



September 6, 2007

**Memorandum**

To: Members of the Board

From: Julia E. Ranagan, Assistant Director

Through: Wendy M. Payne, Executive Director

Subject: **Appropriate Source of GAAP<sup>1</sup> – Tab F**

The purpose of this paper is to present a recommendation to address the long-standing issue of the appropriate source(s) of generally accepted accounting principles (GAAP) for federal government corporations and other federal entities that currently follow accounting standards from a source of GAAP other than that recommended by FASAB.

At the May meeting, staff was directed to meet with representatives from FASAB's three sponsoring agencies (GAO, OMB, and Treasury) to determine how best to address the issue. This paper contains the recommendation that directly resulted from staff's meeting with representatives from each of the three agencies, a discussion of the legal and professional considerations that continue to complicate the issue, and alternative options that the Board may want to consider.

The key decision that staff requests from the board at this meeting is a selection of options on page 9. If you require additional information or wish to suggest another alternative, please contact me as soon as possible. Ideally, I would be able to respond to your request for information or develop more fully the alternative you wish considered in advance of the meeting. If you have any questions or comments prior to the meeting, please contact me by telephone at 202-512-7377 or by e-mail at [ranaganj@fasab.gov](mailto:ranaganj@fasab.gov).

Attachments

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<sup>1</sup> The staff prepares Board meeting materials to facilitate discussion of issues at the Board meeting. This material is presented for discussion purposes only; it is not intended to reflect authoritative views of the FASAB or its staff. Official positions of the FASAB are determined only after extensive due process and deliberations.

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**Abbreviations**

|            |   |
|------------|---|
| AICPA      | American Institute of Certified Public Accountants                    |
| AU         | U.S. Auditing Standards   |
| CFO Act    | Chief Financial Officers Act  |
| CFR        | Consolidated Financial Report of the U.S. Government                  |
| CNCS       | Corporation for National and Community Service                        |
| EXIM       | Export-Import Bank  |
| FACTS      | Federal Agencies' Centralized Trial-Balance System                    |
| FASAB      | Federal Accounting Standards Advisory Board                           |
| FASB       | Financial Accounting Standards Board                                  |
| FDIC       | Federal Deposit Insurance Corporation                                 |
| FMS        | Financial Management Service  |
| FPI        | Federal Prison Industries   |
| GAAP       | Generally Accepted Accounting Principles                              |
| GAO        | Government Accountability Office (formerly General Accounting Office) |
| GCCA       | Government Corporation Control Act                                    |
| GFRS       | Governmentwide Financial Report System                                |
| Ginnie Mae | Government National Mortgage Association                              |
| ITC        | Invitation to Comment   |
| MCC        | Millennium Challenge Corporation                                      |
| MINT       | United States Mint  |
| OCBOA      | Other Comprehensive Basis of Accounting                               |
| OGC        | Office of General Counsel   |
| OMB        | Office of Management and Budget                                       |
| OTS        | Office of Thrift Supervision  |
| PBGC       | Pension Benefit Guaranty Corporation                                  |
| P.L.       | Public Law  |
| SBR        | Statement of Budgetary Resources                                      |
| SFFAC      | Statements of Federal Financial Accounting Concepts                   |
| SFFAS      | Statements of Federal Financial Accounting Standards                  |
| Treasury   | U.S. Department of the Treasury                                       |

## Abbreviations

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|        |                                       |
|--------|---------------------------------------|
| TVA    | Tennessee Valley Authority            |
| U.S.   | United States                         |
| U.S.C. | United States Code                    |
| USSGL  | United States Standard General Ledger |

# Appropriate Source of Generally Accepted Accounting Principles for Federal Government Corporations and Other Federal Entities

## Project Background

### *Prior to March 2007*

Since October 1999, the American Institute of Certified Public Accountants (AICPA) has recognized the Federal Accounting Standards Advisory Board (FASAB) as the standard-setting body for federal governmental entities; therefore, the pronouncements resulting from the FASAB process represent generally accepted accounting principles (GAAP) for the entire federal government (FASAB GAAP). Nevertheless, some federal entities follow GAAP for non-governmental entities promulgated by the private sector Financial Accounting Standards Board (FASB GAAP). For example, federal government corporations, the US Postal Service, certain component entities of the Department of Treasury, and some smaller entities in the executive and legislative branches have historically applied FASB GAAP and continue to do so.

This project was initiated in January 2006 after the topic was considered a top priority as a result of (1) the Board's October 2004 agenda-setting session, and (2) subsequent consideration of comments on the July 2005 invitation to comment (ITC) on the four projects selected by the Board for consideration.

### Proposed Project Approach

| Task  | Completion Date (Estimated) |
|---|-----------------------------|
| 1. Select 10 federal entities that are following the FASB GAAP hierarchy.   | January 2006<br>(see Tab 2) |
| 2. Complete profiles of the 10 federal entities with respect to each entity's mission, structure, operations and size based on revenue, sources of financing, SFFAC 2 conclusive and indicative criteria for including components in a reporting entity, and significant accounting policies. | March 2007<br>(see Tab 2)   |
| 3. Analyze and document similarities and differences that might prove helpful in developing guidance on which source of GAAP is most appropriate.   | April 2007                  |
| 4. Recommend a course of action for the Board to take at the next Board meeting (most likely one of the potential options described above or a combination thereof).  | May 2007                    |
| 5. Present draft of appropriate staff or Board document, if applicable, depending on the approach selected by the Board.  | September 2007              |
| 6. Follow applicable due process if an official document is deemed necessary.   | As deemed necessary         |

Prior to the March 2007 Board meeting, staff had completed the first two phases in the proposed project plan – “Select 10 federal entities that are following the FASB GAAP hierarchy” and “Complete profiles of the 10 federal entities with respect to each entity's mission, structure, operations and size based on revenue, sources of financing, SFFAC 2 conclusive and indicative criteria for including components in a reporting entity, and significant accounting policies.” (See the box above).

### *March 2007*

At the March 22, 2007, FASAB board meeting, staff presented a project plan and background information that included entity profiles and excerpts from financial statements for the following ten federal entities that have historically followed FASB GAAP: Community Development Financial Institution, Corporation for National and Community Service, Federal Deposit Insurance Corporation, Federal Prison Industries (Unicor), Government National Mortgage Association (Ginnie Mae), Millennium Challenge Corporation, Office of Thrift Supervision, Pension Benefit Guaranty Corporation, Tennessee Valley Authority, and U.S. Mint (the Mint switched to FASAB GAAP beginning with its fiscal year 2005 financial statements).

Staff outlined a number of possible outcomes of the project and the pros and cons of each option, provided a draft project timeline, and requested Board input on the next proposed phase in the project – “Analyze and document similarities and differences that might prove helpful in developing guidance on which source of GAAP is most appropriate.” The Board approved additional research on the project at that time.

#### *May 2007*

At the May 24, 2007, meeting, staff provided an analysis of various characteristics of the ten entities that were profiled in the March 2007 briefing materials. The characteristics that staff reviewed were grouped into the following eight categories: (A) General Profile of the Entities; (B) Size of the Entity; (C) Likely Users of the Financial Statements; (D) Title of General Purpose Federal Financial Report; (E) Financial Statements Presented; (F) Main Line Items; (G) Compliance with FASAB Standards and USSGL Requirements; and, (H) Primary Differences between FASAB Standards and FASB Standards. From the population of characteristics contained in the eight areas listed above, staff selected 16 characteristics that it deemed most relevant to the determination of the appropriate source of GAAP. Using those 16 characteristics, staff provided a draft framework for determining which source of GAAP would be more appropriate for a given entity utilizing a non-weighted scoring mechanism (see page 17 for the characteristics reviewed).

At the May meeting, staff also provided feedback from the user community in the form of a brief survey that was circulated to the preparers and auditors of the ten selected entities to provide information on the expected benefits and perceived costs and burdens associated with various approaches to resolving any concerns regarding the source of GAAP. Staff summarized the sense of the comments received from the respondents, which were generally not in favor of converting from FASB GAAP to FASAB GAAP.

After discussion of the options, the Board directed FASAB staff to coordinate with GAO, OMB, and Treasury on potential solutions to the issue and, if possible, come back to the Board with a draft framework that could be used to determine the appropriate source of GAAP for federal entities.

#### *July 2007*

As directed by the Board at the May meeting, FASAB staff met with representatives from GAO, OMB, and Treasury on July 11, 2007, to attempt to come to an agreement on how to address the issue. A summary of that meeting is included on the pages that follow.

