



BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
WASHINGTON, DC 20551

July 2, 2013

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

Dear Ms. Payne:

We appreciate the opportunity to comment on the Federal Accounting Standards Advisory Board's (FASAB) proposed Statement of Federal Financial Accounting Standards entitled *Reporting Entity*. Defining the boundaries of the federal government for purposes of financial reporting is a challenging task and we appreciate the FASAB's effort to enhance the understandability, relevance, and transparency of financial information provided to the public in the federal government's general purpose federal financial reports (GPFRR).

The Board of Governors of the Federal Reserve System (Board) has statutory authority to establish the accounting and financial reporting practices of the Board and the Reserve Banks (collectively, the Federal Reserve System) and, as a result, we believe that it is important to provide comments on this proposed standard, which has implications for Federal Reserve System financial reporting.

The Board shares the FASAB's commitment to financial reporting transparency that underlies the *Reporting Entity* exposure draft. We have no concerns continuing the current GPFRR practice of including substantial information about the Federal Reserve System's financial interactions with the federal government in the footnotes. Similarly, we have no objections to including within the GPFRR additional information sourced from our audited annual financial statements. We do not object to the requirements of the proposed statement that would result in the Reserve Banks and the Board being treated as disclosure organizations with limited disclosure requirements (as opposed to consolidation entities). We do have concerns, however, if the provisions of the proposed standard were to suggest that the Board or the Reserve Banks should consolidate their financial statements with those of the rest of the federal government. Consolidation of this nature would unnecessarily reduce transparency, undermine the

statutorily protected independence of the Federal Reserve System, distort the statements of the U.S. Government, and increase the costs of preparing and auditing the GPFRR.

I. The Federal Reserve System provides a variety of transparent financial reports to the public that exceeds the reporting requirements of the proposed standard.

The Federal Reserve System provides a substantial amount of information to the public, and its financial reporting practices are particularly robust. Each week, the Board publishes the balance sheet of each Reserve Bank along with other significant financial information on their assets and liabilities. The Board also publishes an annual independent audit of the financial statements of the Board, each of the twelve Reserve Banks, and the combined Reserve Banks.¹ The Board began publishing an unaudited quarterly combined Reserve Banks' financial report in 2012. The annual audited Board and Reserve Bank financial statements, and the Reserve Banks' weekly and quarterly financial reports can be accessed from the Board's public website at http://www.federalreserve.gov/monetarypolicy/bst_fedfinancials.htm. We believe that the information we provide to the public demonstrates our ongoing commitment to transparency and should be sufficient for meeting the purposes of the standard without incurring additional costs.

II. Classifying the Reserve Banks and the Board as disclosure organizations provides the most transparent information to the public.

Disclosure of financial information in the GPFRR footnotes, as opposed to consolidation in the federal government's financials, will provide relevant financial information while avoiding misleading perceptions about the relationship between the federal government and the Federal Reserve System. In particular, classifying the Board and the Reserve Banks as disclosure organizations recognizes the Federal Reserve System's independence as a central bank under the Federal Reserve Act, while including focused and relevant financial information in the GPFRR.

Although we understand that the proposed standard intends to provide a broader definition of the federal reporting entity, we believe that the evaluation of each entity should give appropriate weight to those functions and activities that most significantly affect the financial operations of the entity.

The *Reporting Entity* exposure draft recognizes that the federal government achieves its objectives through a wide range of organizations, which fall at different points on the control continuum. The Federal Reserve System performs many functions that fall at different points on the continuum described in the exposure draft. For example, the Reserve Banks interact closely with the federal government in their role as fiscal agents and depositories for the federal government. In that role, the Reserve Banks auction Treasury securities; process electronic and check payments for the Treasury; collect funds owed to the federal government; maintain the Treasury's bank

¹ Annual financial statements of the Board of Governors, the 12 Federal Reserve Banks, and the combined Reserve Banks are prepared on a calendar-year basis.

account; and develop, operate, and maintain a number of automated systems to support the Treasury's mission. The Treasury Department pays the Reserve Banks for these services from appropriated funds that are reflected in Treasury's financial statements. That role, however, accounts for a relatively small portion of the financial operations of the Reserve Banks.

