



July 18, 2013

Memorandum

To: Members of the Board

From: Melissa L Loughan, Assistant Director

Wendy M. Payne

Through: Wendy M. Payne, Executive Director

Subj: **Reporting Entity Comment Letters¹**

OBJECTIVE

To provide the Board with a copy of the responses to the exposure draft, *Reporting Entity* received through July 16, 2013.

MATERIAL

As you are aware, the comment letters are available in electronic form on the website at <http://fasab.gov/board-activities/documents-for-comment/exposure-drafts-and-documents-for-comment/reporting-entity/>. However, staff thought providing a bound copy of all the letters in advance of the briefing materials would also be beneficial. Staff anticipates at least four more comment letters, but could not be certain as to what date.

NEXT STEPS

A public hearing has been scheduled in conjunction with the August 28, 2013 Board meeting. Staff will provide Board members with additional analysis of the comment letters and information about the public hearing.

Please contact me by telephone at 202-512-5976 or by e-mail at loughanm@fasab.gov if you have any questions.

¹ 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.



Federal Accounting Standards Advisory Board

REPORTING ENTITY

Statement of Federal Financial Accounting Standards

Exposure Draft

Written comments RECEIVED THROUGH July 16, 2013

Reporting Entity

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Appendix – Reporting Entity Exposure Draft



Pension Benefit Guaranty Corporation
1200 K Street, N.W., Washington, D.C. 20005-4026

May 7, 2013

VIA: Electronic Mail

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:

The Pension Benefit Guaranty Corporation ("PBGC") appreciates the opportunity to provide comments on the Federal Accounting Standards Advisory Board's (FASAB) Exposure Draft for a proposed Statement of Federal Financial Accounting Standards addressing the *Reporting Entity*. We have no comments for questions 1, 2, 4, and 6 – 12; however, we do want to take this opportunity to comment on questions 3 and 5, as follows.

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.

Questions:

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

Response:

Since PBGC is not a component reporting entity, we have no comment for the first question included in Q3. For the second question in Q3, we agree with the proposed standards' provision to exclude consolidation entities from component reporting entity reports when inclusion would be misleading, as discussed in Paragraphs 62 - 63. PBGC is an example for this exclusion provision. PBGC was legally established as a United States Government owned and self-financed Corporation, and administratively assigned to the Department of Labor (DOL). PBGC was authorized to operate independently, i.e., administered by a Director appointed by the President and confirmed by the Senate. In addition, PBGC has a Board of Directors consisting of the Secretary of Labor, the Secretary of the Treasury, and the Secretary of Commerce. PBGC prepares its own audited financial statements under the Government Corporation Control Act (59 Stat. 597, codified at 31 U.S.C. § 9101 et. seq.), and also submits financial data directly to the Department of the Treasury for the Financial Report of the United States Government. Accordingly, the consolidation of PBGC's financial results and operations with the DOL's General Purpose Federal Financial Reports would not be useful and would only mislead users of the DOL and PBGC financial statements.

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.

Question:

- 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.

#1

Ms. Wendy M. Payne, Executive Director
Federal Accounting Standards Advisory Board

Patricia Kelly
Rebecca Batts

Preparer
Auditor

Response:

We disagree that consolidation of FASAB and FASB based information without conversion for consolidation entities is appropriate.

PBGC applies FASB GAAP for financial statement reporting, and provides intra-governmental FASB to FASAB conversion information with its Government-wide Financial Report System (GFRS) closing package.

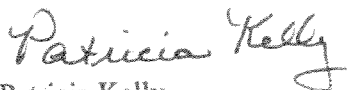
The proposed standard in the Exposure Draft would require PBGC to provide intra-governmental FASB to FASAB conversion information with its own standalone financial statements. PBGC's financial statement users expect and understand FASB GAAP, and will not likely understand or use this FASB to FASAB conversion information. Further, the FASB to FASAB conversion information amounts would likely be material to PBGC's standalone financial statements.

As noted by the majority of the FASAB members who commented on this issue at the June 27, 2012 meeting, any requirement to provide conversion information with the standalone entity's financial statements would not be necessary if conversion information was provided in the closing package.

Accordingly, we recommend the continuation of our current practice to provide intra-governmental FASB to FASAB conversion information with the GFRS closing package.

Thank you for your continuing interest in this area of great importance to the future of PBGC and government-wide financial statement reporting.

Sincerely,



Patricia Kelly
Chief Financial Officer
Pension Benefit Guaranty Corporation



Rebecca Anne Batts
Inspector General
Pension Benefit Guaranty Corporation

US Holocaust Memorial Museum Response to Question 4:

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.

Response to Q4.

I disagree that each component reporting entity and the government-wide reporting entity should consolidate in their entirety organizations for which it is accountable without regard to funding source. It would be misleading to the readers of the report to include non-federal funding to a government-wide report. These funds are not budgeted, owned or controlled by the federal government. Donations are not appropriated funds and are governed by the donor and not the federal government. The activities that they fund may not be tax payer supported. In addition, there are other laws that govern tax exempt, non-profit organizations. It would be more appropriate to footnote information about the non-federal funds in the government-wide general purpose federal financial report.

Reporting Entity

Please submit to fasab@fasab.gov

Name of Respondent: William Joe, on behalf of

Organization: Chief Financial Officer Organization, U.S. Office of Personnel Management

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.** Agree. Each of the inclusion principles provides a basis for an organization to 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.** Yes, we believe the inclusion principles, and the related definitions and indicators, are helpful and clear. They cover the key scenarios.
- 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.** Agree, in that the GPFFR would not be reliable if excluded. Completeness is important.
- 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.** Agree. Each of the inclusion principles provides guidance for determining whether an organization should be included in the government-wide GPFFR. The inclusion principles are comprehensive.

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.

1. **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 between consolidation entities and disclosure organizations. Disclosure organizations enable complete or full disclosure of information to be provided in federal financial reports.
2. **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.** Agree with the attributes used to make the distinction between consolidation entities and disclosure organizations.
1. **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.** Agree that, assuming the organizations are determined to be organizations included in the GPFFRs, the attributes are adequate to make a determination of whether organizations are consolidation entities or disclosure organizations. The attributes for consolidation entities: (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 are all keys for federal government entities.
- 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), Agree.**
- ii. **the objectives for disclosures (see par. 72), Agree.**
- iii. **the examples provided (see par. 73)? Agree.**

Please provide the rationale for your answers. The factors in determining disclosures are comprehensive and appear to support SFFAC 1.

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.** Agree, as each GPFFR will be reliable.
- 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.** Agree, administrative assignments can be identified per the guidance provided in paragraphs 54-63. The criteria appear to be appropriate and comprehensive.

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- 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. Agree that each component reporting entity and the government-wide reporting entity should consolidate in their entirety organizations for which it is accountable without regard to funding source. The funding enables entities to carry out their mission and provide services.

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. Agree that consolidation of FASAB and FASB based information without conversion for consolidation entities is appropriate, per SFFAS 34. The disclosure of intragovernmental amounts facilitates any elimination entries required.

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.** Agree with the minimum disclosures for the central banking system.
- 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.** N/A.

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 with the related parties definition and requirements.
- 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 with the list of the types of organizations that generally would be considered related parties.
- c. **Are there additional organizations that generally should be considered related parties? Please provide the rationale for your answer.** N/A.
- d. **Do you agree or disagree with the list of exclusions? Please provide the rationale for your answer.** Agree with the list of exclusions.
- e. **Are there additional exclusions that should be considered? Please provide the rationale for your answer.** N/A.

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. Agree with the conforming changes to SFFAC 2.

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 with this effective date.

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 the appendices are helpful in the application of the proposed standards.
- b. **Do you believe the appendices should remain after the Statement is issued?** Yes. The guidance will assist entities in adopting the new standard.

- 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. The summary chart in Appendix C appears to be excellent.

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. N/A.

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.** Disagree with the alternative view that the proposed standards should not equate receiverships, conservatorships, and interventions with other disclosure organizations. Believe the proposed standards appropriately distinguish between consolidation entities and disclosure organizations including receiverships, conservatorships, and interventions resulting in ownership or control; as they are not consolidated into a federal reporting

entity's financial report, and the disclosure can use language to make it clear that they are not part of the Federal Government.

- 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.** Disagree with the alternative view. The proposed standards establish principles for when relationships with organizations create a need for accountability, and how information should be included in GPFFRs. This proposed Statement also addresses whether organizations are required to apply the GAAP hierarchy for federal reporting entities, and it was 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.

**UNITED STATES POSTAL SERVICE
OFFICE OF INSPECTOR GENERAL**

**COMMENTS ON THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD'S
PROPOSED STATEMENT ENTITLED *REPORTING ENTITY***

The U.S. Postal Service Office of Inspector General appreciates the opportunity to comment on the Federal Accounting Standards Advisory Board's (FASAB) proposed Statement of Federal Financial Accounting Standards entitled *Reporting Entity*.

We reviewed the exposure draft and addressed question 5 in the document. We do not disagree with the remainder of the proposed Statement or have any suggestions for improving the text. The question, as shown in the exposure draft, is listed below, followed by our response.

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

We agree with the FASAB's proposal that consolidation of FASAB and FASB based information without conversion is appropriate. The proposal is consistent with the FASAB's prior position on the matter.¹ Further, with respect to the Postal Service financial statements prepared in accordance with FASB standards, the FASAB standards have not had a material effect regarding changes prior to submitting financial information to the U.S. Department of the Treasury (Treasury) for the consolidated government-wide financial statements.

We noted paragraph 66 necessitates a component entity using FASB based information to disclose intragovernmental amounts measured in amounts in accordance with federal accounting financial standards to facilitate elimination entries in the government-wide financial statements. We believe this is an unnecessary condition. First, it results in financial statements presented with two accounting standards and, despite accompanying explanations, can be confusing to a reader. Also, after fiscal year end, federal entities must submit financial information to Treasury for the consolidated government-wide financial statements. The financial information must identify intragovernmental amounts, thus supplanting the need for entities using FASB based information to identify such amounts in their published financial reports.

¹ Statement of Federal Financial Accounting Standards 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*.

With implementation of this standard, there could exist a future conflict between it and Treasury's requisite. In recent years, the Treasury Financial Manual² has required agencies using FASB based accounting standards to convert to FASAB based standards prior to submitting financial information for consolidation in the government-wide financial statements. Should Treasury's requirement remain, the conflicting positions would need resolution. Various federal agencies, including the FASAB, might need to discuss and resolve the opposing requirements in favor of the proposed Statement.

Thank you for considering our input.

² | TFM 2-4700, Agency Reporting Requirements for the *Financial Report of the United States Government*, Subsection 4705.25.



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June 25, 2013

BY ELECTRONIC MAIL
(fasab@fasab.gov)

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

RE: Statement of Federal Financial Accounting Standards Exposure Draft

Dear Ms. Payne:

Thank you for the opportunity to share with the Federal Accounting Standards Advisory Board ("FASAB") the views of the Securities Investor Protection Corporation ("SIPC") with regard to the Statement of Federal Financial Accounting Standards Exposure Draft (the "Draft"). Having considered the issue, we respectfully submit the following comments to Questions 1a and 1b. In addition, SIPC understands that the Securities and Exchange Commission ("SEC" or "Commission") will file comments disagreeing with certain principles in the Draft, and SIPC joins in the Commission's opposition to those principles.

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.

Ms. Wendy M. Payne
June 25, 2013
Page 2

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.

SIPC Response: Disagree. SIPC believes that its inclusion in the Budget should not be used as a factor to determine whether SIPC should be included in the government-wide general purpose federal financial report (“GPFFR”).

Congress enacted the Securities Investor Protection Act, 15 U.S.C. § 78aaa *et seq.* (“SIPA”), in 1970 in reaction to a crisis of confidence in the securities industry. SIPA established SIPC as a non-governmental and non-profit corporation whose membership would consist of registered securities broker-dealers. *See* SIPA § 78ccc(a)(2)(A). SIPC’s main function is the protection of customers of failed securities broker-dealers that are members of SIPC and that are in liquidation under SIPA. Among other things, SIPC oversees the administration of the liquidation proceeding and provides funding, as needed, for the administrative expenses of the proceedings and, within limits, for the satisfaction of customer claims. SIPC’s funding derives from a Fund that SIPC administers and that is comprised of assessments paid to it by its members and amounts generated from investment of the Fund. SIPA § 78ddd(c). The amount of the assessments that broker-dealers pay is based on rates that are set under SIPC bylaw and that have varied over time as a result of the amount of the Fund and the applicable target limit of the Fund, also set by SIPC bylaw. SIPA § 78ddd(c)(2).

At present, the SIPC Fund stands at approximately \$1.85 billion. The SIPC Fund is not held at the Department of the Treasury (“Treasury”), and the Treasury has no control over or access to the SIPC Fund. The Fund is used solely for SIPA liquidation proceedings and to support SIPC’s operational costs. *See* SIPA § 78ddd(a)(1). Should the Fund become insufficient to carry out the purposes of SIPA, the SEC may make a loan to SIPC through notes issued to the Treasury of up to \$2.5 billion. *See* SIPA § 78ddd(g), (h). In SIPC’s 43 year history, the Fund level has never dropped so low as to require a borrowing from the Treasury. As stated in the Budget, “the Budget does not project that SIPC will require use of these loans over the next ten years.” *See* Office of Mgmt. & Budget, Exec. Office of the President, Budget of the United States Government, Fiscal Year 2013 (2012) (“Budget”) at 1407.

Throughout SIPC’s history, SIPC has been both excluded and included in the Appendix of 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, the SIPC Fund was included as an account in the Budget, with adjustments going back to FY 2009. As far as SIPC is aware, no legislative changes in those years led to these changes of treatment.

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

Ms. Wendy M. Payne

June 25, 2013


Page 3

SIPC Response: Disagree. Consolidation of a non-governmental private sector entity's financial statements into an agency's financial statements would be difficult when (1) the non-governmental entity's financial statements are issued on a calendar year basis and not on the government's fiscal year; and (2) the non-governmental entity's financial statements are subject to an independent audit in accordance with private sector GAAP. For example, Congress expressly granted to SIPC the power to establish its fiscal year, which, by SIPC bylaw, is the calendar year in accordance with private-sector GAAP. SIPA § 78ccc(b)(9). SIPC's standalone financial statements are audited in accordance with private sector GAAP by an independent auditor. The SEC is not involved in the day-to-day operation of SIPC. Thus, it would create a high burden on the SEC and its auditor to include SIPC's financial statements within its own. Among other things, the SEC would have to reconcile any issues arising from the SIPC fiscal year difference. As the SEC points out in its comments, it is unlikely that the Commission's auditor (the General Accountability Office) would be willing to rely on the work of SIPC's independent auditor, adding work for its auditor and subjecting SIPC to another layer of audit.

We welcome the opportunity to provide FASAB with any additional information that it requires. Please feel free to contact SIPC President Stephen P. Harbeck, myself, or Assistant General Counsel Lauren Attard. Each of us can be reached at 202-371-8300.

Thank you for your consideration.

Very truly yours,



Joseph S. Furr, Jr.
Vice President - Finance

JF/kew

cc: Stephen P. Harbeck, President, SIPC
Lauren T. Attard, Esq.
Kenneth A. Johnson, Chief Financial Officer, SEC (by e-mail)
Caryn Kauffmann, Deputy Chief Financial Officer, SEC (by e-mail)



UNITED STATES DEPARTMENT OF COMMERCE
Chief Financial Officer and
Assistant Secretary for Administration
Washington, D.C. 20230

Wendy M. Payne
Executive Director
Federal Accounting Standards Advisory Board
Washington, DC

Dear Ms. Payne:

The Department of Commerce has reviewed the Exposure Draft, *Reporting Entity*, dated April 2, 2013. If you have any questions, please contact me at (202) 482-1207 or galston@doc.gov or Atisha Burks at (202) 482-2715 or aburks@doc.gov.

Sincerely,

A handwritten signature in black ink, appearing to be "G. Alston", written over a horizontal line.

Gordon T. Alston
Director for Financial Reporting and
Internal Controls

Enclosure

cc: Lisa Casias
Diane Marston
Atisha Burks

**Department of Commerce Response
FASAB Exposure Draft – SFFAS, *Reporting Entity Proposal***

Prepared By: Department of Commerce, Office of Financial Management

Questions and Answers

1.a. Do you agree or disagree with each of the inclusion principles?

The Department of Commerce agrees with the inclusion principles. We believe they enhance transparency because they are inclusive, logical, and cover the entire population of entities that should be included for federal reporting. However, for the third inclusion principle, we would like clarification on the definition of “control” as to whether it includes organizations under temporary control or only those that are permanently controlled.

1.b. Do you believe the inclusion principles, and the related definitions and indicators, are helpful and clear?

The Department of Commerce believes the inclusion principles and related content are helpful and clear. These principles alleviate ambiguity in existing principles, including SFFAC 2.

1.c. Do you agree or disagree that an organization should be included in the general purpose federal financial reports (GPFFR) if it would be misleading to exclude it even though it does not meet one of the three inclusion principles?

The Department of Commerce agrees that an organization should be included in the GPFFR, if it would be misleading to exclude it, despite it not meeting any of the three inclusion principles.

1.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?

The Department of Commerce agrees that the inclusion principles can be applied to all organizations to determine if they should be included in the government-wide GPFFR. Since the inclusion principles are based on indicators of control, they should be applicable to all organizations.

2.a. Do you agree or disagree with the concept of distinguishing between consolidation entities and disclosure organizations?

