Reporting Entity

Please submit to fasab@fasab.gov

Name of Respondent: William Fleming

Organization: Securities and Exchange Commission

All responses are requested by July 3, 2013.

Q1. The Board is proposing three inclusion principles for an organization to be included in the government-wide GPFFR:

- **An organization with an account or accounts listed in the *Budget of the United States Government: Analytical Perspectives—Supplemental Materials* schedule entitled "*Federal Programs by Agency and Account"* unless the organization is a non-federal organization receiving federal financial assistance**
- **An organization in which the federal government holds a majority ownership interest**
- **An organization that is controlled by the federal government with risk of loss or expectation of benefit**

In addition, the Board is proposing that an organization be included in the government-wide GPFFR if it would be misleading to exclude it even though it does not meet one of the three inclusion principles.

Refer to paragraphs 20-36 of the proposed standards and paragraphs A12- A29 in Appendix A - Basis for Conclusions for a discussion and related explanation.

a. **Do you agree or disagree with each of the inclusion principles? Please provide the rationale for your answer.**

   Disagree. The SEC believes that the first proposed inclusion principle, "included in the *Budget ...* schedule entitled "*Federal Programs by Agency and Account*" ("in the Budget"), appears to have more characteristics of a rule than a principle.

   The proposed standard would rescind paragraph 42 of SFFAC 2 and replace it with what the SEC believes to be a narrower definition of a non-federal entity, with the result that it would appear to become a rule rather than a factor to consider.

   Inclusion or exclusion from the Budget is subject to change and based upon decisions over which FASAB has little or no control and which may be unrelated to the principles upon which FASAB's reporting requirements are based.

   In previous issuances the Board has explicitly not permitted the applicability of reporting requirements to be based upon classifications that are solely under the jurisdiction of other organizations, such as the Treasury Department and/or the Office of Management and Budget (OMB), without regard to FASAB's intent for principle-based reporting requirements.

   For example, the provisions of SFFAS 27 *Identifying and Reporting Funds from Dedicated Collections*, and SFFAS 31, *Reporting on Fiduciary Activities*, support the Board's principle-based requirements by explaining that federal reporting entities should not base their classification and reporting for either (a) funds from dedicated collections or (b) fiduciary activities, respectively, based upon the fund type that is assigned and used for reporting funds to Treasury and/or OMB.

Paragraph 7 of SFFAS 27, (**bold added**) states that:

> The following chart shows fund types used in reporting to the Treasury Financial Management Service (FMS) and the Office of Management and Budget (OMB). It is intended only to show the general relationship between fund groups and [funds from dedicated collections] as classified in this statement. **Regardless of classification for reporting to the Treasury FMS or the OMB, funds meeting the definition of [funds from dedicated collections] promulgated in this standard should be so classified and funds not meeting the definition should not be so classified**.

Similarly, paragraph 7 of SFFAS 31 (**bold added**) states that:

> Numerous "fund groups" are used in reporting to the Treasury FMS and the OMB. For example, "deposit funds" may be used for monies that do not belong to the Federal Government. **Regardless of how a fund group may be classified in reporting to the Treasury FMS or to the OMB, only those activities that meet the definition of fiduciary activity promulgated in this standard are subject to the reporting requirements of this standard.** Activities that do not meet the definition of fiduciary activities promulgated in this standard are not subject to the reporting requirements of this standard. Deposit funds that do not meet the definition of fiduciary activities, and therefore are not disclosed in the fiduciary note disclosure, should be recognized in the principal financial statements.

An example of how the classification of "in the Budget" is subject to change is the status of the Tribal Trust Funds. The Tribal Trust Funds were included in the Budget of the U.S. Government and the Department of the Interior from fiscal year (FY) 1969 through FY 1999, but excluded in fiscal years subsequent to FY 1999. Although the Tribal Trust Funds consist of assets that are owned by private individuals and not by the federal government, the Tribal Trust Funds were nevertheless included in the Budget for a period of 30 years. As noted in the FY 2000 Budget,[1] approximately $2.1 billion in trust funds assets were reclassified in FY 2000 from "on-budget" to "non-budgetary." This change illustrates the risk of using "in the Budget" as a primary principle/rule for FASAB reporting requirements that are intended to be principle-based.

Another example is the Securities Investor Protection Corporation (SIPC), which is currently listed in the SEC's section of the Budget. Throughout SIPC's history, SIPC has been both included and excluded from the Budget. For example, in FY 2007, SIPC's line of credit with Treasury had an account in the Budget. In FY 2008, the line of credit was removed from the Budget and replaced with a paragraph explaining the role of SIPC. In FY 2011, SIPC was included in the Budget, with adjustments going back to FY 2009. We are aware of no substantive legislative changes that might explain these changes.

Accordingly, the SEC believes that "in the Budget" is insufficiently aligned with the other two inclusion principles to be put forth as a primary "principle" but rather should be considered as an indicator of control, and taken into consideration together with other factors.

<u>SEC Recommendation 1(a)</u>: In order to provide for a principle-based standard by which the intent of the Board would be consistently applied in the future, regardless of future classification decisions by organizations other than FASAB, the SEC recommends that:

- paragraph 39 should be deleted

[1] See FY 2000 Budget of the U.S. Governments, Analytical Perspectives, Section 15, Table 15-3.