At the other end of the continuum, by statute, the Federal Reserve operates independently with respect to determining and implementing monetary policy, and that function has a much more significant effect on its financial condition and operating results. The Federal Reserve Act provides the Board, the Reserve Banks, and the Federal Open Market Committee with specific separate authorities and responsibilities and is designed to preserve the independence of the Federal Reserve System entities from other government departments and agencies, including the U.S Treasury. The current FASAB Statement of Federal Financial Accounting Concepts 2: Entity and Display recognizes the independence of the monetary policy authority, stating that the Federal Reserve System's "organization and functions pertaining to monetary policy are traditionally separated from and independent of the other central government organizations and functions in order to achieve more effective monetary and fiscal policies and economic results. Therefore, the Federal Reserve System would not be considered part of the government-wide reporting entity." Further, Reserve Banks are not government agencies, and the treatment in the GPFRR should be consistent with their character.

III. Consolidation of the Federal Reserve System would reduce transparency in the GPFRR.

Consolidation of the Federal Reserve System's financial information in the GPFRR would partially eliminate assets and liabilities stemming from both fiscal and monetary policy in a way that would reduce the transparency of the government's fiscal operations. For example, the Reserve Bank's holdings of Treasury securities acquired in the conduct of monetary policy would be eliminated along with the U.S. Treasury's debt liabilities after consolidation, obscuring the federal debt resulting from the federal government's fiscal operations. The portion of interest expense paid on the Reserve Bank's holdings of U.S. Treasury securities would also be eliminated. Consolidation would also result in presenting deposits of private financial institutions held at the Reserve Banks as obligations of the federal government, which they are not.

IV. Consolidation of the Federal Reserve System would increase the cost and administrative effort associated with producing the GPFRR.

Because the Federal Reserve System reports financial information on a calendar-year basis, its audited financial information would be stale by the time it was included in the fiscal year based GPFRR dated as of September 30. Although the information could be updated by performing a nine-month "walk-forward" of Federal Reserve System financial information, the cost to the federal government of auditing this information would be significant.

In addition, the U.S. government, the Board, and the Reserve Banks apply different sets of accounting principles (FASAB, U.S GAAP for public companies, and

Board of Governors established principles, respectively).² Reconciling these principles for reporting purposes would involve additional cost to both the federal government and the Federal Reserve System and could potentially increase financial reporting risk without any material benefit. These costs and efforts may also exist to a lesser extent if the Board and the Reserve Banks were to be classified as disclosure organizations under the standard.

V. The provisions related to minimum disclosures for the central banking system are unnecessary.

The disclosure requirements for the central banking system described in paragraph 77 are inconsistent with the FASAB's objective of providing a principles-based standard. We believe that applying the proposed standard's inclusion principles and disclosure requirements that are applicable to all other organizations will result in an appropriate level of disclosures of Federal Reserve System financial information. The proposed disclosures for disclosure entities and the minimum disclosures for the central bank are very similar, even though the two sets of disclosures are described somewhat differently. For example, paragraph 73a, which is applicable to all disclosure organizations, requires disclosure of "information about how its mission relates to federal policy objectives, actions taken on behalf of the federal government, its organization and any significant involvements with outside parties." That requirement is substantially the same as the minimum disclosure requirement for the central bank described in paragraph 77b, which requires disclosure by the central bank of "significant roles and responsibilities (and how these relate to federal policy objectives)." We recommend deleting paragraph 77 in its entirety.

VI. The authority over the financial accounting and reporting practices of the Board and the Reserve Banks is vested with the Board of Governors.