## **Key Decisions to Date on this Project**

As discussed above, this project was introduced at the March 2007 board meeting so few key decisions have been made at this time. At the March meeting, the Board approved the project plan with the majority of the Board agreeing that staff should continue through at least phase 3 in the proposed project plan (see box previous page) to provide the Board with more decision-useful information and analysis upon which to base its decision regarding the future direction of the project. The only opposition voiced was that of Mr. Werfel who indicated that OMB would rather not pursue the project at this time in light of resource constraints and other issues that are more pressing. At the May meeting, the Board agreed that staff should coordinate with GAO, OMB, and Treasury on potential solutions to the issue and, if possible, come back to the Board with a draft framework that could be used to determine the appropriate source of GAAP for federal entities.

## Purpose of this Paper

The purpose of this paper is to present the recommendation that directly resulted from staff's meeting with representatives from GAO, OMB, and Treasury on July 11, 2007, a discussion of the legal constraints that continue to complicate the issue, and alternative options that the Board may want to consider.

## Summary of July 11, 2007 Workgroup Meeting

### Workgroup Members

Frank Synowiec, GAO  
Audrey Duchesne, OMB  
Ann Davis, Treasury  
David Strobel, Treasury FMS  
Julia Ranagan, FASAB

### Summary of Meeting

As discussed, there are many significant issues involved in the debate over FASAB vs. FASB GAAP. After weighing each of these issues with the overarching desire to receive a clean opinion on the consolidated financial report, FASAB staff believes the group came to the consensus below (this is actually a combination of option 3 and option 5 that were presented on pages 19 – 21 of staff's March 2007 discussion paper).

1. The group would recommend that entities currently following FASB GAAP may continue to do so but would need to present in their individual financial statements an audited footnote reconciliation of the differences between FASB GAAP and FASAB GAAP that supports the numbers submitted to Treasury for the consolidated Financial Report of the U.S. Government (CFR). (The reconciliation prepared by EXIM Bank was discussed as an example – see page A-13. David Strobel has agreed to look back at the footnote reconciliation to see what else, if anything, might need to be included).
2. The group would recommend revoking the “grandfather authority”<sup>1</sup> that allowed entities to comply with FASAB GAAP by continuing to follow the FASB hierarchy. Under the new standards FASB GAAP with a footnote reconciliation would become FASAB GAAP for those entities that had previously followed FASB GAAP.
3. The group would not recommend that any entities be required to convert from FASB GAAP to FASAB GAAP or change their individual financial statements, other than the addition of the new footnote reconciliation. In that same vein, we would not recommend that any exceptions or waivers be permitted. All entities will either report full out FASAB or FASB with a footnote reconciliation to FASAB. Therefore, the characteristics previously presented are deemed irrelevant.
4. At this time, the group would not recommend that budgetary information be required for those entities that are not currently required to submit FACTS II [see update on this under OMB view in the “Sponsor Follow-Up” section immediately following this section]. Treasury and GAO are currently in disagreement over whether a consolidated CFR Statement of Budgetary Resources

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<sup>1</sup> FASAB News, Jan.-March 2000, p. 2.

(SBR) is required and may be resolved at a later point in time. Presently, FACTS II information is combining and not consolidated; Treasury would need consolidating FACTS II submissions if it is required to prepare a consolidated SBR.

5. The group believes that this recommendation should address Treasury's main issue of standardization of GAAP as everyone's Governmentwide Financial Report System (GFRS) numbers would be FASAB. However, it would not require full blown conversion to FASAB. We feel this is a reasonable compromise that will help achieve a clean opinion on the CFR.
6. The group's recommendation, if approved by the Board members, would be presented in the form of a FASAB standard, which would then be coordinated between OMB and Treasury, incorporated into OMB A-136, and supported by Treasury.
7. The group's recommendation does not address Treasury's concern about standardization of timing (different year-ends). It was thought by the group that this concern could be addressed in a separate effort through the use of Agreed-Upon Procedures.
8. The group would recommend that this requirement be effective for FY 2012 (with earlier implementation encouraged), so that FASAB reporting would be in place around the time that the Department of Defense is auditable. The group thought this would give agencies sufficient time to procure the resources and audit coverage necessary to comply, or in some cases, voluntarily convert to FASAB.
9. In the event that the annual CFR due date is pushed back, the group believes that there would also be a benefit from our perspective in that agencies that prepare FASB statements would be permitted additional time to prepare the audited reconciliation. This has been a concern of TVA.
10. The group does not believe that leaving the "grandfather authority" in place would be productive. For some agencies, there is little incentive to comply with FASAB standards other than the loss of a GAAP opinion. However, we believe the suggested recommendation is a reasonable compromise that would prevent the loss of a GAAP opinion from occurring.
11. In the event that an agency feels they are not legally required to comply with FASAB standards, or the auditors do not enforce AU Section 411 for some reason, it was suggested that Treasury and GAO might do some analysis in the off-season to determine if the methodology that an entity is using to crosswalk its FASB statements to FASAB is reasonable. This might help provide some assurance.

**Disclaimer:** A near final draft of this staff paper was sent to representatives from the three sponsoring agencies for comment. While this shaded section contains comments that were received by staff from representatives of the sponsoring agencies during the drafting stage, final comments were not provided to staff to be incorporated into this document. Therefore, it is not known by staff whether the comments below represent the current view of GAO, OMB, or Treasury at the agency level. The agencies were encouraged to communicate any additional comments to the Board separately, if desired. As always, the Board members will be able to represent the current views of each of their respective agencies at the Board table.

#### Sponsor Follow-up

##### **GAO Representative view:**

- via 7/19/07 meeting between Bob Dacey, Frank Synowiec and Julia Ranagan

Bob Dacey is okay with staff presenting the workgroup's recommendation to the Board but he wants to have discussion of (a) OMB enforcement over government corporations and (b) lack of enforcement



over legislative and judiciary agencies. Bob is concerned with compliance being audit-driven; he requested that FASAB staff meet with GAO OGC to discuss legal implications. Julia Ranagan, Frank Synowiec, Jeff Jacobson (GAO OGC), and Abe Dymond (GAO OGC) met on Tuesday, July 31, 2007 to discuss existing legal constraints. (See the related discussion of "Legal and Professional Considerations" in the section below.)

**OMB Representative view:**

- via July 18, 2007 e-mail from Audrey Duchesne

OMB is okay with presenting this recommendation to the Board for its deliberation. Also, OMB understands that this recommendation will be presented to the Board at the September meeting. Therefore, OMB would like the opportunity, as Sponsor staff, to review the materials that will be sent to the Board for that meeting.

[NOTE from Dana James via e-mail on 7/18/2007 and 7/19/2007: All executive branch agencies are required to submit FACTS II. OMB and Treasury continue to work with the small number of agencies that are not consistently compliant. The OMB Circular A-11 Section 130.2 specifies that all Executive Branch agencies are required to electronically report the SF 133 quarterly. In addition, Section 130.1 cites 31 U.S.C. 1511-1514 as a requirement for the President to review Federal expenditures at least four times a year (OMB acting on behalf of the President). OMB and Treasury collaborated and developed FACTS II as the mechanism of obtaining this information for both OMB and Treasury use.]

**Treasury Representative view:**

- via July 18, 2007 and August 30, 2007 e-mails from Ann Davis

Bob Reid concurs with the items except for #4 and #7.

#4 - Bob is concerned that CONSOLIDATED SBRs (they are currently combined) may be needed from the agencies in order to resolve the issue with GAO. Although this will not affect the FR (as Dave noted in the meeting), he feels that the only way to resolve the issue with GAO is for the agencies' numbers to be validated through the audit process.

#7 - Bob's preference is for audited numbers for all significant agencies for the 12 months ended 9/30.

[NOTE from David Strobel via e-mail 7/16/2007: Gary Ward and I examined the EXIM Bank note that was prepared for EXIM'S 2004 financial statement that crosswalks their FASB data to FASAB data (see attachment to this memo). We agreed that this is what we would want from the agencies because it provides a reconciliation for their primary financial statements and provides a textual explanation for the major differences between the two formats. With this note we would not need anything else extra.]

[NOTE from Ann Davis via e-mail 7/18/2007: According to FMS, TVA reports FACTS II for quarter 1 – 3; however, they cannot pass the edits for quarter 4 and must submit a hard copy.]

## Legal and Professional Considerations

A lengthy and technical discussion of various legal and professional considerations was included in staff's March discussion paper and is included in its entirety for your convenience beginning on page A-19. Some of these considerations were also raised by Bob Dacey in the meeting with FASAB staff on July 19, 2007 (and discussed in further detail with GAO OGC on July 31, 2007 and August 27, 2007) and can be more simply summarized as follows:

1. Neither FASAB nor any of its sponsors have legal jurisdiction over the legislative and judicial branches. The legislative and judicial branches, and most entities within those

branches, are not required to prepare financial statements and those that do prepare statements cannot be legally required by any of FASAB's sponsors to prepare a reconciliation between FASAB GAAP and FASB GAAP.