- being "in the Budget" should be included as an "indicator of control" rather than a primary principle.[2] This would be similar to the way SFFASs 27 and 31 provide that federal reporting entities may consider the "fund type" (such as special fund, trust fund, or deposit fund) when evaluating funds, but the decisive factor for classification should be the application of the principles established by SFFAS 27 and 31. In addition, the SEC believes that this change would be more consistent with existing guidance in SFFAC 2.

- Paragraph 22 should be amended as follows:

An organization with an account or accounts listed in the *Budget of the United States Government: Analytical Perspectives—Supplemental Materials* schedule entitled "Federal Programs by Agency and Account" should be ~~included in the government-wide GPFFR unless it is a non-federal organization receiving federal financial assistance.11 Any listed non-federal organizations receiving federal financial assistance should be~~ assessed against the ~~next~~ following two principles (Majority Ownership Interest and Control with Risk of Loss or Expectation of Benefit) to determine whether they should be included in the government-wide GPFFR.

b. Do you believe the inclusion principles, and the related definitions and indicators, are helpful and clear? Please provide the rationale for your answer.

No. The proposed standards include numerous "pro" and "con" indicators, but neither the proposed standards nor the illustrations in the Appendix provide a clear indication of which factors are or should be selected to be the deciding factor(s) or how to go about making this selection. The only factor given priority ("in the Budget") is a factor that, as mentioned in the response to Q1a, has characteristics of a rule rather than a principle.

The SEC is concerned about being required to include in its financial statements, as basic information subject to audit, financial data for organizations that do not report to the Treasury Department, and which the SEC's auditor (the Government Accountability Office (GAO)) does not currently audit. For example, in the SEC's section of the Budget, there are three organizations, the Public Company Accounting Oversight Board (PCAOB), the "Payment to Standard Setting Body" (currently the Financial Accounting Standards Board (FASB)) and the Securities Investor Protection Corporation (SIPC). Each of these organizations is incorporated as a non-profit organization and issues calendar-year financial statements in accordance with private-sector GAAP.

Because none of these three organizations currently report budgetary data to the Treasury Department or to the Office of Management and Budget (OMB), the Budget includes the following footnote for each of these three organizations: "Because [this organization] does not report budgetary data to the Treasury, budget estimates were derived from [this organization's] financial data."

Using "in the budget" as a primary indicator/rule for inclusion would likely create the presumption that all three organizations should be included, even though other factors would indicate against inclusion, such as the fact that these organizations:

- have assets that do not appear to meet the definition of "assets" in FASAB Statement of Federal Financial Accounting Concepts (SFFAC) 5[3] because they are not

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[2] This edit could be accomplished by changing "three" to "two" and moving 21.a. and adding it to the section on "Indicators for Control" in paragraphs 29-31.
[3] See SFFAC 5, paragraph 18

available for use or sale by the federal government (except for the quasi-federal organization that is holding the assets);

- (if consolidated by a federal component reporting entity), have assets that would not appear to meet the definition of either “entity assets” or “non-entity assets” in Statement of Federal Financial Accounting Standards (SFFAS) 1,[4] relative to the federal component entity, because the assets are neither “available for use” by nor “held by” the federal component entity that would be required to consolidate the quasi-federal entity;

- have liabilities that do not appear to meet the definition of “liabilities” in SFFAC 2 because the liabilities are not guaranteed by the full faith and credit of the federal government and must be liquidated by external revenue sources that are separate and distinct from the federal government’s general tax revenues;

- are funded by exchange revenues that in some cases may be augmented at the discretion of the organization without any Congressional action or approval needed;

- issue audited financial statements prepared in accordance with private-sector generally accepted accounting principles (GAAP) that are publicly available;

- have a fiscal year that is different from the federal government’s fiscal year and are not required to report either September 30 information or transactions that would be considered “intragovernmental” if these organizations were to be considered part of the federal government; and

- have employees that are private-sector employees, not subject to civil service rules or eligible for federal employee retirement programs such as CSRS or FERS.

The proposed standard also does not clearly define “disclosure organization” and “consolidation entity” – in particular, the distinction between the terms “entity” and “organization” (within these phrases, as well as throughout the document). The distinction between the two terms is not explained, and there is no explanation as to why a different term is used for the two types of organizations. Throughout the document, the term “organization” is used most often, but paragraph 38 indicates that some organizations are referred to as “[consolidation] entities,” but paragraphs 38-39 still use the word “organization” but clearly are referring to “consolidation entities.” There is no explanation of why some “organizations” are also “entities,” but others (“disclosure organizations”) apparently are not. The term “organization” should be used consistently throughout the document for everything except for references to a *primary federal reporting entity* (government-wide or component level).

Finally, a definition of “non-federal organization” is necessary for evaluating an organization regarding the “in the Budget” provision, which provides that an organization that is in the Budget should be included, “unless the organization is a non-federal organization receiving federal financial assistance.” However, the proposed definitions do not include a definition of the term “non-federal organization.”

[4] SFFAS 1, paragraph 25 (**bold added**) states that “Entity assets are those assets which the reporting entity **has authority to use in** its operations. Non-entity assets are those assets that are **held by** an entity but are not available to the entity.”