The Department of Commerce agrees with the concept of distinguishing between consolidation entities and disclosure organizations because they are two separate groups and should have different accounting treatment. The consolidation entities behave more like government entities and should be included in the financial statements, while the disclosure organizations are mostly quasi-government entities that are financially independent and better detailed in the note disclosures.

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

The Department of Commerce agrees with the attributes for distinguishing between consolidation entities and disclosure organizations. The attributes are practical, logical, and can be linked back to whether the organization needs taxpayer funds. A higher level of funding and influence on an organization demand a higher level of reporting in the statements, and lower levels of funding and influence demand a lower degree of reporting (e.g. disclosure, omission).

2.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 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.

The Department of Commerce agrees that the attributes are adequate to make a sound determination of whether an organization should be included in the GPFFR, because they are logical, practical, and clearly defined.

2.d. Do you agree or disagree with the:

- i. Factors to be considered in making judgments about the extent of appropriate disclosures (see par. 69),
- ii. Objectives for disclosures (see par. 72), and
- iii. Examples provided (see par. 73)?

The Department of Commerce agrees with the factors, objectives, and examples of disclosure provided to discern between consolidation entities and disclosure organizations. We believe all three should be considered to maintain objectivity.

3.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?

The Department of Commerce agrees that each component reporting entity should report in its GPFFR the organizations for which it is accountable, including consolidation entities and disclosure organizations administratively assigned to it. Not including these entities may be materially misleading, since the federal government has substantial control over these entities.

3.b. Do you agree or disagree that administrative assignments can be identified as provided in paragraphs 54-63?

The Department of Commerce agrees that administrative assignments can be identified as provided in paragraphs 54-63.

4. 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?

The Department of Commerce agrees that each component reporting entity 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. However, material non-federal funding sources ought to be distinguishable in the reports and fully disclosed in the notes.

5. Do you agree or disagree that consolidation of FASAB and FASB based information without conversion for consolidation entities is appropriate?

The Department of Commerce disagrees with consolidating FASAB and FASB information without conversion for consolidation entities. Considering that the GPFFR has been prepared under FASAB, consolidation with FASB could make comparison to prior years GPFFR difficult. SFFAS 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*, dictates using FASAB to prepare the GPFFR. We would recommend addressing this idea separately due to its significance.

6.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?

The Department of Commerce agrees with the minimum disclosures for the central banking system. However, additional disclosures may be necessary due to the unique nature of reporting requirements for the central banking system.

6.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 the disclosures.

The Department of Commerce does not believe there are other significant organizations for which minimum disclosures should be made.

7.a. Do you agree or disagree with the related parties definition and requirements?

The Department of Commerce agrees with the related parties definition and requirements. They ensure the inclusion of material and significant items.

7.b. Do you agree or disagree with the list of the types of organizations that generally would be considered related parties?

The Department of Commerce agrees with the list of organization types, which would generally be considered related parties. However, each reporting component would need to exercise sound judgment when applying this standard to decide which organizations would be considered a third party.

7.c. Are there additional organizations that generally should be considered related parties?

The Department of Commerce is unaware of any additional organizations that should be considered third parties.

7.d. Do you agree or disagree with the list of exclusions?

The Department of Commerce agrees with the list of exclusions. This list appears comprehensive and easy to understand.

7.e. Are there additional exclusions that should be considered?

The Department of Commerce is unaware of any additional exclusions that should be considered.

8. Do you agree or disagree with the conforming changes to SFFAC 2?

The Department of Commerce agrees with the conforming changes to SFFAC. While SFFAC 2 will remain the overarching concept for the GPFFR, this standard will refine the GPFFR to make the information more complete and result in better reporting for the government-wide GPFFR and the component GPFFRs. Not having these changes would result in overlapping guidance with conflicting criteria.

9. Do you agree or disagree with this effective date?

The Department of Commerce agrees with the effective date being for periods after September 30, 2016. We believe it provides ample time for agencies to implement, including the preparation of data systems and the identification of consolidation entities and disclosure organizations.

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

The Department of Commerce agrees that the appendices are helpful in multiple ways. Seeing these examples, especially the inclusion principle illustrations in appendices B and C, allows you to understand how to apply the standard in a variety of situations. The appendices also provide good resource information to support the paragraphs in the body of the standard.

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

The Department of Commerce believes that the appendices should remain after the statement is issued, because they assist in understanding and applying the standard.

10.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?

The Department of Commerce does not believe that any changes or additional examples are needed in the illustrations to understand the application of the standards.

11. 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 Department of Commerce is not aware of any other unique situations that should be addressed within this statement.

12.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?

The Department of Commerce generally does not agree with the alternative view that the standards might infer that receiverships, conservatorships, and interventions are part of the

federal government due to them being included in other disclosure organizations. Steps should be taken to highlight the temporary nature of these organizations in the disclosures, so they are not seen as permanent parts of the federal government.

12.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?

The Department of Commerce generally does not agree with the alternative view that guidance for all interventions should be presented in a single standard. Although a single standard would be easy to reference and may decrease the probability of misunderstanding the standards by providing one document, it seems unnecessary since interventions can be clearly presented in additional paragraphs. Future updates will be better accommodated through additional paragraphs, instead of completely replacing the existing standard(s) with a new one.

Reporting Entity

Please submit to fasab@fasab.gov

Name of Respondent: **Carla A. Krabbe, Deputy Chief Financial Officer**

Organization: **Social Security Administration (SSA)**

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.**

SSA's response: We agree with the inclusion principles as these principles provide a basis to decide which organization to include in the government-wide General Purpose Federal Financial Report (GPFFR) for financial accountability purposes. The “Federal Programs by Agency and Account” is a starting point for agencies to determine if an organization should or should not be included in the government-wide GPFFR. For organizations not listed in the “Federal Programs by Agency and Account,” financial statement preparers can use the other inclusion principles (majority ownership interest, control with risk of loss or expectation of benefit, misleading to exclude, and related parties) as a test to determine inclusion in the 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.**

SSA's response: We believe the inclusion principles, and the related definitions and indicators, are helpful and clear. The inclusion principles provide a framework for decision-making and the related definitions and indicators provide additional information to aid preparers in rendering a decision for

inclusion in the GPFFR. For instance, the “indicators of control” provides numerous indicators of whether or not the Federal Government controls an organization. The Appendix also provides helpful information that aids preparers in understanding the concepts of this Standard.

- 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.**

SSA’s response: We agree that an organization should be included in the GPFFR if it would be misleading to exclude it, even though it does not meet the inclusion principles. The inclusion principles are the framework to begin the process to decide if we should or should not include an entity in the GPFFR. We cannot expect these principles to cover every situation that could conceivably occur, especially given the complexities of our Federal Government. Adding the extra requirement to include an organization if it would be misleading to exclude, even if not meeting the inclusion principles, provides an extra dimension for consideration to ensure the GPFFR will include all pertinent and applicable entities.

- 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.**

SSA’s response: We agree that the inclusion principles can be applied to all organizations to determine whether the organization should be included in the government-wide GPFFR. The added information of related definitions and indicators helps further clarify if the entity belongs in the government-wide GPFFR. Financial statement preparers can apply the inclusion principles test to previously excluded organizations, such as the central banking system and Government Sponsored Enterprises. According to Statement of Federal Financial Accounting Concepts (SFFAC) 2, the central banking system was kept separate and independent of the other government functions and therefore was never included in the government-wide GPFFR. However, this Standard requires the comprehensive disclosure of financial information. If an organization is budgeted, owned, or controlled by the Federal Government, it should be included in the government-wide GPFFR.

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.**

SSA's response: We agree with the concept of distinguishing between consolidation entities and disclosure organizations. The distinction will help in meeting Federal financial reporting objectives, as well as provide users with comprehensive disclosure about Federal reporting entities. This distinction will also allow for separate presentation of financial information for organizations with differences in purpose, governance structure, and financial relationships.

- 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.**

SSA's response: We agree the attributes provide clarity towards making the distinction between consolidation entities and disclosure organizations. As discussed in this Standard, it is important to make a distinction between consolidation entities and disclosure organizations to prevent distortions to the consolidated financial statements and to meet reporting objectives.

- 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.**

SSA's response: We believe providing the attributes aids in making a more informed decision in correctly categorizing the organization as a consolidation entity or disclosure organization. The attributes discussed in paragraphs 37-53 and 64-77 illustrate how an organization can be classified as either a consolidation entity or a disclosure organization.

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),

SSA's response: We agree with the factors to be considered in making judgments about the extent of appropriate disclosures. The factors appear suitable and reflect the key aspects needed for appropriate disclosures. Beyond materiality, it is important to consider the guidelines set forth in SFFAC 1 regarding relevance to reporting objectives; potential exposure to risks and benefits associated with the relationship; and understanding the organization's relationships to the Federal Government and others.

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

SSA's response: We agree with the objectives for disclosures. The objectives appear in-line with the desired goals and results of full disclosure as the objectives emphasize relationship and organization, relevant activity, and future risks and exposures.

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

SSA's response: We agree with the examples provided. They are representative of the disclosures needed for full transparency and accountability and are helpful in understanding the reporting required of disclosure organizations.

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.

SSA's response: We agree 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, so that both the component reporting entity GPFFR and government-wide GPFFR are complete.

- 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.**

SSA's response: We agree that administrative assignments typically can be identified in laws and policy documents as noted in paragraphs 54-63 (i.e. statutes, budget documents, regulations, or strategic plans). Furthermore, evaluation of these documents by the component entity will provide insight if reporting of an organization is required.

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.

SSA's response: We agree that the component and government-wide reporting entity should consolidate in their entirety organizations for which they are accountable without regard to funding source. This methodology will ensure that both the component reporting entity and the government-wide reporting entity are not misleading if excluded, and are complete when assessing the financial position of the Federal Government and evaluating the cost of operations financed through taxes and other non-exchange revenues.

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.

SSA's response: We agree that consolidation of FASAB and FASB based information without conversion for consolidation entities is appropriate because Statement of Federal Financial Accounting Standards 34 defines FASAB as the preferred method of reporting for Federal entities. FASAB also is responsible for identifying the GAAP hierarchy for Federal reporting entities. Additionally, converting FASB-based information to a FASAB basis may not be cost-effective, and FASAB and FASB both use accrual-based information.

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.**

SSA's response: We agree with the minimum disclosures for the central banking system because reporting it as a consolidation entity would considerably alter the Federal financial reporting of the Government as it pertains to securities, deposits, expenses, and revenues. The Federal Reserve System (FRS) performs a unique function in the Federal Government as it relates to governance, structure, and activities. Classifying FRS as a disclosure organization will help users in understanding an organization of this type.

- 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.**

SSA's response: We are not aware of any other significant organizations that FASAB should consider for minimum disclosure.

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.**

SSA's response: We agree with the definition and requirements regarding the disclosure of significant related party relationships. We agree that related party concepts applicable to the Federal domain are necessary.

- 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.**

SSA's response: We agree with the list of the types of organizations that FASAB generally considers related parties. If the organization does not meet the inclusion principles, then the related parties "significant influence" test may apply.

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

SSA's response: We are not aware of additional organizations that FASAB should consider as related parties with regards to this draft Standard.

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

SSA's response: We agree with the list of exclusions.

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

SSA's response: We are not aware of additional exclusions FASAB should consider.

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.

SSA's response: We agree with the conforming changes to SFFAC 2 as the language concerning the criteria for determining what organizations are required to be included in a Federal reporting entity's GPFFR will now be included in this Standard.

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.

SSA's response: We agree with the implementation date as it appears to provide preparers and users adequate time to review and implement applicable changes. However, organizations significantly affected by this Standard would be better equipped to respond to this question.

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?

SSA's response: We believe the appendices are helpful. The flowchart in Appendix B helps visually display the sequence of decisions involved in determining whether the entity is a consolidation entity or a disclosure organization. In addition, the flowchart is easy to follow and the page number references are useful to the reader. The illustrations provided in Appendix C help users apply the Standard by providing relevant examples.

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

SSA's response: We believe the appendices should remain after FASAB issues the Standard because the information the appendices provide is helpful in understanding the application of the Standard.

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.

SSA's response: We believe that if the Board retains receivership, conservatorship, and intervention as part of this Standard as disclosure organizations, the Board should include examples of each in the Standard. In addition, it would be beneficial if FASAB relayed to users how they differentiate among these three categories.

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.

SSA's response: We are not aware of any other unique situations that this Standard should address.

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.**

SSA's response: We believe receiverships, conservatorships, and interventions are examples of types of disclosure organizations. In order for the Federal Government to provide a comprehensive and complete GPFFR, inclusion of these three types of organizations is necessary to provide a meaningful representation of operations and financial condition of the Federal Government.

- 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.

SSA's response: We believe FASAB can address the guidance for interventions in the Reporting Entity Standard rather than in a single Statement of Federal Financial Accounting Standard.

Additional item - clerical note: We believe the last sentence of Footnote 3, page 10, of the Standard should reference paragraphs 37 to 53 and not paragraphs 36 to 52.

Reporting Entity

Please submit to fasab@fasab.gov

Name of Respondent: John Lynskey, Division of Financial Management Deputy Director

Organization: National Science Foundation

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.

NO NSF COMMENT

- 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 NSF COMMENT

- 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.

NO NSF COMMENT

- 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.

NSF requests that FASAB further clarify the inclusion of Federally Funded Research and Development Centers (FFRDCs). In the case of the National Science Foundation, pursuant to the NSF Act (Public Law 81-507, amended by 42 USC (1861 – 1887)), provision 42 USC 1873, “The Foundation shall not, itself, operate any laboratories or pilot plants.” Although NSF legally considers and is noted as the sponsoring agency for four FFRDCs, as it relates to the intent of this ED, the Foundation’s inability to manage or operate the facilities makes

them more equitable to contract or grant organizations. NSF requests that FASAB add language to this point in paragraphs 32 – 34.

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.

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

NO NSF COMMENT

2. **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.**

NO NSF COMMENT

1. 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.**

The definition of consolidation entities to include “financed through taxes, and other non-exchange revenues”, and the requirement that disclosure organizations “receive limited or no funding from general tax revenues” should be reconsidered. In several illustrative scenarios, and in practice, the fact that federal funds may be the primary source of funding for an organization does not determine whether it is part of the GPFFR or its status as a disclosure entity or consolidation entities. Furthermore, paragraphs 32 – 34 of the ED indicate that economic dependency does not equate to control. Since economic dependency can be a characteristic of entities that are excluded from the GPFFR, and both consolidation entities and disclosure organizations, removing it from the definition of both should be considered.

- 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),
- ii. the objectives for disclosures (see par. 72), and
- iii. the examples provided (see par. 73)?

NO NSF COMMENT

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.**

NO NSF COMMENT

- 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.**

In the case of FFRDC's, FASAB should consider adding reference to the "Master Government List of Federally Funded Research and Development Centers (FFRDCs)", published annually by NSF. This list could aid in determining FFRDC administrative assignment. The 2013 list can be found at <http://www.nsf.gov/statistics/ffrdclist/>.

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-. 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.

NO NSF COMMENT

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.

NO NSF COMMENT

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.**

NO NSF COMMENT

- 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.**

NO NSF COMMENT

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.**

In paragraph 80, FASAB indicates that significant influence may be exercised by representation on the board of directors or equivalent governing body. The National Science Foundation, by law, must consist of a Director and National Science Board (NSB). The persons nominated for appointment as members of the board are eminent in the fields of the basic sciences, medical science, engineering, agriculture, education, or public affairs and are appointed by the US President. The NSB establishes the policies of NSF within the framework of applicable national policies set forth by the President and Congress. In this capacity, the Board identifies issues that are critical to NSF's future, approves NSF's strategic budget, and approves new major programs and awards. The Board also serves as an independent body of advisors to both the President and the Congress on policy matters and education related to science and engineering.

Several NSB members may be affiliated with entities to which NSF issues grants or contracts. Most often these board members are professors or hold honorary positions at the awardee institution. NSF is concerned that the related party definition as currently written will be applied to organizations with which NSB members are affiliated. NSF does not support this view and does not see any indication in the related party illustration in Appendix C, page 74, Andromeda Prime Power Systems (related Part- GSE), this is FASAB's intent. Indicating a related party relationship between the federal government and organizations that receive grants such as not-for-profit entities and collegial institutions would grossly mislead the public.

In order to clearly denote that NSB members as individuals, or the entities they are affiliated with, are not in related party relationships with NSF; NSF requests that FASAB add additional clarifying language. Suggestions for this clarification are indicated below:

Paragraph 80 – The current reference to policy decisions should be narrowed to distinguish between “operational” (day-to-day, transactional level) and “strategic” (high level strategy and direction) policy decisions. Strategic policy decisions do not have a direct influence on financial transactions and operating decisions and should not be determinative of the existence of related party relationships. In the case of the NSB, the Board's strategic decisions do not directly influence the day to day operational and financial transactions of the Foundation (individual awards to grantees, etc.). NSF suggests adding the language from paragraph 79 to the first sentence of paragraph 80 to clarify the intent: ***“Significant influence (for the purpose of this Statement) is the power to participate in the financial and operating policy decisions of an entity, but not control those policies.”***

Paragraph 84 – Although Paragraph 84 c) indicates that “key executives of the federal government and organizations owned or managed by key executives, other employees of the federal government, or members of their families” should be excluded from the related party definition; NSF suggests that FASAB explicitly add ***“Including Presidentially appointed agency board members”*** to the list of exclusions. Alternatively, paragraph 84 b) could be expanded to state ***“This exclusion also applies to management and board members of institutions that jointly serve on the board of a federal agency. This occurrence does not automatically result in a related party relationship between the federal government and the individual or the federal government and the affiliated institution.”***

Furthermore, NSF requests that FASAB add the term “that may or may not” to paragraph 84 b) as indicated below:

“Organizations with which the federal government transacts a significant volume of business that **may or may not** result in economic dependence such as....”