FASAB's authority, which is derived from statutory authorities of the OMB, GAO, and Treasury, does not include authority to impose reporting requirements on the Board and Reserve Banks, given that (1) the Board is an independent entity in the executive branch; (2) neither the Board nor the Reserve Banks have reporting or other relationships to FASAB; and (3) Congress has separately established the financial reporting requirements applicable to the Federal Reserve System and vested final authority over those reports in the Board without directing the Board or the Reserve Banks to issue financial statements in accordance with FASAB requirements.³ To the extent requirements to report about the Federal Reserve System would be imposed on another entity, such as the Department of the Treasury, it is unclear how the Treasury can be expected to fulfill this obligation when the requested information pertains to the central bank, not the Treasury, and the central bank does not report to the Treasury.

² The Board's and Reserve Banks' accounting and reporting policies are governed by the Board. The Reserve Banks apply accounting standards developed by the Board of Governors, which are documented in the *Financial Accounting Manual for Reserve Banks* <http://www.federalreserve.gov/monetarypolicy/files/BSTfinaccountingmanual.pdf>

³ The Federal Reserve Act requires the Board to order an annual independent audit of the financial statements of the Board and the twelve Reserve Banks. 12 USC section 248b (1999).

The Board's statutory powers and reporting requirements largely address the issues in the proposed statement. These statutory provisions take precedence and the proposal would be in conflict with them. For example, Congress has addressed its expectation regarding transparency of Federal Reserve System financial information.

Public Access to Information- the Board shall place on its home Internet website, a link entitled "Audit", which shall link to a webpage that shall serve as a repository of information made available to the public for a reasonable period of time, not less than 6 months following the date of release of the relevant information, including—

- (1) the reports prepared by the Comptroller General under section 714 of title 31, United States Code;
- (2) the annual financial statements prepared by an independent auditor for the Board in accordance with section 11B;
- (3) the reports to the Committee on Banking, Housing, and Urban Affairs of the Senate required under section 13(3) (relating to emergency lending authority); and
- (4) such other information as the Board reasonably believes is necessary or helpful to the public in understanding the accounting, financial reporting, and internal controls of the Board and the Federal reserve banks. [12 U.S.C. 225b.]

In addition, as required by statute, the Board includes in its annual report to Congress a full account of its operations.⁴ To the extent the information you seek in the proposed statement is included in the Board's existing reports, we suggest that you reference these reports in the GPFRR.

VII. We disagree with the proposal to include forward-looking financial information in the audited financial statements for the Federal Reserve System.

The proposed disclosures and the minimum disclosures both include a requirement to disclose future exposures to gains and losses from future operations. Such information about future events is very difficult to audit and including such information in audited financial statements provides a false sense of reliability to such information. Further, preparers of the financial statements are unable to predict future monetary policy actions or when they will occur. Although it may be possible to report on contingencies arising from past events, it would not be feasible to report relevant and reliable financial information about pre-decisional future operations of the central bank that could be audited. The Federal Reserve System does not include forecasts and forward-looking information in the financial statements of the Board and the Reserve Banks. Instead, as it deems appropriate, such information is provided through other means. We recommend removing the disclosure requirements related to future exposures from paragraphs 72 and 73 of the proposed standard.

⁴ The Federal Reserve Act Section 10. Board of Governors of the Federal Reserve System. 12 USC 247b.

VIII. The characterization of the Bureau of Consumer Financial Protection (CFPB) in the proposal is incorrect, and should be revised.

Paragraph A32, footnote 57, in the proposed standard describes the Federal Reserve System as comprised, in part, of the CFPB. When Congress created the CFPB as a part of the Federal Reserve System, it provided that the CFPB's financial statements "shall not be consolidated with the financial statements of either the Board of Governors or the Federal Reserve System." The proposed standard should be clarified in this regard and, specifically, the references to the CFPB should be removed from the footnote.

In conclusion, we thank the FASAB for the opportunity to comment on the proposed standard and respectfully ask for consideration of the recommendations and suggestions in this letter. If you have any questions or would like to discuss these comments, please contact Greg Evans at 202-452-3945 or Larry Mize at 202-452-5232.

Sincerely,



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Donald V. Hammond
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