<u>SEC Recommendation 1(b):</u>

As noted in SEC Recommendation 1(a), the SEC believes that “in the budget” should be an indicator of control rather than a rule. The SEC also believes the following indicators should be added after paragraph 32 in the section “Situations Where Control Does Not Exist.:

Examples of characteristics that may indicate a lack of control include but are not limited to:

- The organization’s assets do not meet the definition of federal “assets” in FASAB Statement of Federal Financial Accounting Concepts (SFFAC) 5[5] because they are not available for use or sale by any components of the federal government.
- The organizations assets, if consolidated or combined with the assets of a federal component entity, could not be classified as either “entity assets” or “non-entity assets” as defined in Statement of Federal Financial Accounting Standards (SFFAS) 1,[6] because the organization’s assets are neither “available for use” by nor “held by” the federal entity that would be required to consolidate the other organization’s assets.
- The organization’s liabilities do not meet the definition of “liabilities” in SFFAC 2 because the organization’s liabilities are not guaranteed by the full faith and credit of the federal government and must be liquidated by external revenue sources that are separate and distinct from the federal government’s general tax revenues.
- The organization is funded by exchange revenues that may be augmented at the discretion of the organization without any Congressional action or approval needed.
- The organization is not required to follow the hierarchy of federal GAAP in paragraphs 5-7 of SFFAS 34 and is not currently audited by the Inspector General of any federal entity.
- The organization’s employees are private-sector employees who are not subject to civil service rules or eligible for federal employee retirement programs such as CSRS or FERS. The organization’s employees cannot incur liabilities on behalf of the federal government because legislation provides that they are not authorized to act as employees or agents of the federal government.
- The organization issues audited financial statements prepared in accordance with private-sector generally accepted accounting principles (GAAP) that are publicly available.
- The organization has a fiscal year that is different from the federal government’s fiscal year and does not report either September 30 information or transactions that would be considered “intragovernmental” if the organization was to be considered part of the federal government.

In addition, to address inconsistent use of the terms “entity” and “organization,” that the term “organization” should be used consistently throughout the document for everything except for references to a *primary federal reporting entity* (government-wide or component level) that would be considering whether to include an “organization” in its financial statements. This would include changing “consolidation entity” to “consolidation organization.”

[5] See SFFAC 5, paragraph 18

[6] SFFAS 1, paragraph 25 (**bold added**) states that “Entity assets are those assets which the reporting entity **has authority to use in** its operations. Non-entity assets are those assets that are **held by** an entity but are not available to the entity.”

Finally, in situations where the other organization issues stand-alone audited financial statements in accordance with private-sector GAAP, and may also have a different fiscal year, the federal component entity's auditor may not be willing to rely on the work of the other organization's auditor. In such cases, it would not be cost-beneficial for the component federal entity to engage its auditor to audit or review the other organization's financial records in order to include the required information in its audit opinion. In addition, in situations where the federal reporting entity is not involved in the other organization's day-to-day operations, the federal reporting entity often has no way of knowing whether there may be significant changes in information in the intervening period between the issuance date of the other organization's financial statements and the issuance date of the federal component entity's financial statements. For this reason, the federal component entity's management should only be required to report significant changes that it is aware of. The SEC recommends the following:

- Add the following additional language to Paragraph 73e, (list of required disclosures):

    (e) a discussion of the disclosure organization's key financial indicators and changes in key financial indicators <u>or information, such as a website link, to the disclosure organization's most recent audited financial statements.</u>

- Add the following additional language to paragraph 76:

    <u>If the component entity is aware of</u> significant changes in information occurring from the end of the disclosure organization's reporting period, <u>such changes</u> should be reported consistent with the requirements of SFFAS 39, *Subsequent Events: Codification of Accounting and Financial Reporting Standards Contained in the AICPA Statements on Auditing Standards*.

c. Do you agree or disagree that an organization should be included in the GPFFR if it would be misleading to exclude it even though it does not meet one of the three inclusion principles? Please provide the rationale for your answer.

Disagree. The ED appears to be somewhat biased towards inclusion. Paragraphs 35-36 of the ED and the decision tree in Appendix B provide for "misleading to exclude" but do not provide for "misleading to include." A bias toward inclusion may result in the inclusion (by either consolidation or disclosure) of revenues and assets that are not revenues or assets of the federal government.

<u>SEC Recommendations 1(c):</u> Add paragraphs on "misleading to include" that are parallel to paragraphs 35-36 on "misleading to exclude.". If the decision tree in Appendix B is retained in the final SFFAS, it should be edited to reflect this recommendation.

d. Do you agree the inclusion principles can be applied to all organizations, such as the Federal Reserve System, Federally Funded Research and Development Centers, Government Sponsored Enterprises, museums, and others, to determine whether such organizations should be included in the government-wide GPFFR? Please provide the rationale for your answer.

Disagree. See SEC comments and recommendations in response to Q1a, b, and c.

Q2. The Board proposes distinguishing between two types of organizations in GPFFRs and this distinction will ultimately determine how they are reported: consolidation entities and disclosure

organizations. Consolidation entities generally are (1) financed by taxes or other non-exchange revenue as evidenced by their inclusion in the budget, (2) governed by the Congress and/or the President, (3) imposing or may impose risks and rewards on the federal government, and/or (4) providing goods and services on a non-market basis. In contrast, disclosure organizations are those that (1) receive limited or no funding from general tax revenues, (2) have less direct involvement, and influence, by the Congress and/or the President, (3) impose limited risks and rewards on the federal government, and/or (4) are more likely to provide goods and services on a market basis.