- 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.**

NO NSF COMMENT

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

NO NSF COMMENT

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

As noted in response Q7 a above, NSF suggests that FASAB explicitly add in 84c ***“Presidentially appointed agency board members”*** to the list of exclusions. Alternatively, paragraph 84 b) could be expanded to state ***“This exclusion also applies to management and board members of institutions that jointly serve on the board of a federal agency. This occurrence does not result in a related party relationship between the federal government and the individual or the federal government and the affiliated institution.”***

Furthermore, NSF requests that FASAB add the term “that may or may not” to paragraph 84 b) as indicated below:

“Organizations with which the federal government transacts a significant volume of business that may or may not result in economic dependence such as....”

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

As noted in response Q7 d above, NSF suggests that FASAB explicitly add ***“presidentially appointed agency board members”*** to the list of exclusions.

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.

NO NSF COMMENT

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.

NO NSF COMMENT

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?

NO NSF COMMENT

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

Yes – the illustrative scenarios in particular help the reader to understand FASAB's intended application of each definition.

- 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.

NSF, and presumably other agencies with Boards such as the Nuclear Regulatory Commission and Federal Communications Commission, would benefit from a related party scenario involving agency Board members. The scenario should involve a federal agency with a board of directors that approves strategic and high level budget decisions. A board member with an administrative or professor role at a collegial institution, or that serves in a management capacity at a not-for-profit organization should be included. The illustration should indicate that the agency does not have a related party relationship with the board member or the institution/organization with which the board member is affiliated. NSF is open to providing the board with scenario details if desired.

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.

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.

NO NSF 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.

NO NSF COMMENT



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July 1, 2013

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

RE: Proposed Statement of Federal Financial Accounting Standards, *Reporting Entity* – the exposure draft (ED)

Dear Ms. Payne:

We appreciate the opportunity to respond to the proposed Statement of Federal Accounting Standards, *Reporting Entity* – the exposure draft (ED). We support the Board's efforts to develop standards for consolidated and disclosure organizations. However, the wide reach and significant influence of the federal government provide the possibility of a large number of organizations subject to evaluation – possibly by multiple reporting entities. As a result, we anticipate a significant implementation effort at the government-wide and component reporting entity level to identify the population of organizations to which the reporting entity would apply the “control” principle for identification of consolidated and disclosure organizations. A federal reporting entity does not have the same attributes — financial interest or ability to appoint the board -- that a commercial entity or a not-for-profit organization would have, to limit the population subject to evaluation. We believe the Board should thoroughly analyze this level of effort before issuing its final statement.

In addition, we found the use of the term “inclusion entity” unnecessary and confusing as it is used to refer to organizations whose financial statements were consolidated in those of the reporting entity as well as to describe those organizations for which the reporting entity provides only certain disclosures. We also found it confusing to present guidance related to component reporting entities apart from the guidance related to the government-wide entity. Therefore, we suggest simplifying the statement by providing the principles for identifying consolidated or disclosure organizations based on the characteristics of such organizations at the government-wide and component reporting entity level concurrently within the statement. In doing so, the statement will provide a clear distinction between consolidated and disclosure organizations that will enable consistent implementation and ongoing application of the principles both at the government-wide and component reporting entity level. To illustrate this approach, we provide a suggested general structure for the statement with broad comments in Appendix 1.

We also provide more detailed comments related to our suggested general structure in Appendix 2. Appendix 3 provides a revised flowchart supporting this structure. Appendix 4 includes other comments.

We have not responded directly to the specific questions posed by the ED, as the comments included in the Appendices either address those questions or render the questions not applicable.

Ms. Wendy M. Payne
FASAB Executive Director
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If you have questions about our response, please contact Ms. Amanda Nelson at 202-533-5560 or aenelson@kpmg.com.

Very truly yours,
KPMG LLP

KPMG LLP

Appendix 1 - General Structure

I. Purpose

- a. The statement should be divided into two sections – **Principles and Characteristics** and **Presentation Requirements**.
- b. The information included in paragraphs 13-19 (Organizational Approach) should be included within the Introduction/Purpose of the statement.

II. Scope and Applicability

III. Definitions

IV. Principles and Characteristics

- a. This section should present principles for consolidation or disclosure at both the government-wide and component reporting entity level.
- b. The three principles in paragraph 21 should be reduced to two principles: (1) In the Budget and (2) Control with risk of loss or expectation of benefit. Based on the definition in paragraph 24 and footnote 12, the majority ownership interest should be considered a presumptive indicator of control instead of a stand-alone principle.
- c. It should be clear that the principles apply to both the government-wide and component reporting entity level.
- d. In the Budget
 - i. The statement should indicate that this is a presumptive principle for consolidation. If an organization is included in the budget, it should be consolidated at the government-wide or component reporting entity level.
 - ii. The exception related to federal financial assistance should be if the organization is included in the budget ONLY as a recipient of federal financial assistance. The standards should clarify whether these organizations require further evaluation against the second principle (Control) if the exception is met.
 - iii. This section should include relevant information for the component reporting entities as well as the government-wide entity. Information from paragraphs 57 and 57 (a) should be included.
- e. Control with risk of loss or expectation of benefit (Control)

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- i. The statement should indicate that this is a presumptive principle for an organization to be either consolidated or disclosed.
 - ii. This section should include relevant information for the component reporting entities as well as the government-wide entity. Information from paragraph 58 would be included related to the component reporting entities.
 - iii. This section should include the concept of exclusivity of control. We believe that control involves decision-making ability that is not shared with others. Therefore, we believe that consolidated and disclosure organizations would only be controlled by one entity. The ED currently indicates that disclosure organizations could be reported by multiple component reporting entities.
 - iv. The indicators of control should be reordered for ease of application:
 - 1. Paragraph 29;
 - 2. Paragraphs 32-34 (situations where control does not exist);
 - 3. Paragraphs 30-31 (persuasive indicators and other indicators), which would also include adding "Majority Ownership," paragraphs 23 and 24, as a persuasive indicator of control.
 - v. For those organizations that meet the definition of control, this section should reference to the paragraphs that provide the characteristics of a consolidated and disclosure organization.
 - vi. For those organizations that do not meet the definition of control, this section should reference to the paragraphs that provide the characteristics of a misleading to exclude organization. We believe that an organization that meets these characteristics would be subject to related party disclosures.
- f. Characteristics of a consolidated organization
- i. This section should state that the characteristics should be applied to those organizations having met the definition of control in the 2nd principle outlined above. These characteristics would not be evaluated for organizations having met the 1st principle as it is considered a presumptive principle for consolidation.
 - ii. These characteristics would come from paragraph 38. The standard should be clear about whether all characteristics must be met to trigger the consolidation requirement. We do not understand the characteristic in item 38d; therefore, we suggest deleting it. Further, consistent with the approach related to receiverships/conservatorships in paragraph 49 and interventions in paragraph 50 whereby the concept of temporary control is introduced, we believe that the characteristic, other than temporary control, should be added to this section.
- g. Characteristics of a disclosure organization

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- i. This section should state that the characteristics should be applied to those organizations having met the definition of control in the 2nd principle.
 - 1. This section should clearly contrast with the characteristics of a consolidated organization. While judgment will be needed to distinguish between consolidation and disclosure, having the basic characteristics parallel will facilitate the evaluation. These characteristics would come from paragraphs 41-44 presented in the following order – 41, 43, 42, and 44.
- h. We suggest including a flowchart within the statement. Our suggested flowchart is included in Appendix 3.

V. Presentation Requirements

a. Consolidated organizations

- i. This section should present relevant accounting, presentation, and disclosure requirements for consolidated organizations. These requirements will generally include information from paragraphs 64-66. We have included suggestions in Appendix 2.
- ii. This section should include the concepts presented in paragraphs 74-76.

b. Disclosure organizations

- i. This section should clearly prescribe the disclosure requirements (paragraphs 70-73). Paragraphs 72 and 73 should be combined as follows:
 - 1. Items 73a-c should be sub-items of 72a;
 - 2. Item 73d should be a sub-item of 72b;
 - 3. Items 73g-j should be sub-items of 72c; and
 - 4. Items 73e-f should be removed.
- ii. The factors influencing the extent of the required disclosures should include only those factors that management of the reporting entity has the knowledge to evaluate. We have included suggestions in Appendix 2.

c. Related Parties

- i. We believe that related party disclosures would only be evaluated for an organization that was considered by the reporting entity to be subject to its influence to such an extent that the reporting entity evaluated it under this standard; however the organization failed the control criteria but was considered

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misleading to exclude. This is based on our observation that the factors in paragraphs 79 and 80 closely parallel those in paragraph 30. If there is an expectation of an evaluation of a separate population, that expectation should be specifically stated and perhaps a separate standard should be considered.

- i. The statement should contrast the disclosure requirements of a related party to those of a disclosure organization. It appears that a related party is similar to a disclosure organization but with limited disclosure requirements.

Appendix 2 - Detailed Comments on Suggested General Structure

I. Purpose

- a. As noted in paragraph 13 of the ED, SFFAC 2 (paragraph 38) uses the term “financial accountability;” therefore, we suggest that the term “accountability” be replaced with “financial accountability” throughout the statement. In addition, the term “financial accountability” should be added to the definitions section.
- b. In conjunction with our suggested removal of “inclusion entity” and the resulting simplification of the statement, our suggested revision of paragraph 1 is as follows:

The federal government and its relationships with organizations have become increasingly complex. Notwithstanding these complexities, **general purpose federal financial reports** (GPFFR) for the **government-wide reporting entity** should be broad enough to reflect the financial accountability of Congress and/or the President for those organizations. In addition, **component reporting entity** GPFFRs should allow the Congress and/or the President to hold management accountable. Although Statement of Federal Financial Accounting Concepts (SFFAC) 2, *Entity and Display*, addresses identifying **reporting entities** and criteria for including components in a reporting entity, questions have continued in this area indicating the need for standards. Standards that can be used to identify organizations to be consolidated and/or disclosed in the GPFFR of the government-wide reporting entity and each component reporting entity are important to meet federal financial reporting objectives.

- c. Based on our suggestion to divide the statement into two main sections – **Principles and Characteristics** and **Presentation Requirements**, we provide the following suggested revision for paragraph 2, which also includes information from paragraph 3, thereby eliminating paragraph 3:

This Statement guides preparers of GPFFRs in determining what organizations should be consolidated and/or disclosed in the reporting entity’s GPFFR as well as the presentation requirements related to consolidated and disclosure organizations. This statement also provides guidance on identifying and disclosing related parties. This guidance, together with existing guidance, will ensure that users of GPFFRs are provided with comprehensive financial information about federal reporting entities so that the federal financial reporting objectives are met.

- d. Paragraph 4 provides useful guidance for evaluating control. We suggest that it be moved to that section of the statement.
- e. As suggested in the general structure, we recommend placing the information included in paragraphs 13-19 (Organizational Approach) within the Purpose section of the statement. Paragraphs 13 and 14 would follow paragraph 3, and paragraphs 15-17 and 19 would be combined into one paragraph as follows:

Ms. Wendy M. Payne
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This statement:

- establishes the principles for identifying organizations to consolidate or disclose within the government-wide and/or component reporting entity;
- provides the presentation requirements related to consolidated and disclosure organizations; and
- provides guidance for identifying related parties and the disclosure requirements for such relationships.

- f. If the statement will separately discuss the central banking system, the information from paragraph 18 should be included in this section.

II. Scope and Applicability

- a. Paragraph 6 states, “This statement applies to federal reporting entities that prepare GPFFR in conformance with GAAP as defined by SFFAS 34.” GAAP as defined by SFFAS 34 includes FASB standards for those federal reporting entities that have historically prepared financial statements in accordance with FASB standards. The FASB Accounting Standards Codification contains standards for consolidation. The scope paragraph implies that federal reporting entities that follow FASB, as allowed by FASAB 34, would need to follow this statement for consolidation. In doing so, a federal FASB entity would no longer report in accordance with FASB standards as related to consolidation. Therefore, we suggest that this conflict be resolved.
- b. Paragraph 7 of the scope should be revised as follows:

The purpose of this statement is to enable federal reporting entities preparing and issuing GPFFRs to determine what organizations should be consolidated or disclosed in its GPFFR and to determine the presentation requirements for consolidated and/or disclosure organizations.

III. Definitions –

- a. Throughout the ED and its footnotes, embedded definitions should be moved to the definition section.
- b. This section should include a definition for financial accountability.
- c. We do not believe that paragraph 9 is the definition of the government-wide reporting entity. It is a statement of what should be included in the financial statements of such an entity.
- d. The definitions of consolidated and disclosure organizations should be included in this section.

IV. Principles and Characteristics

- a. We suggest the following revision to paragraph 20:

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This Statement provides two principles for determining which organizations should be consolidated or disclosed in the government-wide and/or component reporting entity GPFFR. The statement also provides characteristics of a consolidated and disclosure organization, which should be applied in conjunction with the principles to distinguish between consolidated and disclosure organizations.

b. In the Budget

- i. We believe that for consolidation to be required control should exist. In keeping with the Board's approach, we have maintained in the budget as a separate principle from control, on the basis that if an organization is in the budget (at the component reporting level or government-wide level) it is considered to be controlled by that reporting entity.
- ii. The statement should state which year's budget document to consider when applying the principle.
- iii. Information from paragraph 57a related to the component reporting entity should be moved to this section.
- iv. Paragraph 57b provides another definition of in the budget by its reference to a congressional budget justification document. We believe references to this document should be removed for simplicity and consistency in the application of this statement.

c. Control with risk of loss or expectation of benefit

- i. We believe that the principles should include the concept of exclusivity for purposes of identifying and reporting on consolidated and disclosure organizations. We recommend the following sentence be added to the end of paragraph 25 to incorporate the exclusivity concept:

Control involves decision-making ability that should not be shared with others and, therefore, an organization can only be identified and reported as a consolidated or disclosure organization by one reporting entity.

- ii. Footnote 14 would not be needed based on the changes in our suggested structure.
- iii. Footnote 16 appears to contradict paragraph 30a. Please clarify.
- iv. Footnote 27 should be deleted because it is confusing. The Bureau of Census is included in the budget of the Department of Commerce; therefore, it would not be subject to the evaluation of control.

d. Misleading to exclude

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- i. Based on our belief that an organization that is misleading to exclude should only result in a related party disclosure, we suggest combining paragraphs 35-36 as follows:

There may be instances when an organization does not meet the principles in paragraphs ____ yet the government-wide or component reporting entity GPFFR would be incomplete if information about the organization were excluded. Organizations should be subject to the disclosure requirements for related parties in the government-wide or component reporting entity GPFFR if the omission would be considered material to the reporting entity's financial statements.

- ii. We believe that the concept of misleading to include should be deleted from the statement because it undermines the overall principles stated.

- e. Characteristics of a consolidated organization

- i. Remove paragraphs 39-40 from the statement. Consider including this information within the Basis for Conclusion.

- f. Characteristics of a disclosure organization

- i. The information presented in paragraph 44 should clarify that the types of disclosure organizations presented in paragraphs 45-53 (quasi-governmental and/or financially independent organizations, organizations in receiverships and conservatorships, and organizations owned or controlled through federal government intervention actions) are examples of types of organizations that meet the characteristics of a disclosure organization, but do not include all types of disclosure organizations. To clarify this, we suggest the following revision to paragraph 44.

Disclosure organizations may include but are not limited to: quasi-governmental and/or financially independent organizations, organizations in receiverships and **conservatorships**, and organizations owned or controlled through federal government intervention actions. In some cases, the relationship with the federal government is not expected to be permanent. The following disclosure organization types, while not inclusive of all of the types of disclosure organizations, are presented to assist in identifying organizations that are disclosure organizations.

- ii. Paragraph A45 of the Basis for Conclusion implies that the examples of disclosure organizations are inclusive of all the types of disclosure organizations and as a result conflicts with paragraph 44. This should be clarified.
 - iii. The examples provided in paragraphs 45-53 could be moved to an appendix for readability.

- g. Identifying organizations component reporting entities are accountable for

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- i. As a result of the comments above, this information is no longer necessary as its own section. Paragraphs 54-56 and 59-63 should be deleted. The concepts included within paragraph 57 (except for item 57b, which we suggest deleting) should be incorporated into the “In the Budget” principle and the concepts included in paragraph 58 should be incorporated into the “control” principle.

V. Presentation Requirements

a. Consolidated Organizations

- i. We suggest the following revision to paragraph 64 to ensure consistency between the terms used in the Principles and Characteristics section and the Presentation Requirements section. We also note that the last sentence included in paragraph 64 provides a definition for the term “consolidation,” which we believe should be moved to the definitions section of the statement, and as a result it is not included in our suggestion revision.

Consolidated financial statements should be prepared for the government as a whole to facilitate an assessment of the financial position of the federal government and the cost of operations financed by taxes and other non-exchange revenue. Component reporting entities should consolidate the financial information of all organizations identified through the application of the principles and related characteristics of a consolidated organization.

