FINANCIAL ACCOUNTING FOUNDATION

401 Merritt 7, PO Box 5116
Norwalk, CT 06856-5116
tel: 203.847.0700
www.accountingfoundation.org

By Email: fasab@fasab.gov

July 15, 2013

Wendy M. Payne, Executive Director
Federal Accounting Standards Advisory Board
Mail Stop 6H19
441 G Street, NW, Suite 6814
Washington, DC 20548

Re: Exposure Draft of Proposed Statement of Federal Financial Accounting Standards, entitled *Reporting Entity*

Dear Ms. Payne,

We are writing in response to the invitation by the Federal Accounting Standards Advisory Board ("FASAB") to comment on the FASAB's exposure draft (the "Exposure Draft") relating to its proposed Statement of Federal Financial Accounting Standards entitled *Reporting Entity*. The purpose of the Exposure Draft is to provide principles to guide preparers of financial statements at the government-wide and component reporting entity levels in determining what organizations should be included in the reporting entity's general purpose federal financial reports ("GPFFRs") for financial accountability purposes. The FASAB developed the Exposure Draft to improve guidance for identifying organizations to include in the GPFFRs, and thereby to assist in meeting federal financial reporting objectives.

The Exposure Draft sets forth three basic inclusion principles for determining whether an organization should be included in the government-wide GPFFR.[1] As described in greater detail below, we recommend that the inclusion principles be revised to either eliminate or modify the scope of the inclusion principle relating to an organization that is "in the Budget" – that is, an organization with an account or accounts listed in the *Budget of the United States Government: Analytical Perspectives – Supplemental Materials* schedule entitled "*Federal Programs by Agency and Account*." Our view with respect to this matter is based on the particular circumstances of the Financial Accounting Standards Board (the "FASB"), one of the standard-setting bodies within the Financial Accounting Foundation (the "FAF"), and similarly situated organizations.

[1] The Exposure Draft would also require certain other organizations to be included in the government-wide GPFFR if excluding them would be misleading.

Although the FASB has an account listed in the Budget, we believe that the inclusion principle requiring the FASB to be included in the government-wide GPFFR solely because it is in the Budget would be inconsistent with the general concepts relating to inclusion set forth in the Exposure Draft, and would potentially undermine the integrity and utility of the GPFFRs. We do not believe that the objectives of the Exposure Draft would be met if organizations that do not receive taxpayer funds, and are not owned or operationally controlled by the federal government, are included in the GPFFR.

Background

The FAF is a Delaware nonprofit non-stock corporation, incorporated in 1972, which was created for the purpose of providing a corporate structure for the FASB, the body whose financial accounting and reporting standards for nongovernmental entities have been recognized as authoritative by the American Institute of CPAs ("AICPA") and the U.S. Securities and Exchange Commission ("SEC"). The structure of the FAF and the FASB reflects the view that a standard-setter should be independent from preparers of financial statements, from accounting and auditing firms, and from political or governmental influence. This independence is necessary to assure that the interests of the users of financial statements remain paramount, and has been critical to the integrity of our financial and capital markets.

Prior to the passage of the Sarbanes-Oxley Act of 2002 ("SOX"), concern was expressed that the objectivity and independence of the FAF and the FASB could be affected if their funding was dependent upon groups having interests in the standard-setting process. Although the FAF derived some revenues from sales and licensing of its publication, the FAF's principal revenues resulted from voluntary contributions. This concern was addressed in Section 109 of SOX, which provided that, going forward, the FASB would receive its funding from mandatory accounting support fees assessed on public companies.[2] Section 109 of SOX states that "[a]ccounting support fees and other receipts of … such standard-setting body shall not be considered public monies of the United States." Moreover, the Rules of Construction set forth in Section 109 provide that "[n]othing in this section shall be construed to render [the FASB] subject to procedures in Congress to authorize or appropriate public funds…."[3]

In addition to not being dependent upon governmental appropriations, neither the FAF nor the FASB is subject to the operational control of the federal government. The

[2] These fees are not assessed and collected by the federal government, but are assessed and collected by the Public Company Accounting Oversight Board ("PCAOB") pursuant to a contractual arrangement between the FAF and the PCAOB.