The Board proposes consolidation entities be consolidated in the government-wide financial statements and the information about disclosure organizations be disclosed in notes. The Board also proposes that certain factors and objectives be considered in determining the information about disclosure organizations to be disclosed in notes. The Statement allows flexibility in the information presented as long as the disclosure objectives are met. The Statement also provides examples of information that may meet objectives.

Refer to paragraphs 37- 53 and 64-77 of the proposed standards and paragraphs A30-A54, A62-A63 and A71-A81 in Appendix A - Basis for Conclusions for a discussion and related explanation.

a. **Do you agree or disagree with the concept of distinguishing between consolidation entities and disclosure organizations? Please provide the rationale for your answer.**

Agree with the concept of distinguishing consolidation versus disclosure organizations. However, as noted in the response to Q1 (b), the terms “consolidation entities” and “disclosure organizations” are somewhat confusing. The terms “entity” and “organization” appear to be used inconsistently throughout the ED. The term “organization” is used most often, but paragraph 38 indicates that some organizations are referred to as “[consolidation] entities,” but paragraphs 38-39 still use the word “organization” but clearly are referring to “consolidation entities.” There is no explanation of why some “organizations” are also “entities,” but others (“disclosure organizations”) apparently are not.

SEC Recommendation: that the term “organization” be used consistently throughout the document for everything except for references to a *primary federal reporting entity* (government-wide or component level). This would include changing the term “consolidation entity” to “consolidation organization.”

b. **Do you agree or disagree with the attributes used to make the distinction between consolidation entities and disclosure organizations? Please provide the rationale for your answer and identify additional attributes, if any, that you believe should be considered.**

Disagree. The inclusion principles, in particular for component reporting entities, are confusing and appear to be inconsistent. For example, it is unclear what the standard means by a component entity being “assigned accountability” for another organization. The requirements appear to allow for a category of “disclosure organizations” that are included in a component entity’s section of the Budget, and even included within the component entity’s congressional budget justification (paragraph 57b). However, paragraph 39 and the decision tree in Appendix B appear to indicate that all organizations in the budget must be consolidated, either by a component entity or in the government-wide financial statements. This would create implementation problems if component entities were required to consolidate organizations that do not report in accordance with FASAB requirements, and do not produce a Statement of Budgetary Resources or data in accordance with the United States Standard General Ledger. FASAB requirements for component entities include a reconciliation between budgetary and proprietary account balances; those would be forced out of balance if a federal component entity were to be consolidated with a FASB-GAAP organization. Examples of such FASB-GAAP organizations are the PCAOB and the SIPC, neither of which is included in the SEC's congressional budget justification but both of which are included in the SEC's section of the Budget. It does not appear to be the Board's intent to require the consolidation of such entities. For example, the PCAOB and SIPC receive no funding from general tax revenues, and they impose limited (or no) risks on the federal government because their liabilities are not backed by the full faith and credit of the federal government and must be liquidated by external revenue sources that are separate and distinct from the federal government's general tax revenues. In addition, the reconciliation of budgetary and proprietary balances (originally titled the "Statement of Financing") required by SFFAS 7 would not be possible if a FASB-GAAP organization were to be fully consolidated into a FASAB-GAAP reporting entity.

In addition, the proposed standard would be less cumbersome without the overarching concept of "inclusion" that combines consolidation with disclosure entities. "Consolidation" and "disclosure" are such different reporting treatments that it is hard to see what is gained by combining them into a single category ("apples-oranges") and then separating them out.

> SEC Recommendation: The requirements in the Standards section should be clarified to distinguish between consolidation and disclosure organizations. A clear summary of this distinction is provided in Q2 of the ED, but not in the Proposed Standards section of the ED. The following recommended additional language is adapted from Q2:
>
> > There are two types of organizations in GPFFRs and this distinction ~~will ultimately~~ should determine how they are reported: consolidation entities and disclosure organizations. Consolidation entities generally are (1) financed by taxes or other non-exchange revenue as evidenced by their inclusion in the budget, including a component entity's congressional budget justification, (2) governed by the Congress and/or the President, (3) imposing or may impose risks and rewards on the federal government, and/or (4) providing goods and services on a non-market basis. In contrast, disclosure organizations are those that (1) receive limited or no funding from general tax revenues, (2) have less direct involvement, and influence, by the Congress and/or the President, (3) impose limited risks and rewards on the federal government, and/or (4) are more likely to provide goods and services on a market basis.
>
> Paragraph 39 should be deleted, for reasons explained in the response to Q1a.
>
> In addition, if the decision tree in Appendix B is retained, it should be edited to show that organizations in a component entity's budget may be a disclosure organization (and not automatically a consolidation entity, with no exceptions).
>
> Also, the SEC recommends that the Board should consider simplifying the requirements by addressing consolidation versus disclosure separately from the outset, rather than using the overarching "inclusion" concept which combines two quite dissimilar categories.

Also, two important attributes should be added as indicators that an organization should be disclosed rather than consolidated when the organization's assets and liabilities are not assets or liabilities of the federal government. The SEC recommends that the following two attributes should be added to paragraph 46:

- The organization's assets do not meet the definition of federal "assets" in Statement of Federal Financial Accounting Concepts (SFFAC) 5[7] because they are not available for use or sale by any components of the federal government.