- ii. Although paragraph 65 indicates no new disclosures are needed for consolidated organizations, the last sentence of paragraph 66 implies that there are additional disclosure requirements for consolidated entities that follow FASB standards. The required disclosures in paragraph 66 should result in an amendment to SFFAS 34. Further, we believe that there are appropriate disclosures that should be required, such as the significant organizations being consolidated.
- iii. Paragraph 65 states, “Consolidation entities as defined herein are considered federal reporting entities and should apply GAAP as defined in SFFAS 34.” SFFAS 34 recognizes FASAB standards and FASB standards as GAAP for federal reporting entities. This paragraph implies that a consolidated organization that does not follow FASAB or FASB GAAP (such as a GASB entity) would need to convert their financial statements to either FASAB or FASB GAAP. The statement is silent as to how to consolidate GASB entities and as a result we suggest including guidance on how to consolidate a GASB entity.
- iv. Paragraph 66 states that FASB entities need not be converted to FASAB for consolidation; however this paragraph should address how accounting aspects unique to FASAB GAAP (such as budgetary accounting) be obtained from a FASB entity if conversion is not required. Further, under current practice, federal reporting entities that consolidate FASB GAAP entities do currently convert the

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financial information to FASAB GAAP before consolidation. Paragraph 66 would cause a change in the current practice.

- v. Paragraph 66 also uses the term consolidation entity to refer to the entity doing the consolidation—the government wide reporting entity—as well as those entities being consolidated. To reduce confusion, we suggest that the statement use the term consolidated organization to refer to the organization being consolidated.
- vi. The information presented in paragraphs A14 and A19 should be included in the statement as the paragraphs instead of the Basis for Conclusion.

b. Disclosure Organizations

- i. We believe that paragraph 67 serves as a good introduction to the disclosure requirements and can remain as the introduction to this section.
- ii. We suggest the following revision to paragraph 68:

For those organizations classified as disclosure organizations, the reporting entity should exercise judgment in determining the appropriate disclosures based on the guidance provided in paragraphs 70-73.

- iii. We believe the information provided in paragraph 69 can be removed based on the following:
 - a. 69a (Relevance to reporting objectives) – The concepts presented within paragraph 69a are included within paragraph 72a and the related examples included within paragraph 73 (specifically 73a-c).
 - b. 69b (Nature and magnitude of the potential risks/exposures or benefits associated with the relationship) – The concepts presented within paragraph 69b are included within paragraph 72b and the related examples included within paragraph 73 (specifically 73d).
 - c. 69c (Disclosure organization views/perspectives) – We do not believe that the federal reporting entity would know the disclosure organizations' views/perspectives of its relationship with the federal reporting entity, nor should this influence the level of disclosures included within the reporting entity's financial statements.
 - d. 69d (Complexity of relationship) – This paragraph implies that a more complex relationship would require additional disclosures. If this is true, we believe the additional required disclosures for a complex relationship should be included within the requirements of paragraph 72.

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- e. 69e and 69f – We believe the concepts presented in paragraphs 69e and 69f are too subjective and should not be considered to influence the level of disclosures included in the reporting entity's financial statements.

iv. We suggest the following revision to paragraph 70:

Both qualitative and quantitative factors should be considered in determining whether information about a disclosure organization should be presented separately due to its significance or aggregated with the information for other disclosure organizations. If information is aggregated, aggregation may be based on disclosure organization type, class, investment type, or a particular event deemed significant to the reporting entity.

- v. As noted in our suggested general outline, we believe that paragraphs 72 and 73 should be combined and paragraphs 74-76 should be moved to consolidated organizations as they do not apply to a disclosure organization.
- vi. We believe that when applying the principles (In the Budget and Control) to the central banking system, that a reporting entity could conclude that the central banking system would not be a consolidated or disclosure organization. If the Board believes that at a minimum the central banking system should be considered a disclosure organization, then we believe this requirement should be stated within the Principles section of the statement. We further believe that paragraph 77 should be deleted as the minimum disclosure requirements provide the necessary disclosures for all disclosure organizations.

c. Related Parties

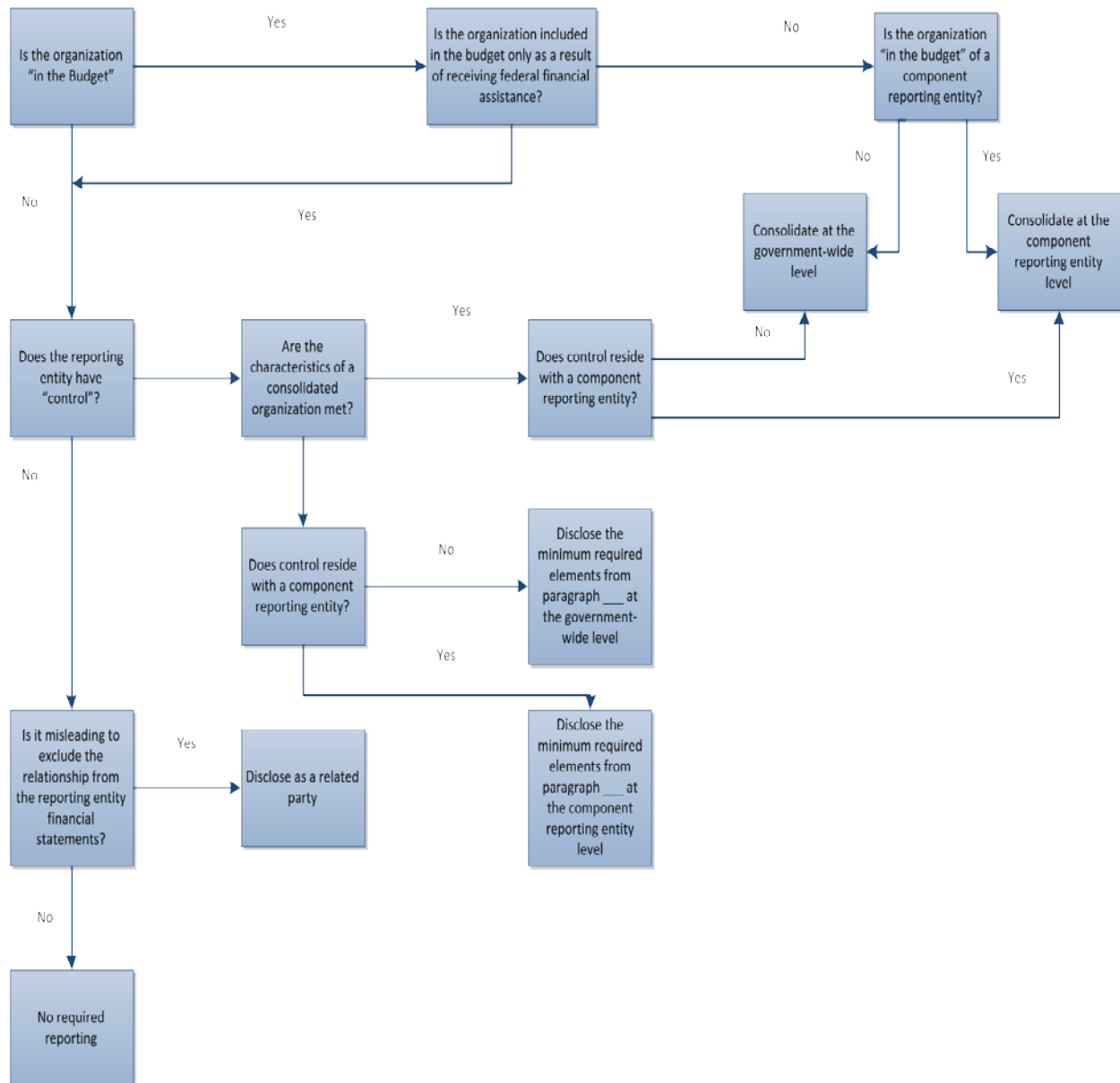
- i. Paragraph 83b seems to suggest that organizations such as the United Nations, World Bank, IMF, etc. would be considered related parties of the federal government and should therefore be subject to disclosure requirements. Is this the Board's intention?

VII. Effective date --We do not agree with allowing for early implementation, because it would lead to inconsistent reporting across federal reporting entities. We suggest stating that early implementation is not permitted.

We did not comment on the changes necessary to the Basis of Conclusion that would correspond to our suggested changes in Appendices 1 and 2.

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Appendix 3 – Revised Flowchart



Appendix 4 – Other Comments

- I. Paragraph 1 states, “the government-wide reporting entity should be broad enough to reflect the Congress and/or President’s accountability for those organizations.” Paragraph A13 of the Basis for Conclusion states, “Although the legislative and judicial branches are not currently required to prepare financial statements, based on the principle (in the budget) those organizations would be reported upon in the government-wide report.” Without commenting on the accountability of each branch under the Separation of Powers included with the Constitution, we believe that the consolidation of the judicial branch would provide a more complete presentation of the financial position of the government-wide reporting entity.
- II. We believe the statement should address how an organization should be consolidated if it appears in the budget in multiple locations. For example, the National Railroad Passenger Corporation (Amtrak) is included in the budget of the Department of Transportation and is also included as an Other Independent Agency (National Railroad Passenger Corporation Office of the Inspector General).
- III. We understand that certain equity investments currently are required by legislation to be accounted for in accordance with the Federal Credit Reform Act and normally follow the requirements of SFFAS 2, *Accounting for Direct Loans and Loan Guarantees*. As equity is an ownership interest, we believe that these equity investments could result in a majority ownership interest, which is considered an indicator of control and therefore would trigger the need to evaluate the organization against the Principles contained in the statement. This will cause a change in accounting principles, which we believe should be addressed by the statement
- IV. We recommend that the Board consider developing a separate standard for Related Parties instead of embedding those disclosures within the Reporting Entity standard. If a reporting entity currently includes related party disclosures in its financial statements, the reporting entity would be using the guidance provided in the FASB standards as FASAB does not currently contain a standard addressing related party reporting. Once the Reporting Entity statement is issued, it may be difficult for a federal reporting entity to know and understand that embedded within the statement is guidance for related party identification and reporting. We believe that this statement can refer to related parties however; a separate standard addressing all aspects of related parties may be beneficial.
- V. We did not review the illustrations provided in Appendix C for consistent application of the principles included within the statement because we believe these examples will become requirements and replace the application of the principles. As a result, we suggest removing Appendix C. If this removal causes concern because the examples provide important guidance, consider whether additional guidance should be added to the Principles and Characteristics section.
- VI. The ED addresses the central banking system because of its uniqueness. We also believe that the Treasury General Fund should be addressed within the statement for the same reason. The consolidation of the Treasury General Fund would appear to be required based upon the application of the “control” principle, but the entity to which it should be consolidated should be specified within the statement.

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VII. Comments related to Amendments to SFFAC 2, *Entity and Display*

- a. As a result of the number of changes that the ED requires for SFFAC 2, we recommend that the Board consider the need to re-evaluate SFFAC 2 in totality and consider a complete revision to SFFAC 2 outside of the required changes resulting from the ED.
- b. Paragraph 91 – The new paragraph (6a) to be included within SFFAC 2 uses the term “accountability.” We believe this should state “financial accountability” to agree with paragraph 38 of SFFAC 2, which uses the term “financial accountability.” This suggestion may require additional edits to SFFAC 2 if there is inconsistent use of “accountability” versus “financial accountability.”
- c. Paragraph 93 – We provide the following suggested revision to the paragraph 10 replacement to SFFAC 2:

Ensure information at each reporting entity includes information about all relevant organizations to support financial accountability by identifying organizations that are in the budget or controlled with risk of loss or expectation of benefit.
- d. Paragraph 94 – We suggest eliminating part of the last sentence to the revised paragraph 38 to SFFAS 2, which includes the concept of misleading to exclude.
- e. Paragraphs 99-100 – We do not believe that the information related to distinguishing between consolidated and disclosure organizations is necessary to be included in a concept statement.

VIII. Comments related to Basis for Conclusion

- a. Paragraph A13 implies that the judicial branch should be consolidated in the government-wide GPFRR, although noting that the judicial branch is not currently required to prepare financial statements. Further, footnote 53 states that FASAB GAAP would be the appropriate accounting standards for these organizations to adopt to the extent they prepare GAAP-based financial statements. Therefore, if the judicial branch were to prepare GAAP-based financial statement, they should follow FASAB GAAP. This statement conflicts with SFFAC 1, paragraph 5, which states, “FASAB does not propose to recommend accounting concepts and standards for the Legislative and Judicial branches.
- b. The “Indicators of Control” in paragraphs A23-A27 is the order which we have suggested in the general structure.
- c. We suggest that the heading before paragraph A30 state, “Characteristics of Consolidated and Disclosure Organizations.

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- d. Paragraph A41 implies that not all of the characteristics of a consolidated organization need to be met to be considered a consolidated organization; however, this should be clarified within the statement at paragraph 38.
- e. We find paragraph A84 to be confusing and do not understand why this statement should defer to OMB for additional disclosure requirements for related parties. We believe this statement should be all inclusive of the required related party disclosures or the Board should consider a separate standard to address related parties.
- f. Paragraphs A89-A93 provide an alternative view as it relates to receiverships, conservatorships, and interventions. While we agree that receiverships, conservatorships, and interventions could be covered within a Risk Assumed statement as is suggested in the alternative view, we believe these types of relationships should remain within this statement, until at a later date it becomes apparent that an amendment to the statement is necessary to place these types of relationships in a separate statement related to other Risk Assumed matters.

Comments on FASAB's Exposure Draft of the Proposed Statement of Federal Financial Accounting Standards on the Reporting Entity

Date: July 2, 2013

Name of Respondent: Mike Fitzgerald, Director, Financial Audit

Organization: Department of the Treasury Office of Inspector General

We appreciate the opportunity to provide comments on the Federal Accounting Standards Advisory Board's (FASAB) Exposure Draft of the proposed Statement of Federal Financial Accounting Standards on the *Reporting Entity*. We have no comments or proposed changes to the proposed standard content referred to in questions 1-4, 6-7, 9, 11 and 12; however, we do want to take this opportunity to comment on questions 5, 8, and 10, as follows:

Question 5. 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?

Answer: We disagree that consolidation of FASAB and FASB based information without conversion is appropriate. The consolidation of material FASB based financial information that has not been converted to the FASAB basis of accounting used for the consolidated entity reporting, could result in a material misstatement and a qualified audit opinion on the consolidated entity's financial statements, and in the worst case, an adverse audit opinion, if the resulting misstatement is pervasive to the consolidated financial statements. A good example of an area where potential material differences in reporting between FASB and FASAB standards could arise is in the accounting for direct loans and loan guarantees.

Question 8. 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?

Answer: If changes are made to the Exposure Draft to implement our response to question 5 above, the rescission of paragraph 78 of SFFAC 2, proposed in paragraph 101 of this Exposure Draft, would need to be revisited. We have no comment on other conforming changes to SFFAC 2.

Question 10. 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 standard?

Answer: We agree that the appendices are helpful in the application of the proposed standard.

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

Answer: Yes, We believe the appendices should remain after the Statement is issued.

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 standard?

Answer: We have no suggested changes or additional examples that would be useful in understanding the application of the standards.

Reporting Entity

Please submit to fasab@fasab.gov

Name of Respondent: Bill Guilford

Organization: Department of Housing and Urban Development

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.

HUD agrees with the first inclusion for an organization to be included in the government-wide GPFFR 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. Identification of an organization in the President’s Budget is the clearest evidence that an organization should be included in the government-wide report.

HUD agrees with the concept that an organization in which the federal government holds a majority ownership interest typically provides owners access to resources and exposure to risks while supporting their desired goals. Federal financial reporting objectives require that information about service efforts, costs, and accomplishments be made available. To ensure such information is included, when the federal government holds a majority ownership in an organization, it should be included in the GPFFR.

HUD agrees with the concept that an organization that is controlled by the federal government with risk of loss or expectation should be included in the government-wide GPFFR to provide accountability. As detailed in the Statement, control involves

the power to impose will on and/or govern the financial and/or operating policies of another organization with the potential to obtain financial resources or non-financial benefits or be obligated to provide financial support or assume financial obligations as a result of those actions. Both the power and the risk of loss or expectation of benefit aspects of the control definition should be present to justify inclusion of the organization in the 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.**

HUD agrees that the inclusion principles, and the related definitions and indicators, are helpful and clear. Determining control requires judgment, and the Statement provides indicators to assist in making determinations. The first set of indicators is “persuasive” as the federal government has the authority to control and any one of the listed items would generally mean control is present. The second set of indicators requires more judgment because the set of indicators is considered in the aggregate to assess whether the federal government has the ability to control the organization. Because the government does not usually seek only financial benefits, the expected benefit associated with control does not have to be a financial benefit. Instead, it may be non-financial. For example, it may be in the form of a service provided on the federal government’s behalf or the ability to direct the work of the other organization to deliver goods and services.

- 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.**

HUD believes that the exposure draft does not provide enough information in paragraphs 35 – 36 and 61 – 62 to be able to 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. It would be helpful to provide examples of unique situations to enhance the preparers’ judgment so that the preparer and auditor can mutually agree that an organization should be included that was not otherwise incorporated as a result of the three principles.

- 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.**

HUD agrees that the inclusion principles can be applied to all organizations, to determine whether such organizations should be included in the government-wide GPFFR. Differences in purposes and governance structures by organizations may require different presentation of related financial information. This Statement provides that the reporting entity should first determine which organizations are to be included in the reports. Next the reporting entity should classify each included organization as a consolidation entity or a disclosure organization.

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.

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

HUD agrees with the concept of distinguishing between consolidation entities and disclosure organizations. In some cases, disclosure of information regarding an individual organization is more appropriate than consolidation of the individual organization's financial statements in the government-wide financial statements. In other instances, consolidation of individual organizations' financial statements is needed to provide fair presentation of activities financed by the taxpayers, and/or relying on the taxpayers to settle liabilities.