2. FASAB is recognized by the AICPA as the Rule 203 standard-setter for all federal governmental entities as defined by Statement of Federal Financial Accounting Concepts (SFFAC) 2, *Entity and Display*. Therefore, it would be accurate to conclude that any federal entity that meets the definition of a federal entity under SFFAC 2 and is not reporting in accordance with the FASAB GAAP hierarchy should not receive a GAAP opinion. In other words, any federal entity that is not following the federal GAAP hierarchy (see Appendix A) should receive an OCBOA or less than unqualified GAAP opinion unless FASAB, acting under the authority of its sponsors, makes provisions otherwise.
3. OMB may be able to enforce FASAB requirements for government corporations under its broad financial management authority provided in 31 U.S.C. § 503(a) or other laws.
4. Treasury can request reports and information it needs from executive branch agencies to prepare the governmentwide financial report under its specific authority provided in 31 U.S.C. § 3513(a).
5. The requirement for federal entities (as defined in SFFAC 2) to follow the FASAB hierarchy is contained in the auditing literature – AU Section 411, *The Meaning of "Present Fairly in Conformity with GAAP"* – and not in the accounting literature.

Therefore, with no enforcement authority over the legislative and judicial branches, and if OMB chooses not to enforce FASAB requirements for government corporations, responsibility to "enforce" compliance with FASAB requirements for all branches of government rests with the auditors indirectly through the issuance of an OCBOA or less than unqualified GAAP opinion.

Bob Dacey is not in favor of this outcome and would caution against implementing the recommendation as developed by the workgroup without due consideration of the implications on the judicial and legislative branches, as well as on the executive branch, where there is no enforcement mechanism in place.

## Potential Options That FASAB Has to Address the Issue

There are many options that FASAB has to address the issue. However, some are deemed less feasible than others due to a number of considerations. None of the sponsors indicated support for requiring all entities to convert to FASAB standards at the component level at this time; therefore, none of these recommendations would result in that outcome.

The three recommendations that staff is requesting that you consider are:

- Option A – Take no action
- Option B – Implement workgroup recommendation
- Option C – Initiate FASAB project to address specific differences

Each of the options are described in more detail on the pages that follow.

**Option A – Take no action**

Take no action. Let OMB and Treasury enforce their legislated authority to obtain FASAB GAAP information that they need for the consolidated CFR and other purposes. Let the auditing community enforce the designation of GAAP for the federal government as deriving from FASAB pronouncements.

This option would most likely require no change to the entity-level presentation.

**Pros**

- Would most likely not require extensive use of FASAB resources, other than intermittent requests to resolve areas of dispute.
- Might maintain historical reporting and comparability against prior years within the entity itself, depending on how OMB and Treasury decide to resolve the issue.
- Might receive the least resistance by government corporations and other entities currently following the FASB GAAP hierarchy, depending on how OMB and Treasury decide to resolve the issue.
- Might avoid potentially costly modifications to existing accounting systems, policies and procedures to conform to FASAB standards, depending on how OMB and Treasury decide to resolve the issue.
- Would most likely require minimal Board time.

**Cons**

- Does not further address AICPA's recommendation for FASAB to determine appropriate source of GAAP for all federal entities.
- Would probably not address other existing FASAB requirements deemed important to fulfill the federal financial reporting objectives, such as budgetary reporting, cost accounting, disclosure of full costs including imputed costs, and management discussion and analysis.
- Might not ensure consistent application to all federal entities, depending on how OMB and Treasury decide to resolve the issue.
- Might not address the concern with inconsistent and incomparable reporting among federal government entities as a result of separate sources of GAAP, depending on how OMB and Treasury decide to resolve the issue.
- Might not address the issue of bureaus and other non-corporation federal entities that continue to apply the FASB GAAP hierarchy, depending on how OMB and Treasury decide to resolve the issue.
- Might not address time-intensive manual processes that occur at year-end to provide required information for consolidation, depending on how OMB and Treasury decide to resolve the issue.
- Might not respond to OIG concerns regarding inconsistent reporting among components, depending on how OMB and Treasury decide to resolve the issue.
- FASAB would most likely still need to address issues individually as they come along.

**Option B – Implement workgroup recommendation**

Implement the workgroup's recommendation which is to (1) permit entities currently following FASB GAAP to continue to do so but require that they present in their individual financial statements an audited footnote reconciliation of the differences between FASB GAAP and FASAB GAAP that would support the numbers submitted to Treasury via GFRS for the CFR; and (2) revoke the "grandfather authority" that allowed entities to comply with FASAB GAAP by continuing to follow the FASB hierarchy.

This option requires no change to the entity-level presentation other than the addition of an audited reconciliation footnote. One line of thinking is that those entities that have no real basis to follow a different source of GAAP will voluntarily convert to FASAB instead of maintaining two different reporting bases.

This option is thought to have undesirable political ramifications because of the implications for the judicial and legislative branches. It has been suggested that an exemption be granted for legislative and judicial branches. However, while FASAB is designated by the AICPA as the Rule 203 body to set accounting principles for all federal government entities, FASAB and its sponsors have no legal authority to set or enforce standards for the legislative and judicial branches. Explicitly granting an exemption to the judicial and legislative branches is a form of setting standards for those branches. Another option would be to craft the standard such that it only applied to executive branch agencies; however, it is staff's opinion that there is no rational basis to do this from the standpoint of a professional accountant.

**Pros**

- Would help ensure consistent application to all federal entities through form and content resulting from a standard on the required footnote reconciliation.
- Would address the concern about inconsistent and incomparable reporting among federal government entities as a result of separate sources of GAAP to a certain extent because all entities would have an audited reconciliation footnote that shows FASAB GAAP reporting for balance sheet and income statement accounts. However, users of the financial statements would need to refer to the footnotes and may be confused by the differences.
- Would help address time-intensive manual processes that occur at year-end to provide required information for consolidation because audited GFRS numbers would eliminate the need for additional reconciliation.
- Might encourage entities that have no basis for reporting under FASB GAAP to voluntarily convert to FASAB GAAP to avoid having to maintain two reporting methods.
- Would maintain historical reporting and comparability against prior years within the entity itself since basic financial statement formats remain unchanged.
- Would most likely receive less resistance by government corporations and other entities currently following the FASB GAAP hierarchy than requiring full conversion.

**Cons**

- Does not further address AICPA's recommendation for FASAB to determine appropriate source of GAAP for all federal entities.
- Would not address other existing FASAB requirements deemed important to fulfill the federal financial reporting objectives, such as budgetary reporting, cost accounting, disclosure of full costs including imputed costs, and management discussion and analysis.
- Might require costly modifications to existing accounting systems, policies and procedures to be able to provide information needed to obtain an unqualified audit opinion on a FASB to FASAB reconciliation footnote; however the information provided for the CFR via GFRS should already be auditable.
- Would most likely require medium to extensive FASAB resources and Board time, including a public hearing.
- Might result in OCBOA or less than unqualified opinions for those entities that prepare audited financial statements under a different source of GAAP but do not include the footnote reconciliation.
- Compliance might be audit-driven for legislative and judicial branches and for executive branch entities where there is no other enforcement.

**Option C – Initiate FASAB project to address specific differences**

Initiate a long-term, resource-intensive project to (1) determine the significant differences between FASB GAAP and FASAB GAAP across government, (2) indicate the appropriate source of GAAP to be used to address each of those significant differences, and (3) develop specific FASAB standards that would address each of the significant differences and/or specifically incorporate or reference FASB standards into the FASAB GAAP hierarchy, as appropriate.

This option would address entity-level presentation for areas where significant differences exist.

**Pros**

- Would further address AICPA's recommendation for FASAB to determine appropriate source of GAAP for all federal entities to the extent that all significant differences are addressed.
- Would help ensure consistent application to all federal entities for those areas where significant differences are addressed.
- Would address the concern about inconsistent and incomparable reporting among federal government entities as a result of separate sources of GAAP to the extent that the significant areas of differences are addressed.
- Would help address time-intensive manual processes that occur at year-end to provide required information for consolidation because audited GFRS numbers based on consistent GAAP would eliminate the need for additional reconciliation.
- Would most likely receive less resistance by government corporations and other entities currently following the FASB GAAP hierarchy than requiring full conversion.

**Cons**

- Would not address other existing FASAB requirements deemed important to fulfill the federal financial reporting objectives, such as budgetary reporting, cost accounting, disclosure of full costs including imputed costs, and management discussion and analysis.
- In instances where FASB standards are not deemed appropriate, it could be costly for entities to modify existing accounting systems, policies, and procedures to conform to FASAB standards.
- Might require costly modifications to existing accounting systems, policies and procedures to comply with FASAB standards that differ from FASB; however the information provided for the CFR via GFRS should already be auditable.
- Would most likely require extensive FASAB resources and Board time, including a public hearing.
- Might result in OCBOA or less than unqualified opinions for those entities that choose not to implement the new FASAB standards that differ from FASB standards.