- The organization's liabilities do not meet the definition of "liabilities" in SFFAC 5[8] because the organization's liabilities are not guaranteed by the full faith and credit of the federal government and must be liquidated by the quasi-federal organization's own assets, which are derived from external revenue sources that are separate and distinct from the federal government's general tax revenues. The organization's employees cannot incur liabilities on behalf of the federal government because legislation provides that they are not authorized to act as employees or agents of the federal government.

c. Do you agree or disagree that, assuming the organizations are determined to be organizations included in the GPFFRs, the attributes are adequate to make a determination of whether organizations such as the Federal Reserve System, Federally Funded Research and Development Centers, museums, and others are consolidation entities or disclosure organizations? Please provide the rationale for your answer and identify any organizations you believe the attributes could not be adequately applied to, and additional attributes, if any, you believe are needed to address these organizations.

Disagree. See recommended additional attributes in response to Q2b above.

d. Do you agree or disagree with:

i. the factors to be considered in making judgments about the extent of appropriate disclosures (see par. 69),

Disagree. Factor 69(c) states that:

> <u>Disclosure organization views/perspective</u> – Information about how the disclosure organization views its relationship with the federal government. For example, whether the disclosure organization views itself as an extension of the federal government or operationally independent of the Congress and/or the President may influence the type and extent of information that is disclosed.

However, the nature of this "influence" upon the type and extent of information disclosed is not specified. An example would greatly assist federal preparers to determine appropriate reporting for such situations. Recommend that this be clarified by adding additional language to provide an example; see SEC recommendation below.

<u>SEC Recommendation</u>: Consider adding the following additional language to paragraph 69c:

> <u>For example, in situations where the organization views itself as operationally independent of Congress and/or the President, and issues stand-alone audited financial statements available to the public, information on how to obtain the organization's audited financial statements may be provided in lieu of disclosures of quantitative financial data relating to the organization.</u>

[7] SFFAC 5, paragraph 18 states that: "An asset is a resource that embodies economic benefits or services that the federal government controls."

[8] SFFAC 5, paragraph 39 states that: "A liability is a present obligation of the federal government to provide assets or services to another entity at a determinable date, when a specified event occurs, or on demand."

ii. the objectives for disclosures (see par. 72), and

Agree. The objectives would provide information useful to financial statement readers.

iii. the examples provided (see par. 73)?

Disagree with one of the examples. Example 73e provides this example:

> e. A discussion of the disclosure organization's key financial indicators and changes in key financial indicators

Example 73d clarifies that the disclosure should focus on the impact of transactions with the disclosure organization and how those transactions impacted the assets, liabilities, expenses, gains and losses of the federal reporting entity.

In contrast, example 73e appears to focus on the assets, liabilities, expenses, gains and losses of the disclosure organization, and does not appear to support any of the three objectives listed in paragraph 72. This problem also applies to paragraphs 74, 75, and 76, which discuss the presentation of financial information for the disclosure entity.

Also, in situations where the federal reporting entity is not involved in the other organization's day-to-day operations, the federal reporting entity's management may not have direct knowledge of whether there may be significant changes in information in the intervening period between the issuance date of the other organization's financial statements and the issuance date of the federal component entity's financial statements. For this reason, the federal component entity's management should only be required to report significant changes that it is aware of.

<u>SEC Recommendation</u>:

a. delete the requirement to report financial data for disclosure organizations, by deleting example 73e as well as paragraphs 74-76 (recommended).

b. Add the following additional language to paragraph 76:
<u>If the component entity is aware of</u> significant changes in information occurring from the end of the disclosure organization's reporting period<u>, such changes</u> should be reported consistent with the requirements of SFFAS 39, *Subsequent Events: Codification of Accounting and Financial Reporting Standards Contained in the AICPA Statements on Auditing Standards*.

Please provide the rationale for your answers.

Q3. The Board proposes each component reporting entity report in its GPFFR organizations for which it is accountable; that includes consolidation entities and disclosure organizations administratively assigned to it. Administrative assignments can be identified by evaluating:

- **the scope of the budget process,**
- **whether accountability is established within a component reporting entity, or**

- **rare instances of other significant relationships such that it may be misleading to exclude an organization not administratively assigned based on the previous two principles.**

The Board recognizes that in rare instances it also may be misleading to include an organization that is administratively assigned to a reporting entity based on the above principles. In such cases, the organization may be excluded.

Refer to paragraphs 54-63 of the proposed standards and paragraphs A55-A61 in Appendix A - Basis for Conclusions for a discussion and related explanation.

a. **Do you agree or disagree that each component reporting entity should report in its GPFFR organizations for which it is accountable, which includes consolidation entities and disclosure organizations administratively assigned to it? Please provide the rationale for your answers.**

Disagree, because there may be instances where an organization does meet one or more inclusion principles but would be misleading to include.

Paragraphs 61 and 62 state that there may be instances where the component entity's financial statements would be "misleading" if the principles in this proposed standard were followed. Although the desire to cover unanticipated future situations is understandable, the purpose of a principle-based standard is to provide principles that should be followed in all known instances. Providing an exception for a broad and undefined reason ("misleading") with no supporting principles or examples would primarily have the effect of creating long-term controversy between preparers and auditors about whether or not the principles in the proposed standard should actually be followed. If there are future unanticipated situations, they should be addressed as such situations have been in the past - by implementation guidance and/or amending the standards.