[3] The independence of the FASB budget was critical to Congress. See 148 CONG. REC. S7355 (Jul. 25, 2002) (statement of Sen. Enzi): "We did something marvelous for the FASB. We made sure of its independence. One way we made sure of its independence, besides citing in the law, was to make sure FASB has independent funding. They will not have to come to Congress with a budget. And they will not have to go to corporate America for funding. They will get independent funding to be able to do the job they need to do. That will inhibit us from trying to change what they are doing in setting accounting standards."

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FAF is governed by a Board of Trustees consisting of from 14 to 18 members, none of whom is a federal government employee. A Trustee's term is generally five years, and new FAF Trustees are appointed by the FAF's Board of Trustees. The Board of Trustees, in turn, appoints the members of the FASB. Although the FASB has a cooperative working relationship with the SEC and with other federal governmental organizations, and governmental representatives regularly attend meetings of the FASB's advisory committees and consult with the FASB with respect to standards and initiatives, the SEC does not operationally control the FAF or the FASB.[4]

For reasons the FAF does not fully understand, the Office of Management and Budget (the "OMB") has included the FASB in the Budget.[5] The line item in the Budget with respect to the FASB refers to mandatory appropriations and mandatory outlays; as we believe is clear from the language in Section 109 of SOX, however, the FASB does not receive any appropriations or any outlays from the federal budget.[6]

The Exposure Draft

As noted above, the FASAB issued the Exposure Draft to provide principles to guide preparers of financial statements at the government-wide and component reporting entity levels in determining what organizations should be included in the reporting entity's GPFFR for financial accountability purposes. The Executive Summary of the Exposure Draft sets forth the principal conceptual underpinning of the Exposure Draft, stating that the government-wide GPFFR should include all organizations:

1. budgeted for by elected officials of the federal government,
2. owned by the federal government, or
3. controlled by the federal government with risk of loss or expectation of benefits.[7]

When any of these conditions exists, the FASAB believes that information regarding the organization is necessary to provide accountability.

Having stated the above three conditions, the Exposure Draft goes on to set forth (in paragraph 21) three principles for inclusion in the government-wide GPFFR. The first inclusion principle refers to an organization that is "in the Budget," which is defined in

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[4] Although pursuant to Section 109 of SOX, the SEC is required to determine annually that the FASB accounting support fee is within the parameters prescribed by Congress, the SEC does not have authority, and is not required, to approve the FASB budget.
[5] The *Budget of the U.S. Government: Analytical Perspectives-Supplemental Materials* schedule entitled "*Federal Programs by Agency and Account*" (Schedule 32-1); referring to the FASB as the "Standard Setting Body" (Account 527-00-5377)).
[6] It should be noted that notwithstanding the explicit statutory language providing that the accounting support fees do not constitute public monies or public funds, the OMB has determined that the FASB is subject to sequestration.
[7] The Exposure Draft also provides guidance regarding the circumstances when consolidated financial statements would be appropriate for an organization in the GPFFRs ("consolidation entities"), or when disclosure would be appropriate ("disclosure organizations").

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paragraph 22 as an organization with an account or accounts listed in the Budget.[8] The Exposure Draft creates an exception with respect to a non-federal organization receiving federal financial assistance. Any non-federal organization receiving federal financial assistance is to be evaluated on the basis of the two additional inclusion principles (the "majority ownership interest" principle and the "control with risk of loss or expectation of benefit" principle). However, the Exposure Draft does not define the term "non-federal organization," and the term "federal financial assistance" is tied to the definition of the term in the Single Audit Act Amendments of 1996, such as grants, loans, etc., which the FASB does not receive.[9]

In discussing the basis for its conclusion that an organization with an account included in the Budget should be included in the government-wide GPFFR, the Exposure Draft states (in paragraph A12) that the:

> "Identification of an organization in the President's Budget is the clearest evidence that an organization should be included in the government-wide report. Absent budgetary actions – originating with the President's Budget and leading to appropriations – federal organizations would be unable to conduct operations. Financial reporting objectives – budgetary integrity, operating performance, stewardship, and systems and controls – could not be met if organizations identified in the budget were not included in the financial reports. Therefore, the most efficient means to identify organizations for inclusion in the GPFFR is by their participation in the budget process as evidenced by being listed in the [Budget]."

