration is responsible for the Agency's financial management function, including consolidation and reporting of the accrued and actuarial FECA liability. GPO accounts for future workers' compensation costs not yet paid and reports the liability in its consolidated financial statements. GPO follows accounting standards promulgated by the Financial Accounting Standards Board (FASB). FASB sets financial reporting standards for privately owned entities in the United States. Those standards are also known as Commercial GAAP.

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[1] Financial volatility is the extent to which the price of something (for example, a security or commodity, or the level of a market, interest rate or currency) changes over time. High volatility implies large upward and downward movements over a relatively short period of time; low volatility implies much smaller and less frequent changes in value.

As FASAB permits, GPO can follow either FASAB or FASB accounting standards.

To accomplish our objective, we reviewed various accounting standards, previous OIG and Government Accountability Office (GAO) audits, GPO policies and procedures governing financial accounting, and financial accounting information. To help auditors understand the sensitivity of certain factors and assumptions on the GPO FECA actuarial liability, OIG contracted with the independent certified public accounting firm of KPMG LLP (KPMG) to conduct a study of various scenarios under generally accepted accounting principles (GAAP) promulgated by FASB and FASAB . We interviewed GPO officials to discuss the FECA actuarial estimate.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. Our objective, scope, methodology, and criteria are detailed in Appendix A.

Results in Brief

Opportunities may exist to address the volatility associated with accounting for the FECA actuarial liability estimate.

The FECA actuarial liability estimate is reported in GPO's Consolidated Balance Sheets and any increase or decrease in the liability is reported in the Agency's Consolidated Statements of Revenues, Expenses, and Changes in Retained Earnings. With the exception of the FECA actuarial liability, GPO's consolidated financial statements are prepared in accordance with accounting standards promulgated by FASB (Commercial GAAP). DOL calculates the actuarial liability as prescribed by FASAB standards (Federal GAAP), which uses the Office of Management and Budget (OMB) economic assumptions for 10-year Treasury notes and bonds. Conversely, under FASB standards or Commercial GAAP, the current market rate is used to discount the payments to recognize the amount that could be paid currently to settle the liability. Combining accounting standards in such a manner is not consistent with generally accepted accounting practices. As of June 2013, GPO was still analyzing the switchover to accounting for the FECA actuarial liability using Commercial GAAP.

Reporting the actuarial liability in accordance with Commercial GAAP could increase volatility as well as negatively impact annual financial results. For example, using Commercial GAAP to report the liability would have resulted in a net income of approximately $1.4 million compared to a higher reported net income in FY 2011 of approximately $5.6 million, and in FY 2012, a lower net income of approximately $2.8 million was reported compared with approximately $6.7 million that would have been reported following Commercial GAAP—differences of $4.1 million and $3.8 million for 2011 and 2012 respectively.

Recommendation

We recommend the Chief Financial Officer analyze in sufficient detail and develop a policy that provides consistent application of accounting standards promulgated by either the Federal Accounting Standards Advisory Board or the Financial Accounting Standards Board.

Management's Response

Management concurred with the recommendation. The complete text of management's response is in Appendix C.

Background

FECA provides benefits to employees who suffer job-related injuries or disabilities. Benefits include:

- Continuation of regular pay for periods of disability as a result of a traumatic job related injury.
- Compensation for wages lost as a result of job-related injury.
- Medical care for injury or disability that is job related.
- Vocational rehabilitation.

DOL sends an annual invoice to GPO for workers' compensation claims paid, processed, and credited. Each 12-month period is known as a chargeback year, ending on June 30. GPO compensates DOL for claims paid.

GPO must account for future workers' compensation costs associated with medical expenses, payments for continuation of wages, and administrative fees not yet paid. Using an actuarial model, the workers' compensation liability is estimated for future payments made to employees injured in previous years and future payments to employees who have been injured in the current year.

The FECA actuarial liability includes the projected liability for death, disability, medical, and other approved costs. DOL provides each agency with actuarial liability estimates for future worker's compensation benefits amounts for both the current and prior years. The figure is the new balance in the actuarial FECA liability account and represents a change in accounting estimate as actuarial liabilities are unfunded. The expense is determined by comparing the current-year amount to the prior-year amount.

Prior Audit Coverage

The Chief Financial Officers Act requires that GPO prepare annual audited financial statements.[2] Since OIG began auditing the annual consolidated financial statements in 1995, GPO has received an unqualified opinion. An opinion is said to be unqualified when the auditor concludes that the financial statements give a true and fair view in accordance with GAAP. As permitted by FASAB, GPO prepares its consolidated financial statements in accordance with GAAP as promulgated by FASB. DOL OIG audits the Special Benefit Fund established under the authority of the FECA. The fund accounts for the FECA actuarial liability.

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[2] The Chief Financial Officers Act of 1990 (Public Law 101-576), as amended by the Government Management Reform Act of 1994 (Public Law 103-356), requires annual, audited financial statements for the U.S. Government and its component entities, referred to as Federal reporting entities.

In January 2013, OIG identified opportunities[3] where additional action could have strengthened the monitoring of FECA operations. At a minimum, monitoring FECA should include: (1) keeping marital status of claimants up to date, (2) evaluation of the continued eligibility of the claimants' dependents, (3) seeking opportunities for bringing claimants back on a modified, limited, or light duty assignment, (4) receiving medical updates on a regular basis, (5) obtaining second medical opinions where the record indicates the claimant has some potential of eventually returning to work, (6) responding to requests for vocational training, and (7) requesting that employees are included in Office of Workers' Compensation Programs (OWCP) Assisted Reemployment program. While GPO performed many of those duties on an ad hoc basis, we found that GPO could not demonstrate it monitored FECA on a program-wide basis. GPO might have also strengthened business unit supervisors understanding of their responsibilities under FECA and expanded its use of information technology to administer the program.