<u>SEC Recommendation</u>: Recommend that paragraph 56 be edited to delete 56c ("misleading to exclude and/or misleading to exclude"), and that paragraphs 61 and 62 be deleted.

b. **Do you agree or disagree that administrative assignments can be identified as provided in paragraphs 54-63? Please provide the rationale for your answers.**

Disagree, because of the broad exception on "misleading to exclude/misleading to include" with no supporting principles or examples in paragraphs 62-63. See response to Q3a above for rationale.

<u>SEC Recommendation</u>: Recommend that paragraph 56 be edited to delete 56c ("misleading to exclude and/or misleading to exclude"), and that paragraphs 61 and 62 be deleted.

Q4. The Statement provides for each reporting entity (the government-wide and component reporting entities) to consolidate financial information for all consolidation entities for which it is accountable without regard to funding source (for example, appropriations or donations). For certain organizations, such as museums and performing arts organizations, this may lead to consolidating funds from sources such as donations that are presently not consolidated in the government-wide GPFFR.

Refer to paragraphs 54-64 of the proposed standards and paragraph A19 in Appendix A - Basis for Conclusions for a discussion and related explanation.

Do you agree or disagree that each component reporting entity (for example, museums) and the government-wide reporting entity should consolidate in their entirety organizations for which it is accountable without regard to funding source, including those receiving appropriations and donations? Please provide the rationale for your answers.

Disagree. This would result in reporting that presents a commingling of the federal government's resources with inflows that do not belong to the federal government. For example, donations to non-profit organizations such as museums generally cannot be used for purposes other than the purposes indicated by the donor; if the donated funds cannot be used for the specified purpose, the donated funds must be returned to the donor. Donations to non-profit organizations such as museums generally would not meet the definition of "revenues" in SFFAS 5[9] because such donated funds cannot by law increase the net position of the federal government. Because of this, it would be misleading to commingle or combine donations to non-profit organizations with tax and other revenues of the federal government.

SEC recommendation: Revenues such as donations to non-profit organizations such as museums currently should not be consolidated in the federal government's financial statements because they do not meet the definition of "revenues" in SFFAS 5. The proposed new requirements should not include any provisions that would be inconsistent with SFFAS 5. This could be explicitly stated in a new footnote, perhaps to paragraph 54 of the ED:

> "Assets, liabilities and revenues that do not meet the definition of assets, liabilities and revenues in SFFAS 5 should not be consolidated in the financial statements of the federal government-wide reporting entity or any federal component entity."

Q5. For consolidation entities, the Statement proposes that FASAB and Financial Accounting Standards Board (FASB) based information should be consolidated without conversion of FASB-based information to a FASAB basis.

Refer to paragraphs 65- 66 of the proposed standards and paragraphs A66-A70 in Appendix A - Basis for Conclusions for a discussion and related explanation.

Do you agree or disagree that consolidation of FASAB and FASB based information without conversion for consolidation entities is appropriate? Please provide the rationale for your answers.

Disagree. The consolidation of FASB-based information into a component entity financial statement is likely to be unachievable because federal component entities are required to prepare a Statement of Budgetary Resources and a footnote that reconciles its budgetary and proprietary information. FASB-based financial statements do not include a Statement of Budgetary Resources or other budget-related classifications required for federal reporting entities, such as which of its expenses are "future funded" and which of its liabilities are "covered or not covered" by budgetary resources. Because of this, if FASB-based financial information were consolidated with FASAB-based information, the component entity's required reconciliation of budgetary and proprietary data would likely be forced out of balance.

The consolidation of mixed-basis data would also likely create technical problems for component-level reporting to Treasury because FASB-based organizations are not required to use the U.S. Standard

[9] Paragraph 52 of SFFAS 5 states that: "A revenue is an inflow of or other increase in assets, a decrease in liabilities, or a combination of both that results in an increase in the government's net position during the reporting period."

General Ledger chart of accounts with required account attributes that Treasury needs in order to prepare the consolidated government-wide financial statements.

The component entity's USSGL-compliant trial balances are currently required to fully support the component entity's audited financial statements; this would not be possible with mixed-basis component-level financial statements because the FASB-basis data would not have sufficient information for USSGL-compliant trial balances. In addition, certain relationships between budgetary and proprietary information (edit check known as "tie points" are required for reporting to Treasury. Those relationships would almost certainly be forced out of balance if FASB-basis data is consolidated with FASAB-basis data.

If the proposed standard results in numerous organizations newly classified as part of the federal government, this would likely also create challenges for Treasury regarding intragovernmental eliminations and reporting on debt held by the public versus intra-governmental debt.

Other implementation difficulties would include differences in fiscal year-end, because many FASB-based entities report on a calendar-year basis. It would be inappropriate to consolidate stale data with more current data into financial statements, because the title of the financial statements ("as of" and "for the period ended") would be inaccurate and hence misleading. However, reliable and timely data is generally not available from organizations that to prepare financial statements on a calendar year, and/or available timely enough to be included in the component entity's audited statements and notes.

Q6. Central banking (through the Federal Reserve System) is a unique federal responsibility with distinctive characteristics. The proposed standards do not specify that the central banking system be included in GPFFRs or whether, if included, it would be classified as a consolidation entity or a disclosure organization. Because of the unique nature and magnitude of central banking transactions, and the fact there is only one organization of this type, the Board proposes certain minimum disclosures regarding the central banking system. These disclosures would be required in addition to any other reporting requirements regarding the central banking system. The information should be disclosed in the government-wide GPFFR and the GPFFR of any reporting entity to which it may be primarily associated with or administratively assigned. Depending on the circumstances, some of the minimum disclosures may have been addressed in other requirements. The resultant disclosures should be integrated so that concise, meaningful, and transparent information is provided and information is not repetitive.