The Exposure Draft appears to take the view that inclusion in the Budget is equivalent to the first condition referred to above, that an organization is "budgeted for by elected officials of the federal government." However, as the circumstances of the FASB indicate, there may be accounts included in the Budget which do not receive federal appropriations, for which elected officials are not accountable, and in which the federal government has no ownership interest and little or no operational control. Accordingly, a rule that inclusion in the Budget requires an organization's financial information to be included in the GPFFRs may not reflect an appropriate consideration of the nature of organizations included in the Budget.[10] An inclusion principle that

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[8] Although the Exposure Draft refers to inclusion in the Budget as a "principle," it appears to us to be more in the nature of a rule, requiring an entity to be included in the GPFFR if it is in the Budget.
[9] It seems anomalous to us that the FASB may not be entitled to rely on this exception (and therefore may be required to be included in the GPFFRs) precisely because it does not receive any form of federal financial assistance.
[10] We assume that, even were the FASB to be included in the GPFFRs, it would not be deemed to be a consolidation entity. As the Exposure Draft states, "Consolidation is not appropriate for organizations operating with a high degree of autonomy. Some organizations that meet the principles for inclusion are insulated from political influence and intended to be non-taxpayer funded. Presenting information about these discrete organizations in consolidated financial statements would obscure the operating results and financial position of the reporting entity." We also believe, though, that the FASB should not be considered to be a "disclosure organization," on the basis that the absence of any governmental ownership, or any operational governmental

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would require an entity in the Budget to be included in the GPFFRs therefore appears to be at odds with the concepts underlying the Exposure Draft, including the acknowledgement that an absence of federal funding, operational control or supervision should not result in an entity being within the scope of the GPFFRs.

We therefore recommend that the FASAB revise the proposed statement to eliminate the principle that inclusion of an organization in the Budget results in the organization being included in the GPFFRs.[11] As an alternative, the FASAB could expand the proposed exception to the Budget criterion beyond the scope of entities that receive federal financial assistance under the Single Audit Act Amendments of 1996 to refer as well to organizations that are not under federal governmental operational control or supervision, and which do not receive federal funds. Either such revision would avoid an anomalous result of including wholly independent entities within the GPFFRs, undermining their integrity and utility.

We appreciate the opportunity to comment on the FASAB's proposal, and would be pleased to respond to any questions the FASAB or its staff may have.[12]

Very truly yours,

<u>/s/ Jeffrey W. Rubin</u>
Jeffrey W. Rubin
Vice President and General Counsel

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control, should not result in the FASB being within the scope of the GPFFRs in any manner. As the Exposure Draft states, "The Board recognizes that in rare instances it also may be misleading to include an organization that is administratively assigned to a reporting entity based on the [inclusion] principles. In such cases, the organization may be excluded." If there is no federal governmental ownership or operational control of an entity, and the entity does not receive federal funds, there would be no justification for including the entity within the scope of the GPFFRs; indeed, to do so would be misleading. The proposed "misleading to include" criteria do not clearly reflect this consideration, and the Exposure Draft states without support that instances when organizations can be excluded are "rare."

[11] We defer to the FASAB as to how an elimination of the "in the Budget" principle should be reflected. For example, the FASAB may determine that inclusion in the Budget is merely one of several factors to be considered in evaluating whether an organization should be included in the GPFFRs.

[12] The Exposure Draft includes twelve specific questions to which commenters are requested to respond. The comments set forth in this letter are intended to respond principally to questions Q1(a), (b) and, (d).