**Please indicate your preference for Option A, B, or C**

☐ Option A

☐ Option B

☐ Option C

☐ None of the above. If none, what other option(s) do you believe that staff should consider?

**(Please contact FASAB staff before the meeting if you would like to suggest additional options to be further developed.)**

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## **TAB 1 – ATTACHMENTS**

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## Government GAAP/GAAP Statements of Financial Position Reconciliation

| (in millions)   | September 30, 2005 |                    | September 30, 2004 |                    |
|---|--------------------|--------------------|--------------------|--------------------|
|   | GAAP               | GOVERNMENT<br>GAAP | GAAP               | GOVERNMENT<br>GAAP |
| <b>ASSETS</b>   |                    |                    |                    |                    |
| Cash  | \$3,981.3          | \$3,957.4          | \$5,095.5          | \$5,095.5          |
| Loans Receivable, Net   | 5,036.7            | 5,517.1            | 5,225.4            | 5,845.8            |
| Receivables from Subrogated Claims, Net                       | 1,222.4            | 1,843.1            | 1,272.4            | 1,887.2            |
| Lease Receivables Consolidated from VIEs, Net                 | 4,992.7            | N/A                | 3,815.2            | N/A                |
| Subsidy Receivable from Program Account                       | N/A                | 375.6              | N/A                | 747.7              |
| Accrued Interest, Fees Received and Other Assets              | 157.7              | 133.1              | 145.3              | 130.3              |
| <b>Total Assets</b>   | <b>\$15,390.8</b>  | <b>\$11,826.3</b>  | <b>\$15,553.8</b>  | <b>\$13,706.5</b>  |
| <b>LIABILITIES &amp; EQUITY</b>                               |                    |                    |                    |                    |
| Borrowings from the U.S. Treasury                             | \$5,848.3          | \$5,848.3          | \$7,237.2          | \$7,237.2          |
| Payment Certificates  | 297.2              | 297.2              | 448.5              | 448.5              |
| Borrowings Consolidated from VIEs                             | 5,150.3            | N/A                | 4,008.5            | N/A                |
| Allowance for Guarantees, Insurance and Undisbursed Loans     | 4,741.8            | N/A                | 6,077.7            | N/A                |
| Claims Payable  | 7.9                | 7.9                | 12.1               | 12.1               |
| Guarantee Loan Liability                                      | N/A                | 2,284.8            | N/A                | 3,071.8            |
| Liability for Subsidy Related to Undisbursed Loans/Guarantees | N/A                | 286.4              | N/A                | 458.9              |
| Subsidy Payable to Financing Account, Net                     | N/A                | 89.2               | N/A                | 288.8              |
| Amounts Payable to the U.S. Treasury                          | 1,884.3            | 1,973.5            | 751.5              | 1,040.3            |
| Deferred Fees   | 859.7              | N/A                | 889.5              | N/A                |
| Other Liabilities   | 73.5               | 49.3               | 83.3               | 68.4               |
| <b>Total Liabilities</b>                                      | <b>18,863.0</b>    | <b>10,836.6</b>    | <b>19,508.3</b>    | <b>12,626.0</b>    |
| Capital Stock held by the U.S. Treasury                       | 1,000.0            | 1,000.0            | 1,000.0            | 1,000.0            |
| Tied-Aid Appropriations                                       | 338.6              | N/A                | 341.7              | N/A                |
| Credit Appropriations   | 328.5              | N/A                | 444.9              | N/A                |
| Unexpended Appropriations                                     | N/A                | 863.7              | N/A                | 1,139.1            |
| Accumulated Deficit   | (5,139.3)          | (874.0)            | (5,741.1)          | (1,058.6)          |
| <b>Total Stockholder's (Deficiency)/Equity</b>                | <b>(3,472.2)</b>   | <b>989.7</b>       | <b>(3,954.5)</b>   | <b>1,080.5</b>     |
| <b>Total Liabilities and Stockholders Equity</b>              | <b>\$15,390.8</b>  | <b>\$11,826.3</b>  | <b>\$15,553.8</b>  | <b>\$13,706.5</b>  |

## 20. GAAP-TO-GOVERNMENT-GAAP RECONCILIATION

Ex-Im Bank prepares its financial statements in accordance with GAAP. In January 2000, the American Institute for Certified Public Accountants (AICPA) recognized the Federal Accounting Standards Advisory Board (FASAB) as the standard setting body for federal entities. FASAB

established generally accepted accounting principles for the preparation of federal agencies' financial statements (government GAAP) which differ in some respects from GAAP.

The manner in which loss reserves are calculated under GAAP differs from the way they are calculated under government GAAP. As detailed in Note 2, Ex-Im Bank's operations are subject to the Credit Reform Act of 1990.

VIE = Variable Interest Entity

Under the Credit Reform Act, the cost of credit risk is defined as the net present value of cash disbursements offset by the net present value of cash receipts, such as fees, premiums, and loan principal and interest. This definition of cost of credit risk is used to determine the level of credit-related loss reserves under government GAAP. However, GAAP generally does not recognize future fees and premiums as an offset to the allowance since to do so would recognize income before it is earned. The difference in treatment of the level of loss reserves between government GAAP and GAAP is reflected in the Government GAAP/GAAP Statements of Financial Position. Under government GAAP guidance, the allowance for loans and subrogated claims receivable is less, the reserve for guarantees and insurance is less, and equity is greater.

The amount of net income reported under government GAAP is also different than net income reported under GAAP. Depending on the level of activity, net income reported on a government GAAP basis may be more or less than net income reported on a GAAP basis.

Ex-Im Bank's Statements of Financial Position is presented in accordance with GAAP for financial reporting purposes. The reconciliation of Ex-Im Bank's Statements of Financial Position prepared in accordance with GAAP to the Statements of Financial Position in accordance with government GAAP is presented on page 74. The reconciliation of net income from the accompanying GAAP Statement of Operations to net income in accordance with government GAAP is presented on page 76.

The following are the differences between government GAAP and GAAP in the statements above:

Cash under government GAAP is lower by \$23.9 million. Government GAAP does not require consolidation of VIE lease receivables as does GAAP; therefore, government GAAP does not account for the cash balance on hand as a result of VIE activity.

Loans Receivable, Net under government GAAP is higher by \$480.4 million in FY 2005 and \$620.4 million in FY 2004. Loan interest and fee income is credited to the loan-loss reserve under government GAAP, which results in a lower loss reserve and a larger receivable. Additionally, the methodology for determining the allowance for loan losses under GAAP differs in some respects with the

methodology under government GAAP, generally resulting in a lower allowance under government GAAP.

Receivables from Subrogated Claims under government GAAP is higher by \$620.7 million in FY 2005 and \$614.8 million in FY 2004. Interest income on rescheduled claims is credited to the loss reserve under government GAAP, which results in a lower loss reserve and a larger receivable.

Lease Receivables Consolidated From VIEs, Net, and Borrowings Consolidated From VIEs are recorded under GAAP, which requires consolidation of certain special purpose entities where Ex-Im Bank is providing a guarantee to the lender and is the primary beneficiary. Government GAAP does not require consolidation and the amounts are zero.

Under government GAAP, the Subsidy Receivable from the Program Account of \$375.6 million for FY 2005 and \$747.7 million for FY 2004 is fully offset by the Liability for Subsidy Related to Undisbursed Loans and Guarantees and the Subsidy Payable to the Financing Account, Net. These amounts are payable to and receivable from different Ex-Im Bank accounts at the U.S. Treasury and net to zero. They are not broken out separately under GAAP.

The Allowance for Guarantee, Insurance and Undisbursed Loans shown under GAAP is the equivalent of the Guarantee Loan Liability and the Liability for Subsidy Related to Undisbursed Loans/Guarantees under government GAAP. The government GAAP figure is lower by \$2,170.6 million in FY 2005 and \$2,547.0 million in FY 2004 because fees are recorded as income when received under government GAAP. Also, the allowance is adjusted for the amounts related to consolidated VIEs under GAAP, no such adjustments is recorded under government GAAP. Additionally, the methodology for determining the allowance under GAAP differs in some respects with the methodology under government GAAP, generally resulting in a smaller allowance under government GAAP.

Amounts Payable to the U.S. Treasury are higher by \$89.2 million in FY 2005 and \$288.8 million in FY 2004 under government GAAP. The annual subsidy re-estimate calculation is made up of two components: an amount due from the U.S. Treasury for cohorts of loans and guarantees that have increased in risk and an amount payable to the U.S. Treasury for cohorts of loans and guarantees that

have decreased in risk. Under GAAP, the two components are netted and shown as Amounts Payable to the U.S. Treasury. Under government GAAP, the amount due to the U.S. Treasury is shown as a payable and the amount due from the U.S. Treasury is recorded as an increase to subsidy expense that is reflected in the Accumulated Deficit. In addition, the net value of credits authorized prior to October 1, 1991, is recorded as a payable to the U.S. Treasury under government GAAP but is reflected in the Accumulated Deficit under GAAP.