Refer to paragraph 77 of the proposed standards and paragraphs A30-A37 in Appendix A - Basis for Conclusions for a discussion and related explanation.

a. **Do you agree or disagree with the minimum disclosures for the central banking system or believe there are additional disclosures that should be considered? Please provide the rationale for your answer.**

   The SEC has no objections to the proposed minimum disclosures.

b. **Do you believe there are other significant organizations for which minimum disclosures should be made? Please specify which entities, if any, and the nature of disclosures and provide the rationale for your answer.**

   The SEC is not aware of any other significant organizations for which minimum disclosure should be made.

Q7. The Board proposes a definition of related parties and disclosures for related parties where the relationship is of such significance that it would be misleading to exclude disclosures about the relationship. The proposal also provides a list of the types of organizations that generally would or would not be considered related parties.

Refer to paragraphs 78 -87 of the proposed standards and paragraphs A82-A84 in Appendix A – Basis for Conclusions for a discussion and related explanation.

a. **Do you agree or disagree with the related parties definition and requirements? Please provide the rationale for your answer.**

Agree, except for question in Q7c below.

b. **Do you agree or disagree with the list of the types of organizations that generally would be considered related parties? Please provide the rationale for your answer.**

Agree, except for the question in Q7c below.

c. **Are there additional organizations that generally should be considered related parties? Please provide the rationale for your answer.**

Yes. It would be helpful if this section could address factors to consider regarding whether non-federal organizations receiving federal financial assistance (which are excluded from the inclusion principles in paragraph 22) might be considered related parties.

d. **Do you agree or disagree with the list of exclusions? Please provide the rationale for your answer.**

Agree. The individuals and organizations listed should not be considered related parties.

e. **Are there additional exclusions that should be considered? Please provide the rationale for your answer.**

The SEC is not aware of any significant omissions from the list.

Q8. The Board proposes conforming changes to Statement of Federal Financial Accounting Concepts (SFFAC) 2, *Entity and Display,* to rescind or amend language to remove criteria for determining what organizations are required to be included in a federal reporting entity's GPFFR from the concepts statement because criteria will be in a statement of federal financial accounting standards. Refer to paragraphs 88-101 of the proposed standards and paragraphs A85-A88 in Appendix A - Basis for Conclusions for a discussion and related explanation.

Do you agree or disagree with the conforming changes to SFFAC 2? Please provide the rationale for your answer.

Disagree. The proposed standard would rescind paragraph 42 of SFFAC 2 and replace it with what the SEC believes to be a narrower definition of a non-federal entity. Paragraph 42 of SFFAC 2 states that: "This does not mean, however, that an appropriation that finances a subsidy to a non-Federal entity would, by itself, require the recipient to be included in the financial statements of the organization or program that expends the appropriation." However, paragraphs 22 and 39 and footnote 11 of the ED refer to federal financial assistance as defined by the Single Audit Act; this implies that organizations must be subject to the Single Audit Act in order to qualify for the exemption currently in paragraph 42 of SFFAC 2.

Also, the SEC disagrees with inconsistent use of the terms "organization" and "entity." For example, in this ED, the terms "consolidation entity" and "disclosure organization" are used. However, in paragraph 100 of the ED, proposed new paragraph 53A refers to the federal governments as an "organization" and proposed new paragraph 53B uses the term "disclosure entity." (This was also noted in SEC response to Q1b and Q2a.)

SEC Recommendation:

The SEC recommends that paragraphs 22 and 39 be deleted and that being "in the budget" should be included only a one indicator of control. The passage referring to non-federal entities listed in the budget should retain the same language as paragraph 42 of SFFAC 2.

Also, to address inconsistent use of the terms "entity" and "organization," the term "organization" should be used consistently throughout the document, including conforming changes to SFFAC 2, for everything except for references to a primary federal reporting entity (government-wide or component level) that would be reporting on an organization.

Q9. The Board proposes the Statement and Amendments to SFFAC 2, *Entity and Display,* be effective for periods beginning after September 30, 2016. Refer to paragraph 102 of the proposed standards.

Do you agree or disagree with this effective date? Please provide the rationale for your answer.

Agree, provided that the SEC's concerns in Q1, Q3, and Q5 are addressed.

Q10. The Statement provides two non-authoritative appendices to assist users in the application of the proposed standards. The Flowchart at Appendix B is a tool that can be used in applying the principles established. The Illustrations at Appendix C offer hypothetical examples that may be useful in understanding the application of the standards.

Refer to Appendix B-Flowchart and Appendix C-Illustration.

a. Do you agree the appendices are helpful in the application of the proposed standards?

- Agree that Appendix B could be helpful, except for recommended edits described in response to Q 1c and as follows: The decision tree appears to indicate that all organizations in the budget must be consolidated, either by a component entity or in the government-wide financial statements. The text of the proposed standard and Q2 indicate that this is not accurate. Accordingly, Appendix B should be edited to more accurately reflect the proposed requirements.
- Disagree for Appendix C.

Reason: Appendix B, with the recommended edits described in response to Q1c, provides a summary decision tree that would be useful for preparers. The recommended edit is that the potential decision of "misleading to exclude" should be deleted. The rationale for this is explained in the SEC's response to Q1c and Q3a.