OIG completed an audit of the GPO FECA Program in September 2009.[4] The audit evaluated the adequacy of controls over GPO's FECA Program. OIG did not report an indication that the program was not operated in accordance with appropriate Federal guidelines, regulations, and directives. Although employee claims for benefits were generally supported with the required documentation, there were several areas where procedural and policy improvements could be made to further enhance and strengthen the GPO FECA Program.

[3] OIG Report Number 13-01, "Management Oversight: Federal Employees' Compensation Act Operations," dated January 15, 2013.
[4] OIG Report Number 09-14, "GPO's Workers Compensation Program," dated September 30, 2009.

Results and Recommendations

Volatility is inherent in the workers' compensation liability. The FECA actuarial liability estimate is reported in GPO's Consolidated Balance Sheets and the increase or decrease in the liability is reported in the Consolidated Statements of Revenues, Expenses, and Changes in Retained Earnings. GPO's consolidated financial statements are prepared in accordance with Commercial GAAP with the exception of the FECA actuarial liability which is estimated following Federal GAAP. As standards permit, GPO can follow FASAB or FASB accounting standards but standards do not provide for GPO's current practice of accounting for the actuarial liability using one set of standards while accounting for the remainder of accounts using a second set of standards.

Neither GPO accountants preparing the financial statements nor OIG identified inconsistent application of accounting standards until FY 2011. As of June, 2013, GPO management had not made a commitment to report its FECA liability in accordance with Commercial GAAP beginning with the FY 2013 consolidated financial statements.

As a result, the volatility in the FECA actuarial liability may increase beginning in FY 2013, causing an unintended negative impact on GPO's reportable net income.

Federal Government Accounting Standards

The Secretary of the Treasury, the Director of OMB, and the Comptroller General established FASAB in October 1990. FASAB is responsible for promulgating accounting standards for the U.S. Government. The standards are recognized as GAAP for the Federal Government.

As required, DOL follows FASAB[5] financial accounting standards, which require the use of Treasury borrowing rates for discounting. The discount rates as of the reporting date should reflect average historical rates on marketable Treasury securities rather than giving undue weight to the recent experience of such rates. Historical experience should be the basis for expectations about future trends in marketable Treasury securities. The discount rate, the underlying inflation rate, and other economic assumptions should be consistent with one another.

DOL projects annual benefit payments discounted to present value. Consistent with past practice, DOL uses the OMB economic assumptions for 10-year Treasury notes and bonds. The interest rate assumption used for discounting was 2.29 percent for the year ended September 30, 1012, and 3.14 percent in subsequent years.

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[5] Statements of Federal Financial Accounting Standards 33, "Pensions, Other Retirement Benefits, and Other Postemployment benefits: Reporting Gains and Losses from Changes in Assumptions and Selecting Discount Rates and Valuation Dates," dated October 14, 2008.

FASAB[6] sponsors do not prescribe accounting standards for the legislative and judicial branches. The legislative and judicial branches, and most entities within those branches, are not required to prepare general purpose financial reports and those that do prepare statements that are not subject to any requirements by FASAB sponsors. However, as the source of GAAP for Federal reporting entities, FASAB would be the appropriate accounting standards for such entities to adopt if they prepare GAAP-based general purpose financial reports.

FASB Accounting Standards

GPO has historically elected to follow FASB. Although FASAB standards have been recognized as GAAP for Federal entities since October 1999, some Federal entities follow GAAP for nongovernmental entities promulgated by the private sector FASB. For example, Federal Government corporations, the U.S. Postal Service, certain component entities of the Department of the Treasury, and some smaller entities in the executive and legislative branches have historically applied FASB and continue to do so.

The FASAB Handbook of Federal Accounting Standards and Other Pronouncements, as amended as of June 30, 2011, and acknowledged in Statement of Federal Financial Accounting Concepts (SFFAC) 2, Entity and Display (paragraph 78), states that some components may be required to prepare and issue financial statements in accordance with accounting standards other than FASAB. Examples of such requirements would be FASB accounting standards or accounting standards established by a regulatory agency. Those components should continue to issue the required reports. The reporting entities of which the components are a part can issue consolidated, consolidating, or combining statements that include the components' financial information prepared in accordance with the other accounting standards.

Comparison of Estimated Liability

A comparison of the FASB rate at year end to the FASAB 10-year historical average rate for FY 2010 through FY 2012 disclosed the volatility associated with the discount rate appears to be less when using FASAB accounting standards.

We had a comparison performed on the resulting estimated FECA liability based on the various rates, to determine the potential monetary difference between the recorded FECA liability using FASAB accounting standards, and the actuarial liability computed under FASB accounting standards. That comparison disclosed that, in FY 2011, the difference between the two methods results in an undervaluation of the

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[6] Statements of Federal Financial Accounting Standards 34, "The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board," dated July 28, 2009.

actuarial liability by approximately $10.5 million. For FY 2012, the difference is an undervaluation of about $6.7 million. See Table I below for detailed results.

Table 1. Comparison of FASAB and FASB Liability Computations

	FY 2010	FY 2011	FY 2012
FASAB Standards			
Interest Rate Used-Yr 1[7]	4.025%	3.535%	2.293%
Interest Rate Used-Yr 2+	4.300%	3.653%	3.138%
Estimated FASAB FECA Liability	$ 70,884,000	$ 68,144,500	$ 70,523,900
Decrease in Liability from FY 2010-11	$2.7 million		
Increase in Liability from FY 2011-12		($2.4 million)	
FASB Standards			
Rate at Year End	3.12%	2.39%	2.05%
Estimated FASB FECA Liability[8]	$ 77,275,757	$ 78,719,546	$ 77,224,644
Increase from FY 2010-11	($4.1 million)		
Decrease in Liability from FY 2011-12		$3.8 million	
Difference Between Standards	**$ (6,391,757)**	**$(10,575,046)**	**$ (6,700,744)**

Comparison of Net Income

Based on the change in actuarial liability, a comparison of GPO's net income disclosed an impact for FY 2011. Using FASB standards would have resulted in a net income of only $1.4 million compared with a reported net income of approximately $5.6 million for FY 2011. In FY 2012, a higher net income of approximately $6.7 million compared with approximately $2.8 million would have been reported.