- 2. 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.**

HUD agrees with the attributes used to make the distinction between consolidation entities and disclosure organizations. The distinction between consolidation entities and disclosure organizations is based on the degree to which the following characteristics are met: the organization is financed by taxes and other non-exchange revenue, is governed by the Congress and/or the President, imposes or may impose risks and rewards to the federal government, and/or provides goods and services on a non-market basis. The examples in Appendix C are helpful to explain these distinctions.

1. 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.**
- 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),**
 - ii. **the objectives for disclosures (see par. 72), and**
 - iii. **the examples provided (see par. 73)?**

Please provide the rationale for your answers.

HUD agrees with the factors to be considered in making judgments about the extent of appropriate disclosures, the objectives for disclosures, and the examples provided, except in the case where an organization is excluded as a result of the three principles, in which exclusion would be misleading. We believe that examples are needed to enhance the judgment of the preparer and the auditor. In addition, HUD believes that the factors are not sufficient to determine whether the Federal Reserve System should be a consolidation entity or a disclosure organization, even with the discussions of the Board in paragraphs A32 – A37 in Appendix A.

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.**

HUD agrees 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. The reasons for including organizations at the component reporting entity level should be consistent with the reasons in the government-wide entity GPFFR. Further, classification as consolidation entities or disclosure organizations would be consistent in government-wide and component reporting entity GPFFRs. FHA agrees that component reporting entities must identify and include in their GPFFR all consolidation entities and disclosure organizations for which they are accountable so that both the component reporting entity GPFFR and government-wide GPFFR are complete.

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.

HUD agrees that administrative assignments can be identified as provided in paragraphs 54-63, except in the case where an organization is excluded as a result of the three principles, in which exclusion would be misleading. We believe that examples are needed to enhance the judgment of the preparer and the auditor. Administrative assignments to component entities are typically made in policy documents such as laws, budget documents, regulations, or strategic plans.

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.

HUD agrees that each component reporting entity 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. The reasons for including organizations at the component reporting entity level should be consistent with the reasons in the government-wide entity GPFFR. Further, classification as consolidation entities or disclosure organizations would be consistent in government-wide and component reporting entity GPFFRs. A single set of principles for inclusion and classification presented from the government-wide perspective provides for the desired consistency. As stated previously, component reporting entities must identify and include in their GPFFR all consolidation entities and disclosure organizations for which they are accountable so that both the component reporting entity GPFFR and government-wide GPFFR are complete.

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.

HUD agrees that consolidation of FASAB and FASB based information without conversion for consolidation entities could be appropriate. However, it could also add confusion for the reader if there are multiple accounting methodologies reporting similar activities. For example, the confusion would occur wherein there were differing amounts for a component in its stand-alone statements and in the consolidated statements of the larger organization. Therefore, disclosure of the basis of accounting can provide clarity as to the governing body of the entity's reporting (FASB v FASAB).

SFFAS 34 provides that GPFFRs prepared in conformity with accounting standards issued by the FASB also may be regarded as in conformity with GAAP, so consolidation entities (i.e. the consolidated government-wide reporting entity or a consolidated component reporting entity) would be able to consolidate component reporting entity or sub-component financial statements for consolidation entities prepared in accordance with SFFAS 34 without conversion for any differences in accounting policies among the organizations.

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.

HUD agrees with the minimum disclosures for the central banking system. The disclosures should be integrated so that concise, meaningful and transparent information is provided.

- 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.**

HUD believes there may be other significant organizations for which minimum disclosures should be made, depending on the circumstances. Materiality is an overarching consideration in financial reporting. Preparers should consider both qualitative and quantitative materiality in determining the information that should be presented regarding disclosure organizations.

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.**

HUD agrees with the related parties definition and requirements. In addition to organizations for which the Congress and/or the President are accountable, the federal government may have relationships with other parties. Only relationships of such significance that it would be misleading to exclude information about such relationships warrant disclosure.

- 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.**

HUD agrees with the list of the types of organizations that generally would be considered related parties.

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

HUD is not aware of additional organizations that would be considered related parties.

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

HUD agrees with the list of exclusions.

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

HUD is not aware of any additional exclusions that should be considered.

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.

HUD agrees with the conforming changes to SFFAC 2. Most of the conforming changes are rescissions that result from movement of criteria for determining what organizations are required to be included in the federal reporting entity's GPFFR from a concepts statement to standards statement.

SFFAC 2 is being amended to ensure that concepts provide a framework for standards-setting but do not themselves establish standards by listing specific exclusions.

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.

HUD agrees with this effective date. It is the beginning of federal government fiscal year.

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?

HUD agrees that the flowcharts and illustrations are useful in understanding the application of the standards.

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

HUD believes the appendices should remain after the Statement is issued.

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.

HUD believes that the illustrations are adequate for understanding the application of this standard.

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.

HUD believes that there are no other unique situations that should be addressed within this Statement.

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.

HUD does not agree with the alternative view that the proposed standard should not equate receiverships, conservatorships, and interventions with other disclosure organizations to avoid an inference that they are part of the Federal government. We believe that including these types of entities makes the standard more complete. Given that certain organizations were established in the private sector, carry out activities not intended to be performed by the federal government and are temporary, **gives** the impression that these entities are not part of the Federal government.

- 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.**

HUD does not agree with the alternative view. We believe that one standard (i.e., this Exposure Draft) should cover all consolidation and disclosure entities in the GPFFR, including interventions, regardless of the type, to maintain consistency.



Tennessee Valley Authority, 400 West Summit Hill Drive, Knoxville, Tennessee 37902

July 2, 2013

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

VIA Electronic Mail: fasab@fasab.gov

Dear Ms. Payne:

Thank you for the opportunity to provide comments on the Federal Accounting Standards Advisory Board's Exposure Draft, *Reporting Entity*, dated April 3, 2013. TVA respectfully submits the following comments to Questions 2 and 5, as attached. If you have any questions, please contact me at (865) 632-2075 or dtwear@tva.gov or Donna Terzak at (865) 632-2871 or djterzak@tva.gov.

Sincerely,

A handwritten signature in black ink that reads "Diane T. Wear".

Diane T. Wear
Vice President and Controller

DTW:DJT:BAR:STB
Attachment: Response to FASAB Request for Comments

Response to FASAB Request for Comments
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SFFAS, Reporting Entity

Please submit to fasab@fasab.gov

Name of Respondent: Diane T. Wear

Organization: Tennessee Valley Authority

RESPONSE TO FASAB REQUEST FOR COMMENTS

TVA wishes to thank the Federal Accounting Standards Advisory Board (FASAB) for the opportunity to comment on its exposure draft of a proposed Statement of Federal Financial Accounting Standards (SFFAS) entitled *Reporting Entity* dated April 3, 2013. Our comments and concerns are provided below.

Q2. The Board proposes distinguishing between two types of organizations in government-wide general purpose federal financial reports (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.

Response to FASAB Request for Comments
July 2, 2013
Page 2

TVA agrees with the concept of distinguishing between consolidation entities and disclosure organizations to ensure that general purpose financial reports issued by federal entities are meeting the needs of its primary users. As described in paragraph 67, there is a difference in purpose, governance structure, and financial relationships within organizations of the federal government. These differences are based in part on differing business models arising from purpose, governance structure, and financial relationships.

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.

TVA agrees with the attributes to distinguish between consolidation entities and disclosure organizations as described in paragraph 37, whereby a distinction is made based on an assessment of the degree to which certain characteristics such as financing source, risks and rewards to the federal government, and non-market goods and services are provided.

Governmental activities are different from business-type activities which more nearly parallel private-sector counterparts. Accountability of consolidation entities (utilizing a non-market model) is primarily to (a) citizens, (b) Congress, (c) federal executives, and (d) federal program managers. Disclosure organizations are often identified with for-profit business models which report to financial institutions, bondholders, investors, banking trade groups, and customers.

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.

As adopted, SFFAS 34 allows that certain federal reporting entities prepare and publish financial reports pursuant to the accounting and reporting standards issued by FASB and these reports may be regarded as in conformity with generally accepted accounting principles (GAAP). TVA agrees in part with paragraph 66 which states that consolidation entities should consolidate component reporting entity or sub-component financial statements for consolidation entities in accordance with SFFAS 34 without conversion for any differences in accounting policies among the organizations.

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Page 3

However, TVA does not agree with the last sentence of paragraph 66 which states that “any component reporting entity that publishes financial reports pursuant to the accounting and reporting standards issued by the FASB should disclose intragovernmental amounts measured in accordance with federal financial accounting standards to facilitate elimination entries in preparation of the government-wide financial statements” and recommends it be removed.

TVA’s reason for the removal of the sentence is that the primary users of TVA’s financial statements are financial institutions, bondholders, investors, banking trade groups, and customers. These users expect TVA’s financial statements to be prepared in accordance with FASB GAAP as required by the Securities and Exchange Commission with whom TVA is required to file financial statements. To present a second set of financial statements with intragovernmental amounts measured in accordance with FASAB standards could be confusing to the user. Also, conversion of information may not be cost-effective at a time when agencies are being asked to evaluate work efforts in order to be more cost-conscious.

Concern for the elimination of intragovernmental activity for the government-wide financial statement could potentially be resolved by Treasury through its Governmentwide Financial Report System Closing Package instructions as contained in Treasury’s Financial Manual and its Intragovernmental Transactions Policy. Both documents may more appropriately address the mechanics of eliminating entries for the consolidated GFRS.

Thank you again for the opportunity to comment on the proposed Statement. TVA appreciates your efforts and continuing commitment to improving federal accounting and reporting.

Reporting Entity

Please submit to fasab@fasab.gov

Name of Respondent: Pamela Hanes, Deputy Chief Financial Officer

Organization: National Aeronautics and Space Administration

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.

NASA agrees with the understanding that meeting any one of the 3 principles require that an organization is included in an agency’s financial statements and inclusion allows for disclosure or consolidation. The inclusion principles are reasonable criteria to determine the significance of the federal government’s relationship and involvement with an organization. The inclusion principles are consistent with the concepts of conclusive criterion and indicative criteria in SFFAC 2, paragraphs 41-46 that should be considered in the aggregate for defining a financial reporting entity in the Federal Government.

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

Overall, NASA agrees that the inclusion principles and related definitions and indicators are helpful and provide guidelines by which to evaluate which organizations should be included in the GPFFR. The section titled, In The Budget, should include acknowledgement of the difference between an organization listed in an agency’s budget and one that is included in the budget but not specifically listed. Consideration may also be given to including a reference to the sections titled, Reporting On Organization – Consolidation Entities Or Disclosure Organizations

and/or Principles for Inclusion in the Government-wide GPFFR, to point to more detailed discussion.

- 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.**

NASA agrees with the concept that an organization should be included in the GPFFR if excluding it would be misleading. The concept of providing information that is not misleading is also applicable to the method used to present the organization's financial information, disclosure or consolidation. Our rationale is based on SFFAC 2, Entity and Display, as provided in paragraph 38.

Paragraphs 35-36 of the Statement discuss the concept of "Misleading to Exclude" for organizations that do not meet the inclusion principles. We recommend enhancing the Statement to provide more guidance that may include the criteria to determine "misleading to exclude" and the rationale for this consideration as it pertains to different types of organization and specifically Federally Funded Research and Development Centers. (Organization types may include FFRDCs, museums, performing arts organizations, universities, or venture capital funds and/or include distinction by method of financing, management agreement, level of autonomy, or applicable regulations.)

- 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.**

NASA agrees given that flexibility is allowed for different and distinct types of organizations and more guidance is provided related to the inclusion principles and how they relate to different types of organization.

NASA requests that FASAB provide clarity regarding the inclusion principles specifically in relation to Federally Funded Research and Development Centers given the special circumstances that FFRDCs are mandated to operate independently.

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.

NASA agrees with the concept of distinguishing between consolidation entities and disclosure organizations. In order to improve upon the information reported on activities financed by taxpayers, it is important to indicate circumstances where financial statement disclosure is more appropriate than consolidation of the results of each organization's financial activities.

Our rationale is based on the reality that there are varying degrees of the federal government's relationship with organizations – i.e. government ownership, control, or significant influence. The related degree of financial reporting and disclosure should mirror the relationship between the federal entity and an 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.

NASA requests that FASAB provide clarity regarding the disposition of the attributes individually and in the aggregate in order to distinguish between consolidation entities versus disclosure organizations. Clarity may be promoted by providing more detail. An example may be:

"Financed through taxes, and other non-exchange revenues", means the entity receiving funds is specified in an appropriation or that are not a result of goods or services provided to the federal agency/government.

An entity is considered to be "governed by the Congress and/or the President" when its direction is specified in appropriation language.

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.

NASA requests that FASAB provide additional clarity and guidance regarding the reporting attributes as they relate to each type of organization and specifically to Federally Funded Research and Development Centers.

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),**
- ii. the objectives for disclosures (see par. 72), and**
- iii. the examples provided (see par. 73)?**

Please provide the rationale for your answers.

- i. Overall, NASA agrees with the factors in determining disclosures and the objectives for disclosure however, this is another area where consideration should be given to the specific types of organization. As an example, information required in item C – Disclosure organization views/perspective, may be provided by a reporting entity as documented in the current FFRDC sponsoring agreement.
- ii. NASA agrees with the objectives for disclosures in paragraph 72 to provide relevant information to financial report users regarding the impact of the activity with the disclosure organization on the government's financial condition.
- iii. Overall, NASA agrees with the examples of information that would be disclosed, as long as the degree of financial reporting and disclosure takes into consideration the relationship between the federal entity and an organization. In other words, information in response to Item #D could include a summary describing the portion of the reporting entity's assets, liabilities, revenues, expenses, gains, and losses that are applicable to the disclosure organization identifying the types of assets/transactions that make up the majority of the balances. To provide further detail would be more consistent with consolidation versus disclosure. Item #E should provide clarity on the objective of this disclosure and how it relates to the reporting entity's financial reports. In addition, for clarity, we recommend the Statement identify each example to the relevant disclosure objective in paragraph 72.

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.**

NASA agrees that the component reporting entity financial reports should be consistent with data reporting in the GPFFR. It is reasonable to expect the inclusion principles and reporting attributes to be applicable at the component reporting entity level.

- 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.**

NASA agrees that administrative assignments can be identified using the criteria in paragraphs 54-63. In particular our interpretation of paragraph 58 a., Statutes or regulations establishing an organization states that it is assigned to or part of a larger federal organization would include the FAR 35.017 that establishes Federally Funded Research and Development Centers (FFRDC) and references the Master List of FFRDCs maintained by the National Science Foundation (NSF).

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.

NASA disagrees that a component reporting entity should consolidate in their entirety organizations for which it is accountable without regard to funding source, including those receiving appropriations and donations. Our rationale is that an organization for which a component reporting entity is accountable may not meet the criteria in paragraph 38 to be a consolidation entity. Given that, the component reporting entity would not consolidate the organization in the financial statements. The sections cited address disclosure also and the question does not.

NASA also disagrees with disclosing any information not directly related to the use of funds provided by the reporting entity and/or activity not directly controlled by the reporting 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.

NASA agrees that consolidation of FASAB and FASB based information without conversion for consolidation entities is appropriate. Our rationale is that the financial statement presentation by both standards is based on the GAAP, accrual based accounting. In addition, the presentation of a component entity's financial information should be consistent in both their individual financial reports and the government-wide financial reports.

However, NASA does not agree with making this requirement effective prior to receiving guidance related to tie points between budgetary and proprietary accounts or specifying which reports are required. FASB does not require budgetary accounts and addition of proprietary accounts alone will cause out of balance conditions not accepted during annual reporting.

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.**

NASA neither agrees nor disagrees with this statement.

- 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.**

NASA neither agrees nor disagrees with this statement.

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.

NASA agrees with the definitions and requirements for related parties.

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.

NASA agrees with the list of the types of organizations that would be considered related parties.

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

NASA does not recommend additional types of organization that should be considered related parties.

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

NASA agrees with the list of types of organization that would not be considered related parties.

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

NASA agrees that the definition for related parties is consistent with generally accepted accounting principles guidance. The list of organizations considered to be related parties is consistent with the definition.

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.

NASA agrees with the conforming changes, with the exception of item noted in our previous responses: Paragraph 94: The Statement should provide clarity on the criteria for the term “misleading”.

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.

NASA agrees with this effective date as long as technical guidance on the accounting treatment of implementing this requirement is provided prior to the effective date to include guidance related to tie points between budgetary and proprietary accounts and specifying which reports are required when FASB entities are consolidated with FASAB entities.

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?

NASA agrees. The appendices provided insight on the Board's objectives and concerns, which facilitated understanding the proposed standard in the Statement.

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

NASA agrees. The appendices will provide clarity on the background of the Statement standards and its applicability to various types of organizations.

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.

NASA does not recommend additional examples.

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.

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.**

NASA neither agrees nor disagrees with this statement.

- 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.**

NASA neither agrees nor disagrees with this statement.

Reporting Entity

Please submit to fasab@fasab.gov

Name of Respondent: Department of Homeland Security

Organization: Department of Homeland Security

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.

i. Agree these principles are objective and could be consistently applied across government agencies.

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

i. Agree, however some real life examples would be helpful and would deter subjectivity.

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.

i. Disagree, this catch all could be too subjective. We believe that the term “misleading” would need to be quantified.

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.