Deferred fees are \$859.7 million in FY 2005 and \$889.5 million in FY 2004 under GAAP and are zero under Government GAAP. Under Government GAAP, guarantee

exposure fees are not deferred but are credited directly to the Guarantee Loan Liability. Under GAAP, such fees are deferred for loans and for guarantees.

Under government GAAP, Stockholder's Deficiency is lower by \$4,461.9 million in FY 2005 and \$5,035.0 in FY 2004 than under GAAP. Lower loss reserves under government GAAP result in less provision expense, which results in higher stockholder's equity. Also, under government GAAP, Unexpended Appropriations of \$863.7 million in FY 2005 and \$1,139.1 million in FY 2004 includes both obligated and unobligated balances. Under GAAP, only the obligated portion of unexpended appropriations is reflected in the Accumulated Deficit.

#### Government GAAP/GAAP Statement of Operations Supplemental Reconciliation

(in millions)

|   | September 30, 2005 | September 30, 2004 |
|---|--------------------|--------------------|
| Reported Net Income, GAAP Basis           | \$2,681.4          | \$2,044.4          |
| ADJUSTMENTS TO INCOME:                    |                    |                    |
| Subsidy Appropriation Used                | 559.6              | 646.4              |
| Appropriation from Prior-Year Re-estimate | 288.8              | 232.6              |
| Administrative Expense Appropriation Used | 68.3               | 71.8               |
| Total Adjustments to Income               | 916.7              | 950.8              |
| ADJUSTMENTS TO EXPENSE:                   |                    |                    |
| Subsidy Expense                           | (958.1)            | (1,677.2)          |
| Financing Resources Transferred Out       | (1,858.1)          | (954.4)            |
| Future Funded Expense                     | (89.2)             | (288.8)            |
| Lease Provision                           | (46.8)             | 156.3              |
| Total Adjustments to Expense              | (2,952.2)          | (2,764.1)          |
| Net Income Government-GAAP Basis          | \$645.9            | \$231.1            |

All of the differences in the schedule above result from differences in the treatment of appropriations and re-estimates between government GAAP and GAAP. Under government GAAP, the receipt and use of appropriations for credit activity, administrative expense and re-estimates is reflected in the Statement of Operations. Under GAAP this activity is shown as part of the Statement of Changes in Capital and Accumulated Deficit.

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**Fiscal Year 2006 Footnote regarding EXIM's subsequent conversion to FASAB GAAP:*****Basis of Accounting***

For FY 2006, the Bank changed reporting methodology from reporting under private-sector generally accepted accounting principles (GAAP) to reporting under generally accepted accounting principles for federal agencies (government GAAP). The decision to change accounting methodologies was prompted by various factors, notably the recognition by the American Institute of Certified Public Accountants (AICPA) of government accounting standards and Ex-Im Bank's determination that presenting statements under government GAAP is the preferable method of presentation. The format of the financial statements and notes are in accordance with form and content guidance provided in Office of Management and Budget (OMB) Circular A-136.

[Source: 2006 EXIM Financial Report]

F  
A  
S  
A  
B

F  
A  
S  
A  
B

| Characteristics that make the entity a <b><u>more likely</u></b> candidate for FASAB<br>(more similar to average federal agency)   | Characteristics that make the entity a <b><u>neutral</u></b> candidate for FASAB   | Characteristics that make the entity a <b><u>less likely</u></b> candidate for FASAB<br>(less similar to average federal agency)   |   |
|--|--|--|---|
| A  | B  | C  | Net Score   |
| (a) Included in the federal budget<br>(b) Bureau and/or consolidated with a parent agency<br>(c) Reports utilized by taxpayers<br>(d) Appropriated funding<br>(e) Included in the CFR<br>(f) Individually significant/material to the CFR            | (g) Government corporation<br>(h) Reports utilized by management<br>(i) Reports utilized by beneficiaries of services<br>(j) User fee funded (not necessarily self-sustaining) | (k) Required by law to follow a different set of accounting rules<br>(l) SEC filer<br>(m) Reports utilized by investors<br>(n) Predominately of a business nature<br>(o) Potentially self-sustaining through the production of revenue<br>(p) Has a large number of business-type transactions with the public | The higher the score is, the more likely the entity is a candidate for FASAB  |
| CDFI (5 – a, b, c, d, e)<br>CNCS (4 – a, c, d, e)<br>FDIC (3 – a, e, f)<br>FPI (3 – a, b, e)<br>GNMA (4 – a, b, e, f <sup>2</sup> )<br>MCC (4 – a, c, d, e)<br>OTS (3 – a, b, e)<br>PBGC (4 – a, b, e, f)<br>TVA (3 – a, e, f)<br>MINT (4 – a, b, e) | Characteristics (g) through (j) were considered by staff to be neutral to the discussion of FASAB GAAP versus FASB GAAP and were not incorporated into the scoring.            | CDFI (0)<br>CNCS (0)<br>FDIC (3 – n, o, p)<br>FPI (2 – n, o)<br>GNMA (4 – m, n, o, p)<br>MCC (0)<br>OTS (3 – n, o, p)<br>PBGC (3 – n, o, p)<br>TVA (6 – k, l, m, n, o, p)<br>MINT (3 – n, o, p)  | <b>A – C</b><br>CDFI (5)<br>CNCS (4)<br>FDIC (0)<br>FPI (1)<br>GNMA (0)<br>MCC (4)<br>OTS (0)<br>PBGC (1)<br>TVA (-3)<br>MINT (1) |

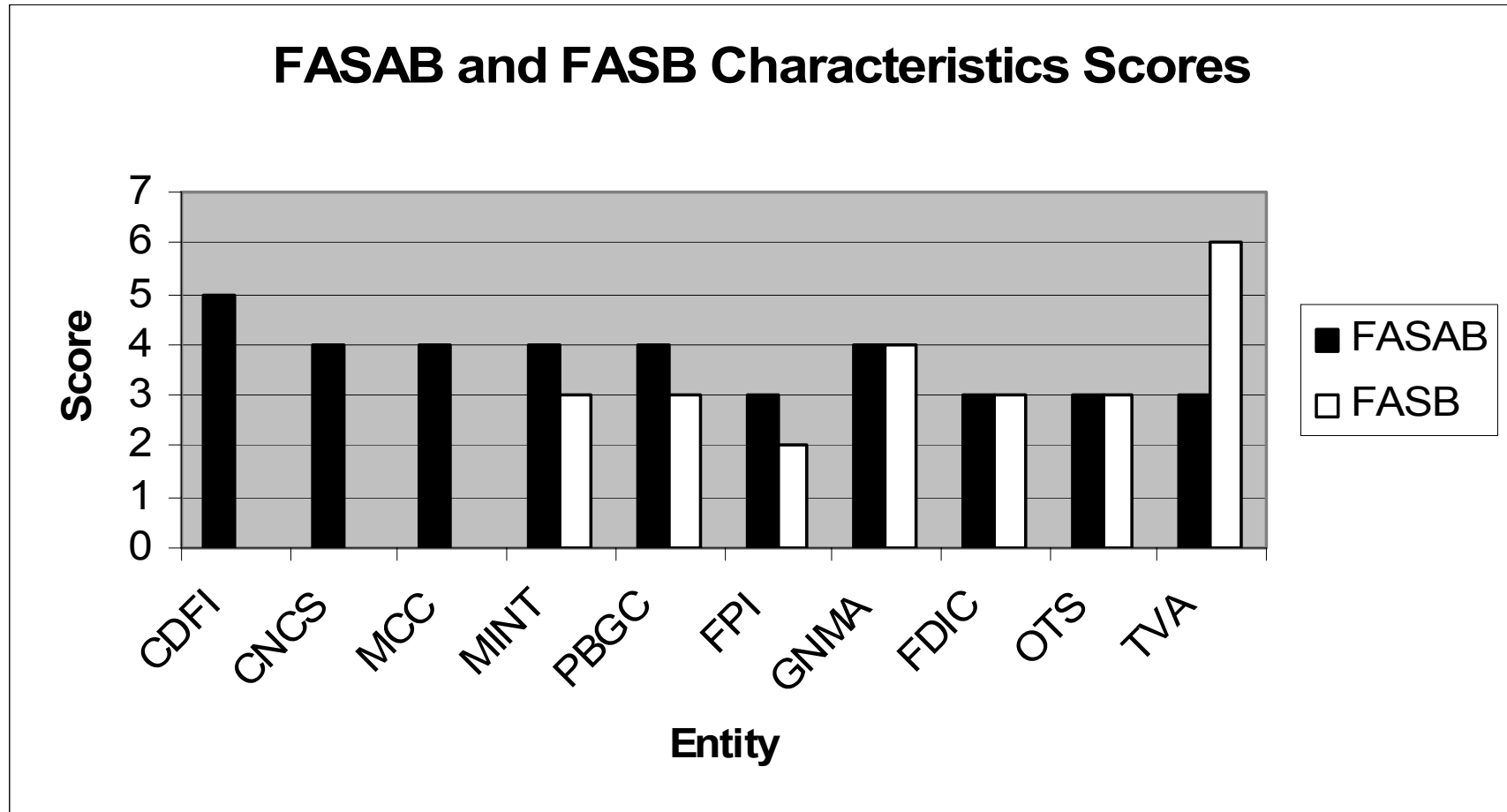
Note: This illustration uses the subjective judgment of staff and assumes equally weighted characteristics. If one were to select different characteristics or weight one characteristic more than another, the scoring outcome might have differing results.