Appendix C does not provide useful implementation guidance because it does not explain which factors were selected as the deciding factors, and why. The explanations imply that factors not mentioned could have been the deciding factors. (Illustrative "tentative conclusions" in Appendix C generally stated that "Management determined and the auditor concurred that, based on the assumed facts and circumstances as well as other considerations not described in the illustration, it would not be misleading to [include/exclude] organization XX.") For this reason, the illustrations in Appendix C do not provide useful implementation guidance.

SEC Recommendation: Retain Appendix B (with recommended edits) but not Appendix C in the final standard.

b. Do you believe the appendices should remain after the Statement is issued?

SEC Recommendation: Agree for Appendix B (with edit described in (a) above); Disagree for Appendix C. See response to Q10a for rationale.

c. Do you believe there should be any changes or additional examples regarding the illustrations that would be useful in understanding the application of the standards? Please provide rationale to support your answer.

No. See explanation in response to Q10a above.

SEC Recommendation: It would be impractical to change Appendix C so that each example spelled out the factor or factors that were considered decisive. Instead, Appendix C should not remain when the Statement is issued.

Q11. Are there other unique situations that should be addressed within this Statement? Please explain fully and also how the situation is not addressed by this Statement when considered in its entirety.

The proposed SFFAS lists a large number of indicators/factors both for and against inclusion, and for and against consolidation. As a result, considerable future resources will likely be expended as federal component entities and their auditors debate which factors should be considered decisive for a large number of organizations, most of which are immaterial for the government-wide GPFFR.

The proposed standard indicates that legislation should not determine inclusion or exclusion (paragraph 4). It is difficult to imagine what could be more authoritative information on the nature of an organization than the legislation that established the organization or authorizes its activities. Entities carrying out governmental functions generally may do so only to the extent authorized by legislation. If the organization's activities are beyond the scope authorized, that raises legal issues regarding governmental responsibility for its actions. Meanwhile, much larger organizations, such as most of the Legislative and Judicial branches of the federal government, are not included in the government-wide GPFFR. This material omission is not mentioned in the proposed standard; it is only mentioned in the Basis for Conclusions, which may or may not be retained in the final standard.

The SEC also questions whether it is cost-beneficial for federal entities to expend increasingly scarce resources evaluating and defending decisions on the inclusion/exclusion of reporting on relatively immaterial organizations.

SEC Recommendation:

In order to avoid expending increasingly scarce resources addressing the pros and cons of reporting relatively immaterial organizations, the SEC recommends a more cost-beneficial approach by making the following edits:

(a) Moving the discussion of the Legislative and Judicial branches from the Basis for Conclusions in paragraph A13 to the Introduction, just before paragraph 4, and change "would" to "should,"

(b) Incorporating existing paragraph 42 of SFFAC 2 into the proposed new SFFAS without change and without an added reference to the Single Audit Act as an indicator of control, and

(c) Making paragraph 4 less biased toward inclusion of numerous immaterial organizations by deleting the following sentence:

Even in cases where legislation indicates an organization is “not an agency or instrumentality” of the federal government, the organization should be assessed against the guidance contained in this Statement to determine whether it should be included in the reporting entity’s GPFFR..

Q12. One member has an alternative view regarding receiverships, conservatorships, and interventions. The Board member does not believe receiverships, conservatorships, and intervention organizations should be equated with other disclosure organizations. He believes guidance in the proposed standards gives the impression that these organizations are part of the federal government. Further, he believes all types of interventions should be addressed in the Board’s project on risk assumed.

The other members believe the proposed standards appropriately distinguish between consolidation entities and disclosure organizations including receiverships, conservatorships, and interventions resulting in ownership or control. The Board deliberated alternatives regarding such organizations, including creating an “exception” similar to the approach taken in SFFAC 2, but determined an exception would be rules-based rather than principles-based. Such an exception would require more detailed guidance, or “rules,” to aid in determining whether ownership or control of such organizations is expected or intended to be permanent.

Instead, the proposed standards establish principles for when relationships with organizations create a need for accountability, and how information should be included in GPFFRs. The Board believes it is important to address these relationship matters in a single Statement of Federal Financial Accounting Standards and has not proposed exceptions. The Board also addresses in this proposed Statement whether organizations are required to apply the GAAP hierarchy for federal reporting entities. Disclosure organizations are not required to apply the GAAP hierarchy for federal reporting entities and this should avoid giving the impression that all disclosure organizations included in GPFFRs are federal reporting entities or “part of the federal government.” To further avoid giving this impression, the Board clarified that it is not the purpose of this Statement of Federal Financial Accounting Standards to assist in determining what entities are “part of the federal government” for legal or political purposes.

Refer to paragraphs 7, 13-14, 41, 49-53, and 65 of the proposed standards and paragraphs A1-A2, A9-A11, A20-A23, A30-A31, A44-A54, and A89-A93 in Appendix A – Basis for Conclusions for a discussion and related explanation.

a. **Do you agree or disagree with the alternative view that the proposed standards should not equate receiverships, conservatorships, and interventions with other disclosure organizations to avoid an inference that they are part of the Federal government? Please provide the rationale for your answer.**

   The SEC has no comment.

b. **Do you agree or disagree with the alternative view that the guidance for all interventions, regardless of type, should be presented in a single Statement of Federal Financial Accounting Standard? Please provide the rationale for your answer.**

   The SEC has no comment.