- i. Agree, as long as the “misleading to exclude” is either removed or better defined with some objective measures.**

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.**

- i. Agree, we also believe that an agency should be required to consistently report either consolidation or disclosure.**

- 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.**

- i. Disagree, with the more “flexible” attributes. For example the phrase: “imposing or may impose risks and rewards on the federal government,” will mean different things to different reasonable people, and therefore will result in different agencies consolidating and/or disclosing some entities while sister agencies under similar circumstances decide to do the exact opposite. Similarly the phrase, “less direct involvement and influence,” is again too subjective and will garner different treatment for similar situations. Also in this complex financial world several entities could provide a mix of goods and**

services both on a market basis and a non-market basis. So using this attribute and scenario alone an agency could argue for either consolidation or disclosure. This raises the question; Are these attributes equally weighted? Paragraph #37 states that “not all characteristics are required to be met to the same degree.” This is not helpful direction if the goal is to have comparable and consistent GPFFRs.

- 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.

- i. Disagree, we believe a hard line test should be developed when choosing between consolidation and disclosure.

- 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),

1. Disagree with subjective judgments about disclosures involving things like the “nature and magnitude of potential risks/exposures and benefits” or “complexity of relationships” etc. Instead we strongly agree that after an objective measure—such as materiality (x% of appropriated dollars for example)—determines that we should disclose, then all entities disclosed in the GPFFRs should disclose comparable data and those disclosure requirements should be developed here as shown in paragraph 72-73.

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

1. Agree

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

1. Agree

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.**

i. **Agree, this will be beneficial to stakeholders.**

- 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.**

i. **Disagree, assignments should be codified in statutes or regulations and supported by budgetary appropriations. Professional judgment should play a role not a “pivotal” role. The fact that a federal agency administers federal grants or contracts awarded to an organization should not be a heavily weighted factor in determining consolidation or exclusion.**

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-**Error! Reference source not found.** of the proposed standards and paragraph A19 in Appendix A - Basis for Conclusions for a discussion and related explanation.

- a. **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.**

i. **Agree, reporting on results, relationships, and risks should apply regardless of funding source.**

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.

- a. 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.**

i. We agree that conversion need not be required when consolidating. However, disclosures should include any significant differences caused by different accounting treatments when entities use FASB vs. FASAB.

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.**

i. We agree with some of the minimum disclosures relating to the central banking system, we do not believe new or onerous reporting requirements are needed.

- 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.**

i. We do not believe there are other significant organizations that won't be included in the three inclusion principals. Standards should include organizations that are significant and do not leave flexibility to include organizations based on subjective criteria.

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.**

i. **We disagree with definitions and requirements for related parties that require professional judgment in calculating significance and whether it would be misleading to exclude information.**

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.**

i. **Disagree, the three inclusion principles would cover an related parties when the government holds a majority interest or controls an organization with risk of loss or expectation of benefits.**

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

i. **There are no additional organizations that should be considered as related parties.**

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

i. **The inclusion principals would capture all objectively measurable related parties requiring disclosure.**

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

i. **No, there are no additional exclusions that should be considered.**

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.

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

i. **Agree, inclusion of organizations that the federal government owns, controls, with risk of loss or expectation of benefits, fits within the objective of accountability for financial reporting purposes.**

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.

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

i. **Agree.**

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?**

i. **Agree**

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

i. **Yes**

- 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.**

i. **Yes.**

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.**

- a. **Yes, when the government divests its ownership interest in an organization. How will comparative statements be prepared.**

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.**

i. Disagree, if an organization meets one of the three inclusion principles it should be included in the GPFFR.

- 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.**

i. Disagree, this exposure draft’s proposed three inclusion principles meets the modern governmental and quasi-governmental arrangements that would also include receiverships, conservatorships, and/or interventions.

From: Rivera, Eric
Sent: Tuesday, July 02, 2013 4:18 PM
To: FASAB
Cc: Vaught, Larry; Zane, Steven
Subject: Comments on Reporting Entity Exposure Draft

Good afternoon,

Attached are NRC/OIG's comments on the Reporting Entity Standard Exposure Draft.
Thank you for the opportunity to comment.

Eric Rivera
Team Leader
Financial and Administrative Audits Team
Office of the Inspector General
U.S. Nuclear Regulatory Commission

Reporting Entity

Please submit to fasab@fasab.gov

Name of Respondent:

Organization:

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.

Answer: I agree with each of the inclusion principles. I believe that comprehensive accountability should be assessed through inclusion in the GPFFR in all cases where a federal entity exercises both financial and/or management control of another entity.

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

Answer: I think the definitions and indicators are mostly helpful. However, the guidance around the “Misleading to Exclude” standard is missing clarity. I think more discussion with some examples around what it would mean to be misleading would, at a minimum, provide the practitioner with the intent of the standard.

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.

Answer: I agree with the standard in that the GPFFR should not be misleading. However, without more clarification, I am not sure how I would apply the standard. Maybe some examples or more discussion would be helpful.

- 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.**

Answer: I agree that all organizations should be subject to the inclusion principles. Allow the inclusion tests to determine if the entity should be excluded, not just categorically exclude them. I think to do otherwise would increase the risk that the GPFFR could be misleading and not reflect comprehensive accountability.

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.**

Answer: I agree with the concept. I think disclosure organizations would provide the GPFFR users with necessary information to fully understand the operations of the reporting entity. Without the disclosure organization's business relationship with the reporting entity, the GPFFR users would not be able to assess the financial risks and would not be able to make informed decisions concerning the reporting entity.

- 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.

Answer: I agree with the attributes used to make the distinction between consolidation entities and disclosure organizations. I think the attributes capture the intent of consolidations. It provides the proper combination of assets, liabilities, and operations to allow the GPFFR users to trace the financial accountability to the controlling decision makers.

- 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.

Answer: I agree. The attributes are well defined and specific enough to provide for the proper determination of the named organizations as consolidation entities or disclosure organizations,

- 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), Answer: I agree with the factors because they provide specific guidance for preparers to follow, and the factors are relevant to the information that GPFFR users would need.
- ii. the objectives for disclosures (see par. 72), and Answer: I agree with the objectives because they are concise and clear and easy to follow.
- iii. the examples provided (see par. 73)? Answer: I agree with the examples because they provide a lot of guidance to preparers to help them understand the nature and intent of what should be included in order to satisfy the objectives identified in par. 69.

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.**

Answer: I agree that each component reporting entity should report organizations for which it is accountable. This is the same principle that's applied in rolling up and consolidating GAAP financial statements. Without a full consolidation of the component reporting entity including disclosure organizations, it's GPFFR would not be complete making the government wide reporting entity's GPFFR also incomplete. In order to get the full financial picture of the government wide reporting entity, all entities that make up that picture must be complete.

- 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.**

Answer: I agree that administrative assignments can be identified as explained in paragraphs 54-63. The factors provided mostly in par. 58 and 59 provide specific indicators to consider to identify accountability assignments within component reporting entities. Preparers are identified with detailed guidance to follow.

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.

Answer: I agree that funding source should not be considered. The purpose of the GPFFR is to assess accountability for managing operations. Government-wide reporting entities can have multiple funding sources that they are accountable for. If funding source was taken into consideration, it would not provide the larger accountability financial picture.

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.

Answer: I disagree that consolidation entities based on two different standards are appropriate in all cases without conversion. Even though both standards are based on accrual rules, other accounting rules are different and can result in different account balances that could be material. I think that an analysis of the account balance differences based on different accounting standards should be completed and the materiality concept applied. If there is a material difference, then the balances should be converted to the government-wide reporting entity accounting standards. To do otherwise could be misleading to the GPFFR user.

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.

Answer: I agree with the minimum disclosure requirements. The disclosures are comprehensive and complete. I think that any additional disclosures would be excessive and not add value to the GPFFR users.

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.

Answer: I am not aware of any other significant financial organizations that might require minimum disclosure.

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.**

Answer: I agree with the definition and requirements for related parties. This standard is similar to GAAP related party disclosure requirements. By requiring disclosure of related party relationships, GPFFR users are provided with additional information that may be material and relevant to sound financial decision making.

- 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.**

Answer: I agree with the list provided, but I think the list could have provided more examples so that the preparers would have a better understanding of the definition of related parties. The list for what is not a related party is longer than the list of what is a related party.

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

Answer: I think this would be dependent on the degree of influence rather than on a type of entity.

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

Answer: I agree with list. These are examples where influence would not be significant.

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

Answer: No additional exclusions.

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.

Answer: I agree with the conforming changes. The changes appear to be necessary to make SFFAC 2 and SFFAC 34 language agree.

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.

Answer: I agree.

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?

Answer: I agree the appendices are very helpful.

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

Answer: I believe the appendices should be part of the Statement after it is issued. Since these are tools to apply the Statement, they should remain.

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.

Answer: I do not have any changes or additional examples regarding the illustrations. I think they provide good examples for guidance of how to apply the Statement.

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.

I am not aware of any unique situations that should be addressed within this Statement.

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.**

Answer: I disagree with the alternative view. I think receiverships, conservatorships, and interventions should be a part of the GPFFR if they meet the criteria of inclusion rules. I think the Statement clearly makes the distinction that disclosure entities are not required to apply the GAAP hierarchy for federal reporting entities.

- 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.**

Answer: I disagree with the alternative view. I think interventions should be addressed in SFFAC 34 because they should be included in an entities GPFFR if they meet the inclusion rules. The financial risks associated with interventions should be disclosed to the GPFFR users to provide them with the necessary information to make informed and sound business decisions.



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 (GPFFR).

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 GPFFR 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 GPFFR 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 GPFFR.

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 GPFFR 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 GPFFR.

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 GPFFR should be consistent with their character.

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

Consolidation of the Federal Reserve System's financial information in the GPFFR 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 GPFFR.

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 GPFFR 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 GPFFR.

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,



Louise L. Roseman
Director
Division of Reserve Bank Operations
and Payments Systems Division



Donald V. Hammond
Chief Operating Officer

**Office of the Inspector General**

Tennessee Valley Authority, 400 West Summit Hill Drive, Knoxville, Tennessee 37902-1401

Richard W. Moore
Inspector General

July 2, 2013

VIA: Electronic Mail

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:

My office recognizes and very much appreciates the work of the Federal Accounting Standards Advisory Board's (FASAB) and its staff to address the issues created by entities such as the Tennessee Valley Authority using Financial Accounting Standards Board (FASB) based information in their federal financial reporting. Thank you for this opportunity to comment on the proposed Statement of Federal Financial Accounting Standards, *Reporting Entity*, dated April 3, 2013, which offers a reasonable solution to this and other federal accounting and reporting issues. In particular, I would like to respond to question 5 and comment on paragraph 66 of the proposed Statement, as follows.

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 A66-70 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.

66. SFFAS 34 recognizes that a limited number of federal reporting entities prepare and publish financial reports pursuant to the accounting and reporting standards issued by the Financial Accounting Standards Board (FASB). SFFAS 34 provides that GPFFRs prepared in conformity with accounting standards issued by the FASB also may be regarded as

Ms. Wendy M. Payne
Page 2
July 2, 2013

in conformity with GAAP. Consolidation entities (i.e. the consolidated government-wide reporting entity or a consolidated component reporting entity) should consolidate component reporting entity or sub-component financial statements for consolidation entities prepared in accordance with SFFAS 34 without conversion for any differences in accounting policies among the organizations. Nonetheless, any component reporting entity that publishes financial reports pursuant to the accounting and reporting standards issued by the FASB should disclose intragovernmental amounts measured in accordance with federal financial accounting standards to facilitate elimination entries in preparation of the government-wide financial statements.

After consultation with my staff, I would like to offer our considered opinion on the issue posed in question 5. While we agree with the first part of paragraph 66, consolidation of FASAB and FASB based information without conversion for consolidation entities is appropriate, we do not agree that any component entity that publishes financial reports pursuant to the accounting and reporting standards issued by the FASB should disclose intragovernmental amounts measured in accordance with federal financial accounting standards to facilitate elimination entries in preparation of the government-wide financial statements.

The restatement of intragovernmental amounts from FASB to FASAB based amounts would not benefit users of the TVA general purpose (standalone) financial statements and would most likely confuse its users, including those in the financial and investor community who need TVA financial information presented consistently with that of other comparable public companies who also file FASB based reports with the Security and Exchange Commission. Since it is necessary for the intragovernmental amounts to be stated consistent with the FASAB standards solely for the purpose of eliminating these amounts during consolidation in preparing the government-wide financial statements, any differences in account balances caused by the use of different accounting standards could be better identified and resolved during the reconciliation process that occurs quarterly between federal trading partners using guidance provided accordingly in the *Treasury Financial Manual*. The reconciled amounts could then be used to eliminate the intragovernmental balances and compile the government-wide statements without reducing the understandability and usefulness of the components' general purpose (standalone) financial statements.

Accordingly, we recommend the following statement in paragraph 66 in the proposed Statement be removed: "Nonetheless, any component reporting entity that publishes financial reports pursuant to the accounting and reporting standards issued by the FASB should disclose intragovernmental amounts measured in accordance with federal financial accounting standards to facilitate elimination entries in preparation of the government-wide financial statements."

Again, thank you for the opportunity to comment on the proposed Statement. I appreciate your commitment and service to our federal accounting and financial reporting community.

Very truly yours,



Richard W. Moore



COMPTROLLER

OFFICE OF THE UNDER SECRETARY OF DEFENSE

1100 DEFENSE PENTAGON
WASHINGTON, DC 20301-1100

JUL 2 2013

Ms. Wendy M. Payne
Executive Director
Federal Accounting Standards Advisory Board
441 G Street, NW, Suite 6814
Mail Stop 6K17V
Washington, DC 20548

Dear Ms. Payne:

The Department of Defense (DoD) appreciates the opportunity to comment on the Federal Accounting Standards Advisory Board exposure draft, "Reporting Entity," dated April 3, 2013. The DoD Consolidated Financial Statements do not include the Non-Appropriated Fund activities. They would need to be disclosed under this proposed standard. This will require some additional Financial Improvement and Audit Readiness effort to meet the established due dates for audit readiness.

Responses to specific questions are enclosed. My contact is Ms. Maryla E. Engelking. She can be reached at maryla.engelking@osd.mil or 703-602-0155.

Sincerely,

A handwritten signature of Mark E. Easton is written over a horizontal line.

Mark E. Easton
Deputy Chief Financial Officer

Enclosure:
As stated

DoD Responses to FASAB Exposure Draft, "Reporting Entity," Dated April 3, 2013

Department of Defense (DoD)

Please submit to fasab@fasab.gov

Name of Respondent: *Mark E. Easton*

Organization: *Office of the Deputy Chief Financial Officer*

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.**

DoD Response: Agree. The inclusion principles conform to the conclusive and indicative criteria for including components in a reporting entity described in Statement of Federal Financial Concepts 2, Entity and Display. Control also discussed as a primary criteria within the Financial Accounting Standards Board Proposed Statement of Financing Accounting Concepts, The Reporting Entity.

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

DoD Response: Agree. The inclusion principles, along with the illustrations in Appendix C, are understandable. Appendix C is especially helpful in demonstrating the nuances of the criteria.

- 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.**

DoD Response: Agree. It would be misleading to exclude the organization if it does not meet the inclusion principles, as the consolidated financial statements would not be complete, accurate, or presented fairly.

- 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.**

DoD Response: Agree. The inclusion principles are comprehensive and include all potential organizations that the government may be responsible for consolidating whether by budget authority, ownership, or control. It is suggested, however, that some additional guidance be added to distinguish museums consolidated under this proposed standard and museums disclosed under Federal Accounting Standards Advisory Board Statement of Federal Financial Accounting Standards (SSFAS) 29, Heritage Assets and Stewardship Land. There may appear to be some conflicting guidance in reading both standards.

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.

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

DoD Response: Agree. The federal government has relationships with organizations which have a greater degree of autonomy than those considered consolidation entities. Entities receiving limited or no funding from tax revenues and providing only rewards or risks to the federal government should not be reported the same as consolidated entities. In order for the GPFFR to be complete, disclosure entities must be included.

2. 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.

DoD Response: Agree. Attributes used to make the distinction between consolidation and disclosure organization entities fall in line with the inclusion principles. No additional attributes are noted, at this time.

1. 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.

DoD Response: Agree. Assuming that an organization is to be included in the GPFFR, the attributes are adequate to make the distinction between consolidation and disclosure organization. The attributes provide a principle based exercise to determine whether an entity should or should not be included in the GPFFR and how they should be reported, as consolidated entities or disclosure entities. No additional attributes are noted, at this time.

- 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),

DoD Response: Agree. The factors seem to assure that disclosures made to the financial statements are presented fairly and without any material misstatements.

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

DoD Response: Agree. The objectives seem adequate to assure that disclosures made to the financial statements are objective and present any potential risks.

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

DoD Response: Agree. The examples provided should provide complete and accurate disclosures to the financial statements.

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.**

DoD Response: Agree. In order to fulfill the completeness assertion, component entities need to report all organizations for which they are accountable, including consolidation and disclosure organizations.

This is likely the most challenging aspect for DoD. Each DoD reporting entity would need to determine who is receiving the funds and how DoD influences the organization, including any reporting requirements that DoD has implemented. Once the entities are identified, they would need to implement a process and/or policy to modify their financial reporting requirements to include the "consolidated" and/or "disclosure" entities. Due to the nature of the relationships (e.g., entities may be funded by more than one DoD reporting entity) they may need to determine who will consolidate and/or disclose the information within the DoD. The newly identified entities would likely need to be audit ready - although, they may already have a clean opinion as they may be commercial entities and may have covenants / requirements for clean opinions. The DoD would need to determine some modified Financial Improvement and Audit Readiness requirements specific to these entities.

Additionally, auditors would have to expand their procedures to address these requirements. Office of Management and Budget Bulletin 07-04, Audit Requirements for Federal Financial Statements, would be revised. There will likely be new financial reporting requirements as well.