The table below depicts the annual net income as adjusted for a change in the workers' compensation liability. The figures were reported in the Consolidated Statements of Revenues, Expenses, and Changes in Retained Earnings for the fiscal years ended September 30, 2012, and 2011.

Table 2. Impact on Net Income—As Reported Under FASAB Standards (x000)

	FY 2011	FY 2012
Income Before other Expenses	$2,897	$5,238
(Increase)/Decrease in Workers' Compensation Liability	2,740	(2,380)
Net Income	$5,637	$2,858

Below is the net income GPO would report if the workers' compensation liability were discounted using standards promulgated by FASB.

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[7] KPMG obtained these rates from GPO's Annual Report, which indicates the payments were discounted to present value using a one-year rate and a rate thereafter.

[8] Amounts represent the Estimated FECA Liability recorded on GPO's financial statements for each year.

Table 3. Impact on Net Income—Reported Under FASB Standards

	FY 2011	FY 2012
Income Before other Expenses	$2,897	$5,238
(Increase)/Decrease in Workers' Compensation Liability	(1,444)	1,495
Net Income/(Loss)	($1,453)	$6,733

Materiality

According to FASAB, it is necessary to sensitize to differences resulting from applying different accounting standards that could be material to the users of the reporting entity's financial statements. If the differences are material, the standards issued by FASAB should be applied.

Determination of whether an item is material depends on the degree to which omitting or misstating information about the item makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or the misstatement.

GPO Actions

GPO Officials advised us that they were aware of the accounting differences between reporting the FECA liability using Commercial or Federal GAAP. Those officials stated that the Agency has been waiting for those differences to be closer together before committing to one set of accounting standards.

Recommendations

We recommend the Chief Financial Officer analyze in sufficient detail and develop a policy that provides consistent application of accounting standards promulgated by either the Federal Accounting Standards Advisory Board or the Financial Accounting Standards Board. The decision should take into account the impact of the volatility of the Federal Employees' Compensation Program actuarial estimate under both sets of accounting standards. The policy should ensure that financial statements provide meaningful representation of operations and financial condition and ensure financial information could be used by interested parties to help them make resource allocation and other decisions and hold the entity accountable.

Management's Response

The GPO Chief Financial Officer agreed with the recommendation and stated that, by the end of the FY 2013 Financial Statement audit, GPO will have formalized its analysis and will develop a policy that will provide for the consistent application of accounting standards.

Evaluation of Management's Response

The Chief Financial Officer's comments and planned actions are fully responsive to the recommendation. The recommendation is resolved but will remain open for reporting purposes pending completion of GPO's analysis and formalization of its policy.

Appendix A – Objectives, Scope, and Methodology

We performed fieldwork from February through June, 2013 at the GPO Central Office in Washington, D.C. We conducted the audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence that will provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Objectives

The objective of our audit was to determine whether opportunities existed for addressing the volatility associated with accounting for the FECA actuarial liability estimate.

Scope and Methodology

To accomplish our objective, we reviewed various accounting standards, previous OIG and GAO audits, GPO policies and procedures governing financial accounting, and financial accounting information. In support of our objectives, OIG contracted with KPMG, an independent certified public accounting firm, to conduct a study of various scenarios under GAAP promulgated by both FASB and FASAB to help OIG gain an understanding of the sensitivity of certain factors and assumptions on the GPO FECA actuarial liability. We interviewed GPO officials about FECA actuarial estimates and the results of the KPMG study.

Management Controls Reviewed

We determined that the following internal controls were relevant to our audit objective:

Program Operations – Policies and procedures GPO management implemented to reasonably ensure that processes met GPO's objectives.

Validity and Reliability of Data – Policies and procedures management implemented that reasonably ensure valid and reliable data are obtained, maintained, and fairly disclosed in reports.

Compliance with Laws and Regulations – Policies and procedures management implemented that reasonably ensure resource use is consistent with laws and regulations.

The details of our examination of management controls, the results of our examination, and noted management control deficiencies are contained in the report narrative. Implementing the recommendations for this audit should improve those management control deficiencies.

Computer-generated data

We did not rely on any computer-processed data from any GPO computer system.

Appendix B – Acronyms Used

DOL	Department of Labor
FASAB	Federal Accounting Standards Advisory Board
FASB	Financial Accounting Standards Board
FECA	Federal Employees Compensation Act
FY	Fiscal Year
GAAP	Generally Accepted Accounting Principles
GPO	Government Printing Office
OIG	Office of Inspector General
OMB	Office of Management and Budget
SFFAC	Statement of Federal Financial Accounting Concepts

Appendix C – Management's Response

GPO U.S. GOVERNMENT PRINTING OFFICE KEEPING AMERICA INFORMED

Memorandum

2013 JUN 27 PM 1:52
OFFICE OF THE INSPECTOR GENERAL

DATE: June 27, 2013

REPLY TO
ATTN OF: Chief Financial Officer

SUBJECT: Management Comments on Draft Audit Report Number 13-14, "Financial Accounting: Volatility of the Federal Employee's Compensation Act (FECA) Actuarial Liability Estimate"

To: Inspector General

Thank you the opportunity to respond to the draft audit report entitled "Financial Accounting: Volatility of the Federal Employee's Compensation Act (FECA) Actuarial Liability Estimate. Report Number 13-14.

We agree with the recommendation and have provided the following analysis/discussion based on the findings within this draft report. By the end of the FY2013 audit, we will formalize our analysis, and develop a policy that will provide for a consistent application of accounting standards.