Letters (a) – (p) correspond to the characteristics selected on page 7 of May 2007 discussion paper.

Next to each entity in the bottom row, the number in parentheses represents the number of characteristics that are met and the letters show which characteristics were met.

<sup>2</sup> Although GNMA is included as part of HUD rather than listed individually, it is a material part of HUD.

Chart 1



**Pages A-19 through A-25 omitted from posted materials.**

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## **TAB 2 – APPENDICES**

|  | <b><u>Page</u></b> |
|--|--------------------|
| <b>A - AU Section 411 – <i>The Meaning of “Present Fairly in Conformity with GAAP”</i></b> | <b>29</b>          |
| <b>B - ET Section 203 – Code of Professional Conduct, <i>Accounting Principles</i></b>     | <b>37</b>          |

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## AU Section 411

### *The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles\**

(Supersedes SAS No. 5)

Source: SAS No. 69; SAS No. 91; SAS No. 93.

See section 9411 for interpretations of this section.

**Effective for audits of financial statements for periods ending after March 15, 1992, unless otherwise indicated.**

.01 An independent auditor's report contains an opinion as to whether the financial statements present fairly, in all material respects, an entity's financial position, results of operations, and cash flows in conformity with generally accepted accounting principles. An identification of the country of origin of those generally accepted accounting principles also is required (see section 508.08*h*).

The purpose of this section is to explain the meaning of "present fairly . . . in conformity with generally accepted accounting principles." [As amended, effective for reports issued or reissued on or after June 30, 2001 by Statement on Auditing Standards No. 93.]

.02 The first standard of reporting requires an auditor who has audited financial statements in accordance with generally accepted auditing standards to state in the auditor's report whether the statements are presented in conformity with generally accepted accounting principles. The phrase "generally accepted accounting principles" is a technical accounting term that encompasses the conventions, rules, and procedures necessary to define accepted accounting practice at a particular time. It includes not only broad guidelines of general application, but also detailed practices and procedures. Those conventions, rules, and procedures provide a standard by which to measure financial presentations. [Revised, June 1993, to reflect conforming changes necessary due to the issuance of Statement of Position 93-3.]

.03 The independent auditor's judgment concerning the "fairness" of the overall presentation of financial statements should be applied within the framework of generally accepted accounting principles. Without that framework, the auditor would have no uniform standard for judging the presentation of financial position, results of operations, and cash flows in financial statements.

.04 The auditor's opinion that financial statements present fairly an entity's financial position, results of operations, and cash flows in conformity with generally accepted accounting principles should be based on his or her judgment as to whether (a) the accounting principles selected and applied have general acceptance; (b) the accounting principles are appropriate in the circumstances; (c) the financial statements, including the related notes, are informative of

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\* Title amended, effective for reports issued or reissued on or after June 30, 2001, by Statement on Auditing Standards No. 93.

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matters that may affect their use, understanding, and interpretation (see section 431); (d) the information presented in the financial statements is classified and summarized in a reasonable manner, that is, neither too detailed nor too condensed (see section 431); and (e) the financial statements reflect the underlying transactions and events in a manner that presents the financial position, results of operations, and cash flows stated within a range of acceptable limits, that is, limits that are reasonable and practicable to attain in financial statements.<sup>1</sup>

.05 Independent auditors agree on the existence of a body of generally accepted accounting principles, and they are knowledgeable about these principles and in the determination of their general acceptance. Nevertheless, the determination that a particular accounting principle is generally accepted may be difficult because no single reference source exists for all such principles. The sources of established accounting principles that are generally accepted in the United States of America are—

- a. Accounting principles promulgated by a body designated by the AICPA Council to establish such principles, pursuant to rule 203 [ET section 203.01] of the AICPA Code of Professional Conduct. Rule 203 [ET section 203.01] provides that an auditor should not express an unqualified opinion if the financial statements contain a material departure from such pronouncements unless, due to unusual circumstances, adherence to the pronouncements would make the statements misleading. Rule 203 [ET section 203.01] implies that application of officially established accounting principles almost always results in the fair presentation of financial position, results of operations, and cash flows, in conformity with generally accepted accounting principles. Nevertheless, rule 203 [ET section 203.01] provides for the possibility that literal application of such a pronouncement might, in unusual circumstances, result in misleading financial statements. (See section 508, *Reports on Audited Financial Statements*, paragraphs .14 and .15.)
- b. Pronouncements of bodies, composed of expert accountants, that deliberate accounting issues in public forums for the purpose of establishing accounting principles or describing existing accounting practices that are generally accepted, provided those pronouncements have been exposed for public comment and have been cleared by a body referred to in category (a).<sup>2</sup>
- c. Pronouncements of bodies, organized by a body referred to in category (a) and composed of expert accountants, that deliberate accounting issues in public forums for the purpose of interpreting or establishing accounting principles or describing existing accounting practices that are generally accepted, or pronouncements referred to in category (b) that have been cleared by a body referred to in category (a) but have not been exposed for public comment.
- d. Practices or pronouncements that are widely recognized as being generally accepted because they represent prevalent practice in a particular industry, or the knowledgeable application to specific circumstances of pronouncements that are generally accepted.

[Revised, October 2000, to reflect conforming changes necessary due to the issuance of Statement on Auditing Standards No. 93.]

<sup>1</sup> The concept of materiality is inherent in the auditor's judgments. That concept involves qualitative as well as quantitative judgments (see sections 150.04, 312.10, and 508.36).

<sup>2</sup> For purposes of this section, the word *cleared* means that a body referred to in subparagraphs (a) has indicated that it does not object to the issuance of the proposed pronouncement.

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**.06** Generally accepted accounting principles recognize the importance of reporting transactions and events in accordance with their substance. The auditor should consider whether the substance of transactions or events differs materially from their form.

**.07** If the accounting treatment of a transaction or event is not specified by a pronouncement covered by rule 203 [ET section 203.01], the auditor should consider whether the accounting treatment is specified by another source of established accounting principles. If an established accounting principle from one or more sources in category (b), (c), or (d) is relevant to the circumstances, the auditor should be prepared to justify a conclusion that another treatment is generally accepted. If there is a conflict between accounting principles relevant to the circumstances from one or more sources in category (b), (c), or (d), the auditor should follow the treatment specified by the source in the higher category—for example, follow category (b) treatment over category (c)—or be prepared to justify a conclusion that a treatment specified by a source in the lower category better presents the substance of the transaction in the circumstances.

**.08** The auditor should be aware that the accounting requirements adopted by regulatory agencies for reports filed with them may differ from generally accepted accounting principles in certain respects. Section 544, *Lack of Conformity With Generally Accepted Accounting Principles*, paragraph .04 and section 623, *Special Reports* provide guidance if the auditor is reporting on financial statements prepared in conformity with a comprehensive basis of accounting other than generally accepted accounting principles.

**.09** Because of developments such as new legislation or the evolution of a new type of business transaction, there sometimes are no established accounting principles for reporting a specific transaction or event. In those instances, it might be possible to report the event or transaction on the basis of its substance by selecting an accounting principle that appears appropriate when applied in a manner similar to the application of an established principle to an analogous transaction or event.