- 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.

DoD Response: Agree. The administrative assignments can be identified and are consistent with the three inclusion principles. The criteria appear to be appropriate and comprehensive, especially with the inclusion of the "Misleading to Exclude/or Misleading to Include" paragraphs. Certain entities, although administratively assigned to another entity should be reported separately. Financial information for certain entities needs to be masked within a consolidated entity.

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-**Error! Reference source not found.** 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.

DoD Response: Disagree. This proposal seems to be contradictory to what is described in paragraph 43 of the Exposure Draft. An entity receiving donations, as opposed to appropriations, should be considered a disclosure entity, and not consolidated.

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.

DoD Response: Agree. Since the objective is to incorporate all required components into the GPFFR, entities with differences in accounting standards should still be consolidated, in accordance with SFFAS 34. In addition, a disclosure of the differences in accounting methodologies should be required. FASB reporting entities need to provide intragovernmental balances based on FASAB standards to allow for the proper elimination of intragovernmental activity. Intragovernmental differences are one of the causes of the disclaimer the GPFFR receives each year.

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.**

DoD Response: Agree. If the central banking system is reported as a disclosure entity, it should be subject to the minimum disclosure requirements mentioned within this exposure draft.

- 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.**

DoD Response: Yes. All segments of the government that are not consolidated entities should be required to provide disclosure information. This is consistent with GAAP principles and enhances government transparency and accountability to the public. However, we do not know of any specific entities that fall into this category.

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.**

DoD Response: Agree. The definition and requirements of related parties are consistent with GAAP terminology and disclosures.

- 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.**

DoD Response: Agree. The list of organizations appears to define the vast majority of potential related parties.

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

DoD Response: No additional organizations are noted, at this time.

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

DoD Response: Agree. The list of exclusions appears appropriate.

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

DoD Response: No additional exclusions are noted, at this time.

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.

DoD Response: Agree. The changes made to SFFAC 2 are consistent with the Exposure Draft guidance.

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.

DoD Response: Agree. The effective date seems reasonable to allow Component Reporting Entities to fulfill these requirements and update their accounting systems.

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?**

DoD Response: Agree. The examples provided help demonstrate the inclusion principles outlined in the exposure draft, as well as the four attributes that distinguish what to consolidate or disclose. The flowchart summarizes the standard in a clear and concise way. "A picture is worth a thousand words."

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

DoD Response: Agree. The guidance will assist Component Reporting Entities in adopting the new standard.

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.

DoD Response: No changes at this time. The examples provided are helpful, they should not be considered all encompassing.

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.

DoD Response: No unique situations are noted, at this time.

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.**

DoD Response: Disagree. The proposed standard appropriately distinguishes between consolidation entities and disclosure entities, including receiverships, conservatorships, and interventions. The Federal Government assumes some risk in these endeavors and does exhibit some control. Therefore, these entities need to be included, but it is important that the disclosures clearly state that they are not part of the Federal Government. It is important for the Federal Government to be as transparent as possible, especially when it involves public funding. Additional explanation within the disclosure could emphasize the government’s position.

- 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.**

DoD Response: Disagree. This proposed standard attempts to establish which entities need to be included in the GPFFR. It also establishes which entities need to be consolidated and which entities need to be disclosed. Receiverships, conservatorships, and interventions need to be disclosed since they pose a potential risk to the Federal Government. Any additional guidance as to the proper accounting for these entities, or risks assumed, could be resident in another standard, but disclosure requirement are appropriately resident in this proposed standard.

Reporting Entity

Please submit to fasab@fasab.gov

Name of Respondent: Sherry A. Laws

Organization: Commodity Credit Corporation

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.

- Do you agree or disagree with each of the inclusion principles? Please provide the rationale for your answer. Agree with the inclusion principles outlined in the exposure draft. All of the principles follow GAAP.**
- Do you believe the inclusion principles, and the related definitions and indicators, are helpful and clear? Please provide the rationale for your answer. The inclusion principles are stated in a clear manner which allows the determining official to make determination and document the reasoning.**
- 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. Yes the definition provided in the misleading to exclude does not provide enough determining factors to allow decision makers to clearly make the decision to include or exclude. The lack of criteria would leave this open for audit disagreements. Paragraph 63 provides further criteria of the misleading to exclude—this would appear to be similar to the Parent/Child reporting outlined in the OMB Circular A-136.**
- 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. Yes the inclusion principles should be applied across the Government. Exclusions for the “other” Federal entities could lead to misstatements. It is possible that some Government entities may qualify for the disclosure reporting rather than full inclusion for consolidated statements.

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.

1. Do you agree or disagree with the concept of distinguishing between consolidation entities and disclosure organizations? Please provide the rationale for your answer. **Yes agree with the concept of reporting some entities as disclosure organizations rather than as consolidating entities. The types of organizations which should be disclosed rather than consolidated might skew the reporting of a consolidated entity.**
2. 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. **Agree. The Document provides clear decision making criteria.**
1. 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. **Agree. The attributes are clear and**

provide adequate criteria to allow for determination of consolidation vs. disclosure.

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), **Agree.**
- ii. the objectives for disclosures (see par. 72), and **Agree, however 72(c) can be open for interpretation within the audit community and reporting projected future exposure financially may be difficult.**
- iii. the examples provided (see par. 73)? **Agree. Examples help provide clarity to the disclosure objectives.**

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. **Agree. The reporting of all organizations which a reporting entity is responsible for fully discloses the breadth and scope of a Federal reporting entity. All organizations within the control should be reported.**
- 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. **Agree. The evaluation items listed in Para 56 provide very clear criteria, especially items a) and b).**

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. Agree with the inclusion of the entire organization for which a Government reporting entity is responsible. The reporting of only sub-components could lead to misinterpretations of financial data. Sources of funding should be part of the disclosure to allow a reader of the report to more fully understand relationship and sources of funds allowing for operations.

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. Federal Financial Reporting should consistently follow FASAB guidance. The mixing of reporting standards could mislead a reader and provide confusion for the report users.

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. Agree. The emphasis of the disclosure however should be from the Reporting Entities viewpoint and outline its business relationship and interactions with the Central Banking System.**

- 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. **None to add.**

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. Definition provided in para 78-83 are clear and concise.**
- 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. **Para 83 is not clear “use of the term generally” allows for substantive judgment by the reporting entity.**
- c. Are there additional organizations that generally should be considered related parties? Please provide the rationale for your answer. **None at this time.**
- d. Do you agree or disagree with the list of exclusions? Please provide the rationale for your answer. **Agree. Definitions in Para 84 are clear.**
- e. Are there additional exclusions that should be considered? Please provide the rationale for your answer. **None at this time.**

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. Agree. The SFFAC 2 should reflect the same reporting decision criteria outline in the standard.

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. Disagree. The change should be further out into the future to allow agencies to complete the necessary analytics and incorporate reporting changes. We would suggest agencies complete the information for FY17, with comparative presentation in FY18 financial statements.

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—all of the appendices provide clarifying guidance. The decision flowchart will clearly aid reporting entities in the determination of inclusion and presentation.**
- b. Do you believe the appendices should remain after the Statement is issued? **Yes.**
- 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. **None at this time.**

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. Not aware of any at this time.

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. **Disagree. While the inclusion of these organizations greatly broadens the scope—the disclosure of Government involvement in the organization management and financial actions provides the user of the statements significant information. The disclosure needs to be concise and not duplicate information reported.****
- 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. **Disagree. The current statement is focused on the reporting entity—it should ensure that it is not in conflict with other statements or concept papers.****

The Statement and Account Clause, the Obamacare Litigation and the FASAB's Unconstitutional Reporting Entity Proposal

Joseph H. Marren (1) (2) (3)
Concerned Citizen
July 3, 2013

- (1) The views expressed herein are solely Mr. Marren's and do not represent the views of KStone Partners LLC or any of its other Members.
- (2) Mr. Marren's biography: http://www.linkedin.com/profile/view?id=57346984&trk=nav_responsive_tab_profile
- (3) End notes for this "working draft" document have not been completed.

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The Statement and Account Clause, the Obamacare Litigation and the FASAB's Unconstitutional Reporting Entity Proposal

1) Introduction

Does current financial reporting by the federal government comply with the requirements of the United States Constitution? This is a central question that Congress needs to address but will not. This memorandum attempts to answer that question.

It will surprise few that the conclusion reached in this memorandum is that the federal government's financial reporting falls far short of Constitutional requirements and that the proposed Exposure Draft does little more than maintain the current status quo with respect to fraudulent financial reporting by the federal government. The Exposure Draft reflects the fact that our political leaders have subverted the democratic process to protect their self interests. They have failed and continue to fail to comply with an important Constitutional check on power, the requirement for the publication of a complete and truthful statement and account.

Article I, Section 9 clause 7 of the United States Constitution provides that:

“No Money shall be drawn from the Treasury, but in Consequence of Appropriations made by law; and a regular Statement and Account of the Receipts and Expenditures of all public Money shall be published from time to time.”

The first part is called the Appropriations Clause and the second part is called the Statement and Account Clause. The Tax and Spending Clause is found in Article I, section 8, Clause 1:

“The Congress shall have Power To lay and collect Taxes, Duties, Imposts and Excises, to pay the Debts and provide for the common Defence and general Welfare of the United States; but all Duties, Imposts and Excises shall be uniform throughout the United States.”

The inquiry into whether financial reporting violates the Constitution includes a review of a broad range of evidence from our nation's early history including the Articles of Confederation, statements by the Framers at the Constitutional Convention and at the state ratification conventions, government practices both

before and after enactment of the Constitution and the only court case to reach the Supreme Court regarding the Statement and Account Clause. A detailed analysis of the Appropriations Clause, the Statement and Account Clause and the Tax and Spending Clause is presented. This discussion is followed by a review of the legislative history affecting financial reporting from the late 1800s to the present day. An overview of current financial reporting by the federal government including detailed analysis of the President's Budget and the Financial Report follows. Included in the commentary of the Financial Report is an estimate of the federal government's actual financial results over the last decade. Also depicted is an estimated current balance sheet for the nation. The psychological factors that make it virtually impossible for the Legislative or Executive branches or state legislatures to correct the financial reporting problem are summarized. Finally, the question of whether reporting requirements have changed since the Constitution was ratified is addressed.

Why does financial reporting by the federal government matter? Based on Supreme Court decisions the deficient financial reporting violates numerous private rights conferred by our Constitution including the right to vote, freedom of speech, due process, equal protection, the right to financial information and the right to political accountability. In addition, the Supreme Court has ruled extensively on the meaning of the antifraud provisions of the securities laws. It appears that these principles are inherent in the Statement and Account Clause.

Many believe that the Statement and Account is subject to the plenary power of Congress and that no court or citizen has any ability to challenge any financial reporting that Congress wishes to undertake. This assertion will be reviewed and proven to be a false.

In addition to undermining private rights granted by the Constitution the deficient financial reporting by the federal government has led the Supreme Court of the United States to decide at least one case based on financial facts that are clearly untrue. On June 28, 2012 the Supreme Court resolved constitutional challenges to two provisions of the Patient Protection and Affordable Care Act of 2010 ("ACA" or the "Act"): the individual mandate and the Medicaid expansion.¹ The memorandum contains a discussion of the second provision resolved by the Court, the Medicaid expansion. Seven members of the Supreme Court agreed that the Medicaid expansion in the Act is unconstitutional.² Each of the opinions issued by the Court, Justice Ginsburg and the Dissenters (Justices Scalia, Kennedy, Thomas and Alito) contains economic and political accountability analyses that are seriously flawed.

Information submitted in merit briefs and orally to the Supreme Court included financial information published by the federal government that does not appear to comply with the Statement and Account Clause. In addition, relevant material financial information that was published only after the passage of the ACA but prior to the submission of merit briefs and oral argument was not raised or discussed in either. The fraudulent material submitted by each state to the Court relates to each state's financial results. This information is fraudulent as it does not include the full costs directly related to each state's participation in the Medicaid program. The full cost of the Medicaid program for each state has never been published by any state.

The basic framework for the analysis contained in this memorandum was created for a first-of-its-kind conference "Representation Without Accountability" which was held at Fordham Law School on January 23, 2012. The conference addressed the federal government's actual expenditures, its current financial reporting and questions surrounding the Statement and Account Clause including whether financial reporting by the federal government comports with Constitutional requirements. A nonpartisan panel of speakers included Hon. David Walker, former Comptroller General, David Mosso, former Chairman of the Federal Accounting Standards Advisory Board ("FASAB"), Professor Brian Fitzpatrick, a constitutional law professor at Vanderbilt Law School and Joseph Marren, President & CEO of KStone Partners. Professor Sean Griffith, Director of the Fordham Law Corporate Center delivered opening remarks and acted as moderator for the conference. The conference was presented by the Fordham Corporate Law Center and sponsored by Joseph and Joan Marren and KStone Partners LLC. A video of the conference as well as a transcript, all presentations and the conference brochure can be found at <http://law.fordham.edu/accountability>.

All figures used in the memorandum are taken or calculated directly from the federal government's reported financial results.

This memorandum is not intended to support either policy option (raising taxes or cutting spending) that are required to stabilize the nation's finances. The author believes that once all members of Congress and the Administration must deal with the same set of facts with respect to the nation's financial results and financial position, they will navigate their way to an acceptable outcome for the electorate. Furthermore, this memorandum does not attempt to assign blame for the current state of financial reporting. There is more than enough for both political parties.

In this memorandum the federal Government's Constitutional authority to suppress financial information related to national security matters is not being questioned. Also, Congress' authority to determine the amount of detail associated with its financial results is not being questioned. What is being asserted is that the federal Government is falsely reporting total receipts, total expenditures and the resulting deficit calculated by subtracting the second figure from the first. These three figures, it is asserted, are not subject to the plenary power of Congress.

2) Exposure Draft

a. Current Law

The determination as to which organizations and agencies will be included in the Financial Report of the United States Government ("Financial Report") is governed by Federal laws and is also based on guidance issued by the FASAB in their Statement of Federal Financial Accounting Concept No. 2 ("SFFAC 2"), Entity and Display³.

Conclusive Criteria according to SFFAC 2 is if an entity is included in the President's Budget, then it should be included in the reporting entity. Indicative Criteria are: 1) Exercises sovereign power, 2) Is owned by the federal government, 3) Carries out missions and objectives, 4) Is subject to direct or continuing control by the reporting entity, 5) Determines outcome of matters affecting the recipients of services, and 6) Has a fiduciary relationship with the reporting entity. However, no single criterion is determinative.

All SFFAC are not considered to be Generally Accepted Accounting Principles ("GAAP"). At present, the following hierarchy constitutes GAAP⁴:

1. Category A – Officially established accounting principles, consist of FASAB Statements and Interpretations, as well as American Institute of Certified Public Accountants ("AICPA") and Financial Accounting Standards Board ("FASB") pronouncements, specifically applicable to federal government entities by FASAB Statements and Interpretations.
2. Category B – consists of FASAB Technical Bulletins and, if specifically applicable to federal governmental entities by the AICPA and cleared by FASAB, AICPA Industry Audit and Accounting Guides and AICPA Statements of Position.

3. Category C – consists of AICPA, Accounting Standards Executive Committee (“AcSEC”) Practice Bulletins if specifically applicable to federal governmental entities and cleared by FASAB, as well as Technical Releases of the Accounting and Auditing Policy Committee (“AAPC”) of FASAB.
4. Category D – includes implementation guides published by FASAB, as well as practices widely recognized and prevalent in the federal government.

Although Title 2 of the Government Accountability Office’s (“GAO”) Policy and Procedures Manual for the Guidance of Federal Agencies is not specifically mentioned in the above hierarchy, it is included in the fourth level of authority, as practices widely recognized and prevalent in the federal government. Moreover, the Handbook was based substantially upon Title 2. Accordingly, Title 2 is considered a proper reference for accounting principles and standards where it does not conflict with guidance provided for in the first three levels of the accounting hierarchy.

b. Current Reporting⁵

Fiscal Year 2012 Financial Statement Audit Results

The Government-wide Reporting Entity - The financial statements [in the Financial Report] cover the three branches of the Government (legislative, executive and judicial). Legislative and judicial branch reporting focuses primarily on budgetary activity. Executive branch entities, as well as certain legislative branch agencies are required, by law, to prepare audited financial statements. Some other legislative branch entities voluntarily produce audited reports.

A number of entities and organizations are excluded due to the nature of their operations, including the Federal Reserve System (considered to be an independent central bank under the general oversight of Congress), all fiduciary funds, and Government-Sponsored Enterprises, including the Federal Home Loan Banks, the Federal National Mortgage Association (Fannie Mae), and the Federal Home Loan Mortgage Corporation (Freddie Mac). The Emergency Economic Stabilization Act (EESA) of 2008 gave the Secretary of the Treasury temporary authority to purchase and guarantee assets from a wide range of financial institutions through the Troubled Asset Relief Program (TARP). Following U.S. GAAP for Federal entities, the Government has not consolidated into its financial statements the assets, liabilities, or results of operations of any financial organization or commercial entity in which Treasury holds either a direct, indirect, or beneficial equity investment. Even though some of the equity investments are significant, the entities in which the Federal Government holds equity investments meet the criteria under

paragraph 50 of the SFFAC 2, which directs that the financial results of such entities should not be consolidated into the financial reports of the United States Government, either in part or as a whole. However, the investments in these entities and any related liabilities are recorded in the financial statements.

c. Proposed Rules⁶

“The principles herein are not intended to establish whether an organization is or should be considered a federal agency for legal or political purposes. Rather this exposure draft (ED) provides principles to guide preparers of financial statements at the government-wide and component reporting entity levels in determining what organizations should be included in the reporting entity’s GPFFR (author’s note: the “Financial Report” for all practical purposes) for financial accountability purposes.