FASAB vs. FASB FECA Estimate

As the report indicates, the OIG conducted this audit, "…to determine whether opportunities exist for reducing volatility associated with the accounting for the Federal Employees' Compensation Act (FECA) actuarial liability estimate." Volatility is inherent in a discounting process for long-term liabilities as interest rates fluctuate. The OCFO concurs with the statement on page 2 of the report, "Reporting the actuarial liability in accordance with Commercial GAAP could increase volatility…."

However, while we may not be able to reduce volatility, we disclose the impact so that our financial statements are more meaningful and useful. On the Consolidated Statements of Revenues, Expenses, and Changes in Retained Earnings, we include a subtotal, Net Income before Other Operating Expenses. This discloses the net income or loss before the (Increase) Decrease in Workers' Compensation Liability. The Workers' Compensation liability is also separately identified on the Consolidated Balance Sheet. We include the impact of the FECA long-term liability on our financial statements in the Public Printer's Message, the Management Discussion and Analysis, and the footnotes.

The audit also states, "We recommend the Chief Financial Officer analyze in sufficient detail and develop a policy that provides consistent application of accounting standards promulgated by either the Federal Accounting Standards Advisory Board (FASAB) or the Financial Accounting Standards Board (FASB)." Policy issues raised by the audit recommendation include whether, in applying FASB GAAP, GPO should continue to make an exception for the FECA liability; and, more broadly, whether GPO should continue to employ FASB standards, as allowed by the FASAB, or change to FASAB standards. We plan to review the FECA liability calculation in the preparation of our financial statements for the current fiscal year.

The following is an explanation of our relevant policies and the analyses upon which they are based.

Regarding the consistent application issue, there are somewhat contradictory aspects of consistency and comparability. If we change to FASB standards for the FECA liability, we may not be consistent with prior-years and we would not be comparable with other Legislative Branch agencies that many primary users of our financial statements might compare us to. The usefulness of our reporting for decision purposes could be impaired, when used in comparison to other agencies with similar FECA liabilities that are calculated differently. There would be a risk of leading to wrong conclusions about both the relative size of, and changes to, GPO's FECA liability, and to perceived differences in program management performance and expectations, in comparison to other Legislative Branch agencies.

For the past several years, we have calculated the liability under FASB to determine the materiality of differences. While the difference has been determined to be immaterial, consistent application of FASB GAAP would support discontinuing our practice of using FASAB estimates of the FECA liability. We will consider changing the FECA liability calculation to be consistent in applying FASB standards in preparing the annual financial statements for the current fiscal year. We will consider the needs of the users of the financial statements and the comparability issues stated above, in consultation with your office, and our external auditors.

<u>FASAB vs. FASB Accounting Standards</u>

An issue raised by the recommendation that is greater in scope than the FECA liability, is our policy to use the FASB GAAP, instead of changing to FASAB standards. The GPO revolving fund is intended to finance a continuous cycle of business-type activities. GPO's authorizing legislation for the revolving fund, at Section 309 of Title 44, requires that:

> **(b)** The fund shall be—
>
> > **(1)** reimbursed for the cost of all services and supplies furnished, including those furnished other appropriations of the Government Printing Office, at rates which include charges for overhead and related expenses, depreciation of plant and building appurtenances, except building structures and land, and equipment, and accrued leave; and
> >
> > **(2)** credited with all receipts including sales of Government publications, waste, condemned, and surplus property and with payments received for losses or damage to property.

(c) An adequate system of accounts for the fund shall be maintained on the accrual method, and financial reports prepared on the basis of the accounts. The Public Printer shall prepare and submit an annual business-type budget program for the operations under this fund. This budget program shall be considered and enacted as prescribed by section 9104 of Title 31.

(e) The Public Printer shall prepare an annual financial statement meeting the requirements of section 3515 (b) of Title 31, United States Code…."

FASB is the appropriate standard to support the needs of the primary users of GPO's financial statements and complies with GPO's statutory mandates. FASB standards support commercial-type business operations where there are exchange-revenue transactions. Exchange revenue transactions (fee or payment for services rendered) are inherent in revolving funds, such as GPO's.

FASAB standards do not support detailed business-type revenue recognition and matching of expenses, to provide a fair presentation of the results of operations on an accrual basis, and cash flow information for financial management of the GPO revolving fund. FASAB revenue standards apply to entities where there are non-exchange revenue transactions (taxation, for example). GPO does not have legal authority to collect non-exchange revenue.

SFFAS 34 states, "General purpose financial reports prepared in conformity with accounting standards issued by the FASB also may be regarded as in conformity with GAAP for those entities that have in the past issued such reports." The applicable factors in SFFAS 34, as they apply to GPO, provide clear justification that FASB GAAP is most appropriate standard for GPO.

SFFAS 34 lists the following factors to consider in determining the applicability of FASB standards, of which factors a., through d., apply to GPO:

"Examples of factors to consider [in applying FASB standards] include but are not limited to:

a. The entity's primary funding is derived from a source other than through annual federal appropriations.

b. The entity has been delegated the financial and operational authority to carry on its activities in a manner similar to private business enterprises.

c. The entity sells goods and/or services to individuals outside of the government reporting entity as its principal activity.

d. The entity is intended to, in the normal course of its operations, maintain its operations and meet its liabilities from revenues received from sources outside of the federal government reporting entity.

e. It is desirable to compare general purpose financial reports of the federal entity that is preparing GAAP-based general purpose financial reports for the first time with an existing entity that is already following FASB GAAP."