### Application to Nongovernmental Entities

**.10** For financial statements of entities other than governmental entities<sup>3</sup>—

- a. Category (a), officially established accounting principles, consists of Financial Accounting Standards Board (FASB) Statements of Financial Accounting Standards and Interpretations, Accounting Principles Board (APB) Opinions, and AICPA Accounting Research Bulletins.
- b. Category (b) consists of FASB Technical Bulletins and, if cleared<sup>4</sup> by the FASB, AICPA Industry Audit and Accounting Guides and AICPA Statements of Position.
- c. Category (c) consists of AICPA Accounting Standards Executive Committee (AcSEC) Practice Bulletins that have been cleared<sup>4</sup> by the

<sup>3</sup> Rules and interpretive releases of the Securities and Exchange Commission (SEC) have an authority similar to category (a) pronouncements for SEC registrants. In addition, the SEC staff issues Staff Accounting Bulletins that represent practices followed by the staff in administering SEC disclosure requirements. Also, the Introduction to the FASB's *EITF Abstracts* states that the Securities and Exchange Commission's Chief Accountant has said that the SEC staff would challenge any accounting that differs from a consensus of the FASB Emerging Issues Task Force, because the consensus position represents the best thinking on areas for which there are no specific standards.

<sup>4</sup> The auditor should assume that such pronouncements have been cleared by the FASB unless the pronouncement indicates otherwise.

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FASB and consensus positions of the FASB Emerging Issues Task Force.

- d. Category (d) includes AICPA accounting interpretations and implementation guides ("Qs and As") published by the FASB staff, and practices that are widely recognized and prevalent either generally or in the industry.

.11 In the absence of a pronouncement covered by rule 203 [ET section 203.01] or another source of established accounting principles, the auditor of financial statements of entities other than governmental entities may consider other accounting literature, depending on its relevance in the circumstances. Other accounting literature includes, for example, FASB Statements of Financial Accounting Concepts; AICPA Issues Papers; International Accounting Standards of the International Accounting Standards Committee; Governmental Accounting Standards Board (GASB) Statements, Interpretations, and Technical Bulletins; Federal Accounting Standards Advisory Board (FASAB) Statements, Interpretations, and Technical Bulletins; pronouncements of other professional associations or regulatory agencies; Technical Information Service Inquiries and Replies included in AICPA Technical Practice Aids; and accounting textbooks, handbooks, and articles. The appropriateness of other accounting literature depends on its relevance to particular circumstances, the specificity of the guidance, and the general recognition of the issuer or author as an authority. For example, FASB Statements of Financial Accounting Concepts would normally be more influential than other sources in this category. [Revised, June 1993, to reflect conforming changes necessary due to the issuance of Statement of Position 93-3.]

## Application to State and Local Governmental Entities

.12 For financial statements of state and local governmental entities<sup>5</sup>—

- a. Category (a), officially established accounting principles, consists of GASB Statements and Interpretations, as well as AICPA and FASB pronouncements specifically made applicable to state and local governmental entities by GASB Statements or Interpretations. GASB Statements and Interpretations are periodically incorporated in the *Codification of Governmental Accounting and Financial Reporting Standards*.
- b. Category (b) consists of GASB Technical Bulletins and, if specifically made applicable to state and local governmental entities by the AICPA and cleared<sup>6</sup> by the GASB, AICPA Industry Audit and Accounting Guides and AICPA Statements of Position.
- c. Category (c) consists of AICPA AcSEC Practice Bulletins if specifically made applicable to state and local governmental entities and cleared<sup>6</sup> by the GASB, as well as consensus positions of a group of accountants organized by the GASB that attempts to reach consensus positions on accounting issues applicable to state and local governmental entities.<sup>7</sup>

<sup>5</sup> State and local governmental entities include public benefit corporations and authorities; public employee retirement systems; and governmental utilities, hospitals and other health care providers, and colleges and universities.

<sup>6</sup> The auditor should assume that such pronouncements specifically made applicable to state and local governments have been cleared by the GASB unless the pronouncement indicates otherwise.

<sup>7</sup> As of the date of this section, the GASB had not organized such a group.

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- d.* Category (*d*) includes implementation guides ("Qs and As") published by the GASB staff, as well as practices that are widely recognized and prevalent in state and local government.

.13 In the absence of a pronouncement covered by rule 203 [ET section 203.01] or another source of established accounting principles, the auditor of financial statements of state and local governmental entities may consider other accounting literature, depending on its relevance in the circumstances. Other accounting literature includes, for example, GASB Concepts Statements; the pronouncements referred to in categories (*a*) through (*d*) of paragraph .10 when not specifically made applicable to state and local governmental entities either by the GASB or by the organization issuing them; FASB Concepts Statements; FASAB Statements, Interpretations, Technical Bulletins, and Concepts Statements; AICPA Issues Papers; International Accounting Standards of the International Accounting Standards Committee; pronouncements of other professional associations or regulatory agencies; Technical Information Service Inquiries and Replies included in AICPA Technical Practice Aids; and accounting textbooks, handbooks, and articles. The appropriateness of other accounting literature depends on its relevance to particular circumstances, the specificity of the guidance, and the general recognition of the issuer or author as an authority. For example, GASB Concepts Statements would normally be more influential than other sources in this category. [Revised, June 1993, to reflect conforming changes necessary due to the issuance of Statement of Position 93-3.]

**Application to Federal Governmental Entities**

.14 For financial statements of federal governmental entities<sup>8</sup>—

- a.* Category (*a*), officially established accounting principles, consists of Federal Accounting Standards Advisory Board (FASAB) Statements and Interpretations, as well as AICPA and FASB pronouncements specifically made applicable to federal governmental entities by FASAB Statements or Interpretations. FASAB Statements and Interpretations will be periodically incorporated in a publication by the FASAB.
- b.* Category (*b*) consists of FASAB Technical Bulletins and, if specifically made applicable to federal governmental entities by the AICPA and cleared by the FASAB, AICPA Industry Audit and Accounting Guides and AICPA Statements of Position.<sup>9</sup>
- c.* Category (*c*) consists of AICPA AcSEC Practice Bulletins if specifically made applicable to federal governmental entities and cleared by the FASAB, as well as Technical Releases of the Accounting and Auditing Policy Committee of the FASAB.
- d.* Category (*d*) includes implementation guides published by the FASAB staff, as well as practices that are widely recognized and prevalent in the federal government.

[Paragraph added, effective April 2000, by Statement on Auditing Standards No. 91.]

<sup>8</sup> Federal Accounting Standards Advisory Board (FASAB) Concepts Statement No. 2, *Entity and Display*, defines federal governmental entities. [Footnote added, effective April 2000, by Statement on Auditing Standards No. 91.]

<sup>9</sup> The auditor should assume that such pronouncements specifically made applicable to federal governmental entities have been cleared by the FASAB, unless the pronouncement indicates otherwise. [Footnote added, effective April 2000, by Statement on Auditing Standards No. 91.]

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.15 In the absence of a pronouncement covered by rule 203 [ET section 203.01] or another source of established accounting principles, the auditor of financial statements of a federal governmental entity may consider other accounting literature, depending on its relevance in the circumstances. Other accounting literature includes, for example, FASAB Concepts Statements; the pronouncements referred to in categories (a) through (d) of paragraph .10 when not specifically made applicable to federal governmental entities by the FASAB; FASB Concepts Statements; GASB Statements, Interpretations, Technical Bulletins, and Concepts Statements; AICPA Issues Papers; International Accounting Standards of the International Accounting Standards Committee; pronouncements of other professional associations or regulatory agencies; Technical Information Service Inquiries and Replies included in AICPA Technical Practice Aids; and accounting textbooks, handbooks, and articles. The appropriateness of other accounting literature depends on its relevance to particular circumstances, the specificity of the guidance, and the general recognition of the issuer or author as an authority. For example, FASAB Concepts Statements would normally be more influential than other sources in this category. [Paragraph added, effective April 2000, by Statement on Auditing Standards No. 91.]

**Effective Date**

.16 This section is effective for audits of financial statements for periods ending after March 15, 1992. [Paragraph added, effective April 2000, by Statement on Auditing Standards No. 91.]

**Transition**

.17 Most of the pronouncements or practices in categories (b), (c), and (d) of paragraphs .10 and .12 had equal authoritative standing prior to the issuance of this section. An entity following an accounting treatment in category (c) or (d) as of March 15, 1992, need not change to an accounting treatment in a category (b) or category (c) pronouncement whose effective date is before March 15, 1992. For example, a nongovernmental entity that followed a prevalent industry practice (category (d)) as of March 15, 1992, need not change to an accounting treatment included in a pronouncement in category (b) or (c) (for example, an accounting principle in a cleared AICPA Statement of Position or AcSEC Practice Bulletin) whose effective date is before March 15, 1992. For pronouncements whose effective date is subsequent to March 15, 1992, and for entities initially applying an accounting principle after March 15, 1992 (except for FASB Emerging Issues Task Force consensus positions issued before March 16, 1992, which become effective in the hierarchy for initial application of an accounting principle after March 15, 1993), the auditor should follow the applicable hierarchy established by paragraphs .10 and .12 in determining whether an entity's financial statements are fairly presented in conformity with generally accepted accounting principles. [Paragraph added, effective April 2000, by Statement on Auditing Standards No. 91.]