In order to change standards, GPO would need to review and evaluate the applicability of current and pending FASAB standards. In a memo to the FASAB, dated October 7, 2009, the Assistant Director provided the following list of areas where differences were noted between FASAB and FASB accounting and reporting, many of which are relevant to GPO:

- SFFAS 1, *Accounting for Selected Assets and Liabilities*:
  - Valuation of Investments in Treasury Securities, pars. 68-70;
- SFFAS 2, *Accounting for Direct Loans and Loan Guarantees, as amended by SFFAS*
- *18 and 19*:
  - Valuation of liability for guarantees of principal and interest payments on loans
    between a non-federal lender and a non-federal borrower;
- SFFAS 3, *Accounting for Inventory and Related Property*:
  - Inventory Valuation, par. 20;
- SFFAS 4, *Managerial Cost Accounting Standards and Concepts*:
  - General Requirement for Cost Accounting, pars. 67-76;
  - Inter-entity Costs, pars. 108 and 109;
- SFFAS 5, *Accounting for Liabilities of the Federal Government*:
  - Recognition of Non-exchange Transactions, par. 24;
  - Accounting and Reporting for Pensions, Other Retirement Benefits, And Other
    Postemployment Benefits, pars. 56-96;
- SFFAS 6, *Accounting for Property, Plant, and Equipment (PP&E)*:
  - Valuation of Transferred PP&E, par. 31;
- SFFAS 7, *Accounting for Revenue and Other Financing Sources*:
  - Financing Imputed for Cost Subsidies, par. 73;
  - Budgetary Reporting, pars. 77-82;
- SFFAS 15, *Management's Discussions and Analysis*; and
- SFFAC 2, *Entity and Display*.

We believe that the cost of changing standards would be great and that the change would severely impact the ability to measure performance on the 95% of the GPO's operations that are not funded by specific program related appropriations. At a minimum, implementation would require major analysis of the changes required, the re-training of employees in the application of FASAB GAAP as well as designing, implementing and changing processes, systems, and internal controls. It is likely there would be a need for financial restatements, additional headcount, and increased audit fees. As such, we do not believe that adopting FASAB GAAP would be an appropriate change for the Agency.

Summary

We will strongly consider the option to change our FECA liability calculation to FASB GAAP during the preparation of the current year financial statements in order to achieve a more consistent application of standards recognizing that this change could increase the volatility of an estimated measurement of a non-operational potential future liability.

Thank you,

Steve Shedd

Appendix D–Summary of Historical Trends and Sensitivity Analysis

Government Printing Office
Federal Employees Compensation Act Liability
Summary of Historical Trends and Sensitivity Analysis
Purchase Order No. 3016311 Deliverable

Background:

The Federal Accounting Standards Advisory Board (FASAB) allows the GPO to prepare its consolidated financial statements in conformity with U.S. generally accepted accounting principles (GAAP) as promulgated by the Financial Accounting Standards Board (FASB). That is, the GPO uses commercial GAAP (FASB) and not Federal GAAP (FASAB) like most other Federal agencies.

The U.S. Department of Labor (DOL) administers the Federal Employees Compensation Act (FECA) Programs and makes all decisions regarding the eligibility of injured workers to receive workers' compensation benefits. The DOL provides direct compensation to medical providers, claimants, and beneficiaries and is reimbursed by agencies based on the claims related to the respective agencies. The GPO reimburses DOL for all workers' compensation claims in addition to paying an administrative fee.

The actuarial liability for future workers' compensation developed by the DOL is calculated using Federal GAAP. The actuarial liability includes the expected liability for death, disability, medical and miscellaneous costs for approved cases as well as an estimate for those cases incurred but not reported. The actuarial liability is determined by using a method that utilizes historical benefit payment patterns related to a specific incurred period to predict the ultimate payments related to that period. The actuarial model uses a Paid Loss Development Method by agency, by defined agency groups, and in total using inflation rate assumptions on both past and future indemnity and medical benefits to adjust past data and project forward. The DOL actuarial model also projects the amount and timing of expected cash payments. Such estimates are used by agencies to develop their annual operating budget which is used by the Office of Management and Budget (OMB) to develop the annual Federal budget.

Consistent with past practice these projected annual benefit payments have been discounted to present value using the Office of Management and Budget's (OMB) economic assumptions for 10-year Treasury securities as set forth in their Budget Mid-Session Review (MSR). The DOL uses the OMB Mid-Session Review[1] as the source of the discount rates as they are the most current projections available from OMB at the time that the actuarial valuation is being finalized.

During the FY 2011 financial statement audit, the GPO determined that actuarial liability for future workers' compensation developed by the DOL was not calculated using the same methodology as commercial GAAP which requires the use of a discount rate (often referred to as "Spot rate") as of the financial reporting period end. The discount rate is based on current interest rates of risk free U.S. Treasury securities that match the duration of the cash flows being discounted at year end which is different than the 10 year average historical discount rate used for Federal GAAP (described above). The difference between the two methodologies resulted in an understatement of the GPO's FECA liability by

[1] Section 1106 of Title 31, United States Code, requests that the President send to the Congress a supplemental update of the Budget that was transmitted to the Congress earlier in the year. This supplemental update of the Budget, commonly known as the Mid-Session Review (MSR), contains revised estimates of receipts, outlays, budget authority, and the budget deficit for the remainder of the current fiscal year and for the following 10 years. For example, the MSR for FY2011 was issued in September 2011 and provided revised estimates of receipts, outlays, budget authority, and the budget deficit for fiscal years 2011 through 2021.

an estimated $14 million at September 30, 2011. The GPO deemed the liability as recorded under a non-GAAP policy and determined that the difference was not material and, therefore, did not record an adjustment in the financial statements.

The summary of historical trends presented below is from work performed and documented as part of the GPO financial statement audits for those respective years. The opinion on the financial statements for those years was on the financial statements as a whole and not on individual lines of the financial statements. The work performed herein is an analysis under various scenarios using different factors and assumptions on the FECA liability as a part of the annual financial statement audit. The sensitivity analysis below was developed beginning with undiscounted cash flows as provided by the DOL and certain other methodology assumptions as of September 30, 2012. The analysis is not forecasting or predicting future trends or amounts, but only presenting the monetary effects of changes in certain factors and assumptions as described in more detail below.

Detailed Procedures

1. Perform a retrospective reserve analysis for the past 3 years (2010, 2011 and 2012) to demonstrate:
   a. Changes in the FECA liability recorded and
   b. The difference between using the 10 year average rate (FASAB) and the applicable spot rate (FASB) used to compute the FECA Liability at the end of each fiscal year.
2. Using current information as of September 30, 2012, perform a sensitivity analysis to determine potential impacts on the FECA liability using different assumptions. Inputs/variables to include:
   a. Assumptions for change in September 30, 2012 Discount Interest Rates.
      i. +1.0%
      ii. +0.5%
      iii. -.25%
      iv. -.50%
   b. Assumptions for change in Projected Cash Flows (development rate) using FY 2012 undiscounted cash flows projections under each of the spot rate assumptions above including the Discount Interest Rate at September 30, 2012.
      i. Development Rate at 90% of actual (assumes existing claims are paid sooner than expected).
      ii. Development Rate at 100% of actual (assumes existing claims are paid as expected).
      iii. Development Rate at 110% of actual (assumes existing claims are paid later than expected).
3. Summarize results of sensitivity analysis to demonstrate the impacts on the FECA Liability reported in the financial statements.
   a. Results to include interest rate assumptions used and liability calculated using the discount rate determined under the FASB standards.
   b. Results to include changes in development factors applied to the undiscounted cash flows.

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Sources

1. Undiscounted Cash Flows provided by the DOL as of September 30, 2012
2. Discount Rate as of September 30, 2012 for FASB purposes from U.S. Treasury website
3. The DOL report for the actuarial liability for future workers' compensation as of September 30, 2012 computed under Federal GAAP
4. The GPO FY2010, FY2011, and FY2012 financial statement and related footnotes included in the Annual Financial Report
5. Relevant Accounting Standards promulgated by FASB (See excerpts at Appendix I)

Results

Historical trends

KPMG compared the FASB spot rate at year end to the FASAB 10 year historical average rate for FY 2010 - FY 2012. KPMG also compared the resulting estimated FECA liability based on the different rates to determine the potential monetary difference between the recorded FECA liability (using Federal GAAP) and the actuarial liability computed under commercial GAAP. Additionally, KPMG compared the computed differences to total assets and total revenues recorded in each fiscal year. See Table I below for results:

Table I

	FY 2010	FY 2011	FY 2012
Interest Rate Used-Yr 1[2]	4.025%	3.535%	2.293%
Interest Rate Used-Yr 2+[2]	4.300%	3.653%	3.138%
Estimated FASAB FECA Liability	$ 70,884,000	$ 68,144,500	$ 70,523,900
Spot Rate at Year End	3.12%	2.39%	2.05%
Estimated FASB Calc FECA Liability[3]	$ 77,275,757	$ 78,719,546	$ 77,224,644
Difference	**$ (6,391,757)**	**$(10,575,046)**	**$ (6,700,744)**
Total Assets	$655,547,000	$625,000,000	$805,889,000
Difference as % of Assets	0.98%	1.69%	0.83%
Total Revenue	$928,338,000	$928,338,000	$737,067,000
Difference as % of Revenue	0.69%	1.14%	0.91%

Sensitivity Analysis

KPMG performed a sensitivity analysis to determine the effects on the estimated FECA liability using different cash flow assumptions and changes in discount rates when using the FASB discount rate at year end. In performing our analysis, we have relied on the cash flows estimated by the DOL for the year ended September 30, 2012. We have not audited, verified, or reviewed this data beyond tests for reasonableness and consistency. Such procedures are beyond the scope of this engagement. If the underlying data or information is not complete or accurate, adjustments may be required to the findings and conclusions developed from the procedures. We offer no opinion on the reasonableness of the estimated FECA liability recorded by the GPO as of September 30, 2012. Our procedures are limited to a study of the impact of changes in discount rates and the DOL estimated cash flows. In addition, we note that the scenarios provided are only illustrative, and that actual fluctuations to discount rates and cash flows could be quite different from the scenarios presented here.

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[2] KPMG obtained these rates from GPO's Annual Report which indicates the payments were discounted to present value using a one year rate and a rate thereafter.
[3] Amounts represent the Estimated FECA Liability recorded on GPO's financial statements for each year.

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Methodology

The undiscounted cash flows by year have been obtained directly from the model that the DOL uses to estimate the GPO liability. The separate compensation and medical cash flows have been combined for our analysis.

The ultimate losses in the DOL model used to estimate the undiscounted cash flows are derived using a paid loss development method. The paid development method uses historical loss payment patterns to project actual payments as of a given maturity to ultimate. The selected paid loss development factors are based on a review of the change in paid losses over time.

Discount ("Spot") rates of various maturities as of September 30, 2012 have been obtained from the U.S. Treasury Department's website. As based on the current GPO estimates of the discounted liability, the weighted average duration is 15.22 years. Interpolating between the 10-year and 20-year spot rates, a weight average duration of 15.22 years corresponds to an interest rate of 2.05%. To show a range of discounted reserve scenarios, we vary the discount rates from 0.5% lower to 1.0% higher than the interpolated discount rate and increase/decrease. Additionally, we have varied the selected paid loss development factors in the DOL model by +/- 10% at each age of maturity. The change in payment development patterns leads to a change in both the weighted average duration and the estimate of the ultimate unpaid liabilities. This variation serves to demonstrate a change in the expectation of the timing of payments from the expectation the DOL used in their calculation.