## The Meaning of "Present Fairly in Conformity With GAAP"

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.18 GAAP Hierarchy Summary<sup>†</sup>

| Nongovernmental Entities |  | State and Local Governments  | Federal Governmental Entities   |
|--------------------------|--|--|---|
|                          |  | Established Accounting Principles  |   |
| .10c                     | FASB Statements and Interpretations APB Opinions, and AICPA Accounting Research Bulletins  | .12a GASB Statements and Interpretations plus AICPA and FASB pronouncements if made applicable to state and local governments by a GASB Statement or Interpretation  | .14a FASAB Statements and Interpretations plus AICPA and FASB pronouncements if made applicable to federal governmental entities by a FASAB Statement or Interpretation   |
| .10b                     | FASB Technical Bulletins AICPA Industry Audit and Accounting Guides, and AICPA Statements of Position                                    | .12b GASB Technical Bulletins, and the following pronouncements if specifically made applicable to state and local governments by the AICPA: AICPA Industry Audit and Accounting Guides and AICPA Statements of Position | .14b FASAB Technical Bulletins and the following pronouncements if specifically made applicable to federal governmental entities by the AICPA and cleared by the FASAB: AICPA Industry Audit and Accounting Guides and AICPA Statements of Position |
| .10c                     | Consensus positions of the FASB Emerging Issues Task Force and AICPA Practice Bulletins  | .12c Consensus positions of the GASB Emerging Issues Task Force <sup>‡</sup> and AICPA Practice Bulletins if specifically made applicable to state and local governments by the AICPA                                    | .14c AICPA AcSEC Practice Bulletins if specifically made applicable to federal governmental entities and cleared by the FASAB and Technical Releases of the Accounting and Auditing Policy Committee of the FASAB                                   |
| .10d                     | AICPA accounting interpretations, "Qs and As" published by the FASB staff, as well as industry practices widely recognized and prevalent | .12d "Qs and As" published by the GASB staff, as well as industry practices widely recognized and prevalent  | .14d Implementation guides published by the FASAB staff and practices that are widely recognized and prevalent in the federal government  |

(continued)

<sup>†</sup> Paragraph references correspond to the paragraphs of this section that describe the categories of the GAAP hierarchy.

<sup>‡</sup> As of the date of this section, the GASB had not organized such a group.

| Nongovernmental Entities   | State and Local Governments<br><i>Other Accounting Literature</i> <sup>  </sup>   | Federal Governmental Entities  |
|--|---|--|
| .11 Other accounting literature, including FASB Concepts Statements; AICPA Issues Papers; International Accounting Standards Committee Statements; GASB Statements, Interpretations, and Technical Bulletins; FASAB Statements, Interpretations, and Technical Bulletins; pronouncements of other professional associations or regulatory agencies; AICPA <i>Technical Practice Aids</i> , and accounting textbooks, handbooks, and articles | .13 Other accounting literature, including GASB Concepts Statements; pronouncements in categories (c) through (d) of the hierarchy for nongovernmental entities when not specifically made applicable to state and local governments; FASB Concepts Statements; FASAB Statements, Interpretations, and Technical Bulletins, and Concepts Statements; AICPA Issues Papers; International Accounting Standards Committee Statements; pronouncements of other professional associations or regulatory agencies; AICPA <i>Technical Practice Aids</i> ; and accounting textbooks, handbooks, and articles | .15 Other accounting literature, including FASAB Concepts Statements; pronouncements in categories (c) through (d) of the hierarchy in paragraph .10 when not specifically made applicable to federal governmental entities; FASB Concepts Statements; GASB Statements, Interpretations, Technical Bulletins, and Concepts Statements; AICPA Issues Papers; International Accounting Standards of the International Accounting Standards Committee; pronouncements of other professional associations or regulatory agencies; AICPA <i>Technical Practice Aids</i> ; and accounting textbooks, handbooks, and articles |

[Revised, June 1993, to reflect conforming changes necessary due to the issuance of Statement of Position 93-3. Paragraph renumbered and amended, effective April 2000, by Statement on Auditing Standards No. 91.]

[The next page is 725.]

<sup>||</sup> In the absence of established accounting principles, the auditor may consider other accounting literature, depending on its relevance in the circumstances.

## **ET Section 203 Accounting Principles**

### **Rule 203--Accounting Principles**

Rule 203—Accounting Principles – A member shall not (1) express an opinion or state affirmatively that the financial statements or other financial data of any entity are presented in conformity with generally accepted accounting principles or (2) state that he or she is not aware of any material modifications that should be made to such statements or data in order for them to be in conformity with generally accepted accounting principles, if such statements or data contain any departure from an accounting principle promulgated by bodies designated by Council to establish such principles that has a material effect on the statements or data taken as a whole. If, however, the statements or data contain such a departure and the member can demonstrate that due to unusual circumstances the financial statements or data would otherwise have been misleading, the member can comply with the rule by describing the departure, its approximate effects, if practicable, and the reasons why compliance with the principle would result in a misleading statement.

[As adopted January 12, 1988.]

## **Interpretations under Rule 203 Accounting Principles**

### **203-1--Departures From Established Accounting Principles [Amended]**

203-1—Departures From Established Accounting Principles [Amended] – Rule 203 [ET section 203.01] was adopted to require compliance with accounting principles promulgated by the body designated by Council to establish such principles. There is a strong presumption that adherence to officially established accounting principles would in nearly all instances result in financial statements that are not misleading.

However, in the establishment of accounting principles it is difficult to anticipate all of the circumstances to which such principles might be applied. This rule therefore recognizes that upon occasion there may be unusual circumstances where the literal application of pronouncements on accounting principles would have the effect of rendering financial statements misleading. In such cases, the proper accounting treatment is that which will render the financial statements not misleading.

The question of what constitutes unusual circumstances as referred to in rule 203 [ET section 203.01] is a matter of professional judgment involving the ability to support the position that adherence to a promulgated principle would be regarded generally by reasonable men as producing a misleading result.

Examples of events which may justify departures from a principle are new legislation or the evolution of a new form of business transaction. An unusual degree of materiality or the existence of conflicting industry practices are examples of circumstances which would not ordinarily be regarded as unusual in the context of rule 203 [ET section 203.01].

### **203-2--Status of FASB, GASB and FASAB Interpretations**

203-2—Status of FASB, GASB and FASAB Interpretations – Council is authorized under rule 203 [ET section 203.01] to designate bodies to establish accounting principles. Council has designated the Financial Accounting Standards Board (FASB) as such a body and has resolved that FASB Statements of Financial Accounting Standards, together with those Accounting Research Bulletins and APB Opinions which are not superseded by action of the FASB, constitute accounting principles as contemplated in rule 203 [ET section 203.01]. Council has also designated the Governmental Accounting Standards Board (GASB), with respect to Statements of Governmental Accounting Standards issued in July 1984 and thereafter, as the body to establish financial accounting principles

for state and local governmental entities pursuant to rule 203 [ET section 203.01]. **Council has also designated the Federal Accounting Standards Advisory Board (FASAB), with respect to Statements of Federal Accounting Standards adopted and issued in March 1993 and subsequently, as the body to establish accounting principles for federal government entities to rule 203** [ET section 203.01]. [emphasis added]

In determining the existence of a departure from an accounting principle established by a Statement of Financial Accounting Standards, Accounting Research Bulletin or APB Opinion encompassed by rule 203 [ET section 203.01], or the existence of a departure from an accounting principle established by a Statement of Governmental Accounting Standards or a Statement of Federal Accounting Standards encompassed by rule 203 [ET section 203.01], the division of professional ethics will construe such Statements, Bulletin or Opinion in the light of any interpretations thereof issued by the FASB or the GASB.

[As amended April 30, 2000.]

**[203-3]--[Deleted]**

[203-3]—[Deleted]

**203-4--Responsibility of Employees for the Preparation of Financial Statements in Conformity With GAAP**

203-4—Responsibility of Employees for the Preparation of Financial Statements in Conformity With GAAP – Rule 203 [ET section 203.01] provides, in part, that a member shall not state affirmatively that financial statements or other financial data of an entity are presented in conformity with generally accepted accounting principles (GAAP) if such statements or data contain any departure from an accounting principle promulgated by a body designated by Council to establish such principles that has a material effect on the statements or data taken as a whole.

Rule 203 [ET section 203.01] applies to all members with respect to any affirmation that financial statements or other financial data are presented in conformity with GAAP. Representation regarding GAAP conformity included in a letter or other communication from a client entity to its auditor or others related to that entity's financial statements is subject to rule 203 [ET section 203.01] and may be considered an affirmative statement within the meaning of the rule with respect to members who signed the letter or other communication; for example, signing reports to regulatory authorities, creditors and auditors.

[Effective November 30, 1993.]