Three cash flow assumptions based on the paid loss development method used by the DOL are used in the analysis below:

1. Low- $92,204,244
2. Central- $102,801,870
3. High- $113,446,644

The GPO's cash flow assumption as calculated by the DOL in the estimated FECA liability as of September 30, 2012 is at the central level noted above ($102,801,870). A comparison was made in each scenario's resulting discounted reserves to the September 30, 2012, estimated FECA liability (as highlighted in green below) to determine the dollar value and percentage difference.

Table II below summarizes the change in estimated reserves (liability), discounted according to commercial GAAP, due to changes in discount rates and cash flows.

Table II

Range of discounted reserves			
	-10% to paid loss factors	No change to current GPO loss factors	+10% to paid loss factors
Spot rate + 1.0%	$63,078,000	$68,715,000	$74,142,000
Spot rate + 0.5%	$66,607,000	$72,726,000	$78,636,000
Spot rate	$70,557,000	$77,225,000	$83,686,000
Spot rate - .25%	$72,711,000	$79,682,000	$86,448,000
Spot rate - .50%	$74,999,000	$82,293,000	$89,385,000

Table III below shows the percentage change of the various scenarios relative to the current recorded GPO FECA liability of $77,224,644.

Table III

Change as a percentage of reserves discounted at spot rate with central cash flows			
	-10% to paid loss factors	No change to current GPO loss factors	+10% to paid loss factors
Spot rate + 1.0%	-18.3%	-11.0%	-4.0%
Spot rate + 0.5%	-13.7%	-5.8%	1.8%
Spot rate	-8.6%	0.0%	8.4%
Spot rate - .25%	-5.8%	3.2%	11.9%
Spot rate - .50%	-2.9%	6.6%	15.7%

Assuming both a 1.0% increase in discount rates and 10% decrease in paid development factors, the estimated reserves on a discounted basis decreases to $63,078,332, or -18.3% lower than the current liability estimate. Alternately, assuming both a 0.5% decrease in discount rates and 10% increase in paid development factors, the estimated reserves on a discounted basis increases to $89,384,851, or 15.7% higher than the current liability estimate.

The 10% decrease in paid loss factors leads to a weighted average duration of 14.55 years, which corresponds to an interpolated interest rate of 2.00%. The 10% increase in paid loss factors leads to a weighted average duration of 15.83 years, which corresponds to an interpolated interest rate of 2.10%.

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Table IV below summarizes the differences between the current recorded liability and the varying assumptions for each scenario described above:

Table IV

Rate Assumption	Rate Change	Cash Flow Assumption	Calculated Discounted Reserves	Difference[4]	% Change
1.75%	-0.25%	$92,204,244	$72,711,483	$ (4,513,161)	-5.8%
1.80%	-0.25%	$102,801,870	$79,682,046	$ 2,457,402	3.2%
1.85%	-0.25%	$113,446,644	$86,447,623	$ 9,222,979.	11.9%
1.50%	-0.50%	$92,204,244	$74,998,697	$ (2,225,947)	-2.9%
1.55%	-0.50%	$102,801,870	$82,293,216	$ 5,068,572	6.6%
1.60%	-0.50%	$113,446,644	$89,384,851	$ 12,160,207	15.7%
2.00%	0.00%	$92,204,244	$70,556,483	$ (6,668,161)	-8.6%
2.05%	0.00%	$102,801,870	$77,224,644[5]	$ -0-	0.00%
2.10%	0.00%	$113,446,644	$83,685,751	$ 6,461,107	8.4%
2.50%	+ 0.50%	$92,204,244	$66,606,832	$ (10,617,812)	-13.7%
2.55%	+ 0.50%	$102,801,870	$72,725,596	$ (4,499,048)	-5.8%
2.60%	+ 0.50%	$113,446,644	$78,635,751	$ 1,411,107	1.8%
3.00%	+ 1.00%	$92,204,244	$63,078,567	$ (14,146,077)	-18.3%
3.05%	+ 1.00%	$102,801,870	$68,714,567	$ (8,510,077)	-11.0%
3.10%	+ 1.00%	$113,446,644	$74,141,853	$ (3,082,791)	-4.0%

Summary:

The discount rates have been declining slightly over the last several years (see Table I). Consequently, the difference between the spot used by the DOL under Federal GAAP (10 year historical average) and the spot rate required under commercial GAAP (current discount rate at year end) has been decreasing. This trend, if it continues, will lead to a smaller difference in the estimated FECA liability computed under Federal GAAP versus commercial GAAP assuming no other changes in assumptions such as estimated undiscounted cash flows and the methodology itself.

GPO is not able to influence the effect of the changes in spot rate assumptions as they are market rates

[4] The "Difference" Column represents the +/- change in discounted reserve levels of the varying scenarios compared with the calculated discounted reserves currently recorded in the GPO financial statements (see highlighted row). Among the varying assumptions, the largest change would be -18.3% and approximately $14 million change (rate assumption increases to 3.0% and the discount spot rate increases by 1.0% point) and 15.7% and approximately $12 million (rate assumption decreases to 1.60% and the discount spot rate decreases by -0.50%points). KPMG based these figures on the spot rate at September 30, 2012, which would be used to discount the reserves when using FASB. The scenarios vary the interest rate up to +1% and - .50% as noted above.

[5] This amount represents the estimated FECA liability using the September 30, 2012 spot rate. See comparison to amounts recorded in GPO's financial statements in the previous table.

published by the U.S. Treasury. As the spot rate decreases, the liability increases and conversely, as the discount rate increases, the liability decreases. Table II above summarizes the effect of a change in the interest rates. The column labeled "No change to current GPO loss factors" demonstrates the effects of the interest rates.

The paid loss development factors uses historical loss payment patterns to project actual payments as of a given maturity to ultimate. Therefore, as payment patterns change the estimated liability also changes. Table II above summarizes the effects on the liability for a change in the paid loss factors under different spot rate scenarios.

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Discounting of Self-Insurance Liabilities Under Commercial Accounting Standards

RELEVANT ACCOUNTING STANDARDS

FASB Accounting Standards Codification (ASC) 405-30—*Insurance-Related Assessments*, states that:

30-9 Current practice in the insurance industry is to allow, but not require (with limited exceptions, such as pensions and postretirement benefits), the discounting of liabilities to reflect ***the time value of money*** *when the aggregate amount of the obligation and the amount and timing of the cash payments are fixed or reliably determinable for a particular liability.*

30-10 Similarly, for assessments that meet those criteria, the liability may be recorded at its present value by discounting the estimated future cash flows at an appropriate interest rate.

Additionally, ASC **405-30 states that** "*if the amounts have been discounted, the entity shall disclose in the financial statements the undiscounted amounts of the liability.....as well as the discount rate used.*

ASC Subtopic 410-30 (SOP No. 96-1, *Environmental Remediation Liabilities*), indicates that an entity may discount liabilities to reflect the **time value of money** if the aggregate amount of the liability and the amount and timing of cash payments are fixed or reliably determinable.

ASC 820-55-5 (c), Fair Value Measurement defines "time value of money" for purposes of determining the present value of a liability as:

c The time value of money, represented by the rate on risk-free monetary assets that have maturity dates or durations that coincide with the period covered by the cash flows (risk-free interest rate). For present value computations denominated in nominal U.S. dollars, the yield curve for U.S. Treasury securities determines the appropriate risk-free interest rate. U.S. Treasury securities are deemed (default) risk free because they pose neither uncertainty in timing nor risk of default to the holder.

SEC Staff Accounting Bulletin No. 92, *Accounting and Disclosures Relating to Loss Contingencies* (SAB 92), includes guidance with respect to the discount rate to be used—

a rate that will produce an amount at which the liability theoretically could be settled in an arm's-length transaction with a third party and that rate should not exceed the interest rate on monetary assets that are essentially risk-free and have maturities comparable to that of the liability.

Discounting of Loss Reserves - ASC paragraph 944-20-S99-1 (SAB 62) - The SEC staff's position is that insurance companies can follow the specific guidance in ASC paragraph 944-20-S99-1 (SAB 62), that is, using the discount rate permitted or prescribed by the state regulatory authority. In addition to the guidance in ASC paragraph 944-20-S99-1 (SAB 62), the staff would not object to loss reserve discounting using one of the following methods:

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A. Risk-free rate locked in for each period (i.e., accident year). The rate used would be determined on an annual basis reflecting the weighted average risk-free rate for the period. Once established there would be no adjustments to the rate for that period. Subsequent reserve adjustments would be discounted at the same rate regardless of when the adjustment is recognized.
B. Settlement rate locked in for each period (i.e., accident year). The settlement rate should be the rate that will produce an amount at which the liability theoretically could be settled in an arm's length transaction, and should be no greater than the risk-free rate. Similar to A above, the same lock in provisions will apply.
C. Floating risk-free rate. A risk-free rate would be determined at the end of each period and the entire liability would be re-measured using the current, end-of-period, settlement rate.
D. Floating settlement rate. A settlement rate would be determined at the end of each period and the entire liability would be re-measured using the current, end-of-period, settlement rate.

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EXCERPTS FROM REMARKS OF JEFFREY A. SWORMSTEDT

PROFESSIONAL ACCOUNTING FELLOW

AT THE NATIONAL CONFERENCE ON CURRENT SEC DEVELOPMENTS

JANUARY 11, 1994

DISCOUNTING LIABILITIES

Accounting Principles Board Opinion 21, *Interest on Receivables and Payables*, (Opinion 21), [ASC Subtopic 835-30], *Interest - Imputation of Interest*,] discusses the imputation of interest on a note exchanged for cash, property, goods, or services. The principle underlying Opinion 21 is that the amount recorded for a note exchanged should be based on fair values.[6] Many of the liabilities being discounted in practice, however, do not arise as a result of an exchange per se; rather, such liabilities arise as a result of litigation, claims and other assessments, which must be recognized in accordance with Statement 5 [ASC Topic 450.] By analogy to Opinion 21 [ASC Subtopic 835-30], such liabilities should be recorded at their fair value. That is, such liabilities should be recognized at the amount that could be paid currently to settle the liability.[7] Inasmuch as the objective of discounting a liability is to establish the amount necessary to settle the obligation, the discount rate to be used should be a market settlement rate. However, in the absence of market transactions, the staff recognizes that such a settlement rate may not be readily determinable. Accordingly, the staff will not object to discounting liabilities other than Pension and OPEB benefits provided that both the amount and timing of the cash outflows are fixed or reliably determinable and that the discount rate used does not exceed the risk-free rate.[8]

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[6] Paragraph 12 of Opinion 21 [ASC paragraph 835-30-25-10] states in part that "... the note, the sales price, and the cost of the property, goods, or service exchanged for the note should be recorded at the fair value of the property, goods or services, or at an amount that reasonably approximates the fair value of the note, whichever is more clearly determinable."

[7] The advisory conclusion to Issue 3 in the AICPA Issues Paper, The Use of Discounting in Financial Reporting for Monetary Items with Uncertain Terms Other Than Those Covered by Authoritative Literature, states in part that, "Twelve AcSec members and three task force members believe that a settlement rate should be used to determine the present value of future cash flows in the initial recognition of monetary liabilities with uncertain terms. The discount rate should be objectively determinable and the best estimate of the rate at which the monetary liabilities with uncertain terms could be settled or effectively settled ..."

[8] The term "risk-free rate" refers to the rate on monetary assets that are essentially risk free, as described in paragraph 4 of FASB Statement 76, and that have maturities comparable to those of the liability being discounted.

Appendix E - Status of Recommendations

Recommendation	Resolved	Unresolved	Open/ECD*	Closed
1	X		12/31/13	

*Estimated Completion Date.

Appendix F - Report Distribution

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