The government-wide GPFFR should include all organizations (1) budgeted for by elected officials of the federal government, (2) owned by the federal government, or (3) controlled by the federal government with risk of loss or expectation of benefits.

The ED provides for determining the most appropriate means-consolidated financial statements or disclosures – to include information about these organizations in GPFFRs. Determining the most appropriate means requires an assessment of the degree to which the following characteristics are met: the organization is financed by taxes or other non-exchange revenue, is governed by the Congress and/or the President, imposes or may impose risks and rewards on the federal government, and/or provides goods and services on a non-market basis. Note, however, not all characteristics are required to be met to the same degree; classification is based on the assessment as a whole.

Generally, consolidated financial statements presenting the financial position and results of operation are appropriate for those organizations financed by the taxpayer, governed by elected officials, imposing risks and rewards on the federal government, and providing goods and services on a non-market basis....Organizations to be included in the consolidated financial statements within the GPFFR are referred to as “consolidation entities” and are subject to the hierarchy of generally accepted accounting principles (“GAAP”) established for “federal entities” in Statement of Federal Financial Accounting Standards 34.

Consolidation is not appropriate for organizations operating with a high degree of autonomy. Some organizations that meet the principles for inclusion are insulated

from political influence and intended to be non-taxpayer funded. Presenting information about these discrete organizations in consolidated financial statements would obscure operating results and financial position of the reporting entity. Instead, information about these types of discrete organizations should be disclosed in notes to the consolidated financial statements of reporting entities applying federal financial accounting standards....Organizations to be disclosed in the GPFFR are referred to as “disclosure organizations.”

d. Summary Observation

The proposed rules will largely continue current unconstitutional reporting practices with respect to the Federal Reserve System and Government Sponsored Enterprises such as Fannie Mae and Freddie Mac. They will not be consolidated in the Financial Report and hence, the government’s consolidated financial statements will remain substantially misleading. The concept of “consolidation entities” and “disclosure entities” is directly at odds with the Statement and Account Clause’s “all public Money” requirement.

3) The Statement and Account Clause

a. Historic Review

i. Constitutional Convention

The Articles of Confederation and Perpetual Union (hereafter the “Articles” or the “Articles of Confederation”) was the first written constitution for the U.S. Government. It was created by the delegates from the states in the Second Continental Congress. It was drafted in 1776-77 and became the working constitution in 1777. It was not formally ratified until 1781.

The new states preferred to think of themselves as separate republics in an alliance of convenience. The Articles of Confederation described “a firm league of friendship.” Article II made it clear that the individual states were not subject to the United States: Each state retained its sovereignty, freedom, and independence, and every power, jurisdiction, and right, which was not expressly delegated to the United States. One of the major problems with the Articles was the requirement that all thirteen states had to approve any changes.

There was no president, executive agencies, judiciary or tax base. The lack of a tax base meant that the government was unable to pay off state and national debts. The states and the Continental Congress both incurred large debts during the War, and repaying those debts was a major issue. The government was funded by money from the states when nine states voted to do so. As a result funds were contributed sporadically and Congress printed money in large amounts which had the effect of depreciating its value.

In May 1779 John Jay, president of the Continental Congress requested \$45 million from the states saying that taxes were “the price of liberty, the peace, and the safety of yourselves and posterity.” He argued that Americans should avoid having it said “that America had no sooner become independent than she became insolvent” or that “her infant glories and growing fame were obscured and tarnished by broken contracts and violated faith.” The states did not respond with any of the money requested from them. Between 1781 and 1784, less than \$1.5 million came into the Treasury although the states were asked for \$2 million in the single year 1783.⁷

Congress under the Articles did not have the power to regulate either foreign trade or interstate commerce and, as a result, all the states maintained control over their trade policies. By 1787 states had started attacking private contracts and interstate commerce.

At the Annapolis Convention in 1786 Alexander Hamilton led a group of federalists that believed in a strong central government that petitioned Congress to call a constitutional convention in Philadelphia in May 1787 to revise the Articles. It should be noted that Hamilton estimated that as of 1790 that the Confederation government owed approximately \$52 million to its creditors.⁸ The inability to repay its debt was one of the principal reasons for calls for a stronger national government.⁹

The Constitutional Convention met in Philadelphia between May 25 and September 17, 1787. The debates of the Convention indicated that there was widespread agreement that, in the words of Roger Sherman, “money matters” were “the most important of all”; or, as Madison put it, the “compleat power of taxation [was] the highest prerogative of supremacy . . . proposed to be vested in the National Govt.”¹⁰ Throughout the Convention, delegates focused on the “purse strings” or the “purse”.¹¹ —Every discussion was based on the premise that the protection of the people’s money is a legislative function.¹²

The Framers were vitally concerned about ensuring democratic control and accountability over the revenue and appropriations powers. In addition, one of the

most challenging issues during the convention concerned the apportionment of seats in the legislative branch. States with small populations preferred the existing practice under the Articles of Confederation which was equal representation of the states. The more populous states, such as Virginia and Massachusetts, preferred that legislative representation reflect a state's population. In addition the debates demonstrate that the Framers viewed fixing responsibility for taxing and spending was critical to the success of the new constitution. In this regard, no delegate argued that the President or any combination of Executive officers should possess the power to tax or spend. All believed that a democratically accountable Legislature should have this power.

In June 1787, the draft of the Constitution allowed either house to originate taxation and appropriations measures. During the debates on June 13, Elbridge Gerry, of Massachusetts, "[m]oved to restrain the Senatorial branch from originating money bills."¹³ He reasoned that "[t]he other branch was more immediately the representatives of the people, and it was a maxim that the people ought to hold the purse-strings."¹⁴ Gerry's motion was defeated, by a margin of three states in favor and eight opposed.¹⁵

When the Convention reached an impasse between the large and small states regarding the apportionment of seats in the House and Senate the delegates appointed a special committee to consider the question of apportionment.¹⁶ The Committee of Eleven presented its report to the Convention on July 5, 1787.¹⁷

The Committee of Eleven proposed the Great Compromise.¹⁸ The Great Compromise established a bicameral legislature with proportional representation in the House of Representatives and equal representation of the states in the Senate. In order to appease the larger states for accepting equal representation of all states in the Senate, the power of originating taxation and appropriations measures was vested in the House of Representatives and the Senate was prohibited from either originating or amending such legislation (described as strong version of the Origination Clause). However, this agreement did not hold.

George Mason, of Virginia suggested that "[t]he consideration which weighed with the Committee was that the [first] branch would be the immediate representatives of the people, the [second] would not."¹⁹ In light of this, "[s]hould the latter have the power of giving away the peoples [sic] money, they might soon forget the Source from whence they received it" and "[w]e might soon have an aristocracy."²⁰

Benjamin Franklin agreed saying "it was always of importance that the people should know who had disposed of their money, & how it had been disposed of."²¹

Franklin added that “those who feel, can best judge” and “[t]his end would . . . be best attained, if money affairs were to be confined to the immediate representatives of the people.”²²

On July 16, 1787, the delegates adopted the Great Compromise. The resolution incorporated the strong version of the Origination Clause and passed by a vote of five to four, with one state delegation abstaining.²³ On July 26, 1787, the delegates charged a “Committee of Detail” with preparing a new working draft that would reflect and incorporate the various resolutions and amendments adopted up to that point.²⁴

On August 6, John Rutledge, of South Carolina, delivered the Report of the Committee of Detail.²⁵ Article IV, section 5 of the working draft included a strong version of the Origination Clause.

The Convention considered this provision on August 8, 1787. At that time, Charles Pinckney, of South Carolina, moved to strike the provision from the draft. He argued that “[i]f the Senate can be trusted with the many great powers proposed, it surely may be trusted with that of originating money bills.”²⁶

George Mason objected strongly to the motion. Mason argued that “[t]o strike out the section, was to unhinge the compromise of which it made a part.”²⁷ Mason was referring to the equal suffrage of all states, regardless of population, in the Senate. Characterizing the Senate as a bastion of “[a]ristocracy,” Mason believed that “[t]he purse strings should never be put into its hands.”²⁸

The delegates voted in favor of Pinckney’s motion by a margin of seven states in favor and four states against.²⁹ This vote had the effect of striking the Origination Clause and put the Great Compromise in doubt. For several representatives’ control over taxation and appropriations was so important that, without it, they were willing to revisit the decision to provide equal representation in the Senate.

On August 9, 1787, Edmund Randolph, of Virginia gave the Convention notice that he would seek reconsideration of the vote at a later time. On August 11, 1787, he moved for reconsideration.³⁰

Randolph’s motion to reconsider passed by a vote of nine states in favor to one state opposed, with one state abstaining. Two days later, on August 13, 1787, the Federal Convention took up reconsideration of the Origination Clause. At this juncture, the linkage between the issues of origination and equal representation was obvious.

Randolph moved to limit the clause to “revenue raising” bills.³¹ This amendment served to eliminate the objection that the term “money bills” was overly broad so as to potentially bring within the restriction “all bills under which money might incidentally arise.”³²

George Mason spoke strongly in favor of vesting the House of Representatives with control over the power of taxation and spending. Mason’s argument largely focused on the character of the Senate as distanced from and unaccountable to the voting citizens. This was so because as constituted “the Senate did not represent the *people*, but the *States* in their political character.”³³ Accordingly, “[i]t was improper therefore that it should tax the people.”³⁴ He concluded that “in all events he would contend that the purse strings should be in the hands of the Representatives of the people.”³⁵

Gerry stated “Taxation and representation are strongly associated in the minds of the people, and they will not agree that any but their immediate representatives shall meddle with their purses.”³⁶ He warned that “acceptance of the plan will inevitably fail, if the Senate be not restrained from originating Money bills.”³⁷

The vote in favor of restoring the origination restriction was defeated and the Origination Clause was to be stricken.³⁸

On August 15, 1787, Caleb Strong moved to amend to include a weaker version of the Origination Clause that the delegates had rejected. Strong’s amendment provided that:

Each House shall possess the right of originating all Bills, except Bills for raising money for the purposes of revenue or for appropriating the same and for the fixing of salaries of the Officers of Government which shall originate in the House of Representatives; but the Senate may propose or concur with amendments as in other cases.³⁹

The delegates postponed debate on the amendment without comment, by a vote of six to five.⁴⁰

On August 31, 1787, the delegates created the Committee of Eleven, consisting of a delegate from each state, to consider “such parts of the Constitution as have been postponed, and such parts of reports as have not been acted on.”⁴¹ On September 5 the Committee proposed a weaker version of the original Origination Clause—the House of Representatives would have the power to originate revenue measures, but the Senate would enjoy full powers of amendment to such legislation. The provision

was reworked over the next several days into “but the Senate may propose or concur with amendments as in other bills”⁴² and was agreed to by the delegates.

The Federal Convention delegates signed the Constitution on September 17, 1787. Significantly, Randolph, Mason, and Gerry—all supporters of a strong version of the Origination Clause—refused to sign the draft.

“The Statement and Account Clause was first proposed in the final week of the Constitutional Convention, when George Mason moved on 14 September 1787 that a clause be adopted requiring “that an Account of the public expenditures should be annually published.”⁴³ George Mason’s timing for his proposal was not accidental. Mason’s fervor for the strong version of the Origination Clause, his lack of success in achieving its inclusion and his views on the need for direct accountability to the people on tax and spending matters all clearly impacted his desire for the Clause. The fact that the provision was adopted given that all at the Convention knew Mason’s strongly held views on accountability needs to be taken into consideration when considering the meaning of the Clause. The important change to Mason’s proposal that added all receipts to the Clause clearly reflects a desire to have the Statement and Account be complete and encompass the Government’s entire economic reality.

In the initial debate on Mason’s proposal, Gouveneur Morris urged that such accounting would be “impossible in many cases.” And Rufus King remarked that it would be “impracticable” to account for “every minute shilling.”⁴⁴ James Madison then proposed an amendment to require an accounting “from time to time” rather than annually. The debate surrounding the adoption of Madison’s amendment is important. Farrand gives a brief account of the debate at the Convention, taken from Madison’s notes. Madison thought that the substitution of “from time to time” for “annually” would ensure frequent publication and “leave enough to the discretion of the Legislature.”⁴⁵ Madison’s notes from the Convention do not elaborate on the concept of legislative discretion, except to say that if too much is required, “the difficulty will beget a habit of doing nothing.”⁴⁶

The rationale behind Madison’s amendment came more fully to light in the debate in the Virginia ratifying convention. On 12 June 1788 Madison stated that under the Constitution as proposed, congressional proceedings were to be “occasionally published,” and that this requirement included all receipts and expenditures of public money.⁴⁷ He praised this as a security not enjoyed under the then existing system of government. Then, in a sentence reflecting on the degree of discretion to

be allowed under Clause 7, he stated: “That part which authorizes the government to withhold from the public knowledge what in their judgment may require secrecy, is imitated from the confederation—that very system the gentleman advocates.”⁴⁸ Madison’s language strongly indicates that he believed that the Statement and Account Clause, following his amendment, would allow government authorities ample discretion to withhold some expenditure items which require secrecy.

Any ambiguity in Madison’s statement is removed by a more lengthy debate that occurred five days later on 17 June 1788 between Madison and George Mason. Arguing against Madison’s “from time to time” provision, Mason criticized it as too loose an expression. He then summarized the arguments made by proponents of the provision:

The reasons urged in favor of this ambiguous expression, was [sic], that there might be some matters which might require secrecy. In matters relative to military operations, and foreign negotiations, secrecy was necessary sometimes. But he did not conceive that the receipts and expenditures of the public money ought ever to be concealed. The people, he affirmed, had a right to know the expenditures of their money.⁴⁹

Mason’s statement clarifies several points concerning the Framers’ intent. First, it appears that Madison’s comment on government discretion to maintain the secrecy of some expenditures, far from being an isolated statement, was representative of his fellow proponents of the “from time to time” provision. Second, as to what items might legitimately require secrecy, the debates contain prominent mention of military operations and foreign negotiations. Finally, we learn that opponents of the “from time to time” provision, exemplified by Mason, favored secrecy only for the operations and negotiations themselves, not for receipts and expenditures of public money connected with them. But the Statement and Account Clause, as adopted and ratified, incorporates the view not of Mason, but rather of his opponents, who desired discretionary secrecy for the expenditures as well as the related operations.

In reply to Mason’s argument, Madison did not pursue the point on the need for secrecy, but argued that publication from time to time would provide more satisfactory and fuller reports to the public and would be of sufficient frequency. He added that he believed that “this provision went farther than the constitution of any state in the union, or perhaps in the world.”⁵⁰ The remainder of the exchange between Madison and Mason was brief, and did not touch on secrecy of expenditures.⁵¹

In addition to the statements of Madison and Mason, there is only one other statement from the Virginia ratifying convention expressing a view on the secret expenditure issue. This is a statement of Patrick Henry on 15 June 1788, apparently expressing a fear of the effect of the “from time to time” provision: “By that paper the national wealth is to be disposed of under the veil of secrecy; for the publication from time to time will amount to nothing, and they may conceal what they may think requires secrecy. How different it is in your own government!”⁵² Though perhaps more exaggerated than Mason’s language, Henry’s statement further confirms the interpretation of the Madison-Mason debate.

Viewed as a whole, the debates in the Constitutional Convention and the Virginia ratifying convention convey a very strong impression that the Framers of the Statement and Account Clause intended it to allow discretion to Congress and the President to preserve secrecy for expenditures related to military operations and foreign negotiations.

Madison mentions the legislature specifically, but not exclusively.⁵³ That the President shares in this discretion is suggested by one of the Federalist Essays of John Jay, who had gained diplomatic experience in the service of the Continental Congress during the Revolution and of the Confederation afterwards. Commenting on the newly proposed Constitution, he observed:

It seldom happens in the negotiation of treaties of whatever nature, but that perfect secrecy and immediate dispatch are sometimes requisite. There are cases where the most useful intelligence may be obtained, if the persons possessing it can be relieved from apprehension of discovery. Those apprehensions will operate on those persons whether they are actuated by mercenary or friendly motives, and there doubtless are many of both descriptions, who would rely on the secrecy of the president, but who would not confide in that of the senate, and still less in that of a large popular assembly. The convention have done well therefore in so disposing of the power of making treaties, that although the president must in forming them act by the advice and consent of the senate, yet he will be able to manage the business of intelligence in such manner as prudence may suggest.⁵⁴

The establishment of secret funding practices soon after the Constitutional Convention indicates a contemporaneous understanding that the Framers of Clause 7 did not intend it to require disclosure of expenditures for secret military and foreign diplomacy matters. It is difficult to imagine stronger contemporaneous evidence of the Framers’ intent, when one considers that the contingent fund was initially requested by President Washington, who presided over the Constitutional

Convention in 1787, and that a further secret funding measure was enacted under Madison, who in his earlier role as “Father of the Constitution” had introduced the “from time to time” amendment.”⁵⁵

ii. Federalist Papers

In *Federalist No. 48*, Madison argued that the legislative power was by far the most extensive, in part because “the legislative department alone has access to the pockets of the people.”⁵⁶

In *Federalist No. 58*, Madison, responding to a concern that the equality of representation in the Senate might allow a minority to frustrate the majority’s will of a majority, stated:

“The House of Representatives cannot only refuse, but they alone can propose the supplies requisite for the support of government. They, in a word, hold the purse—that powerful instrument by which we behold, in the history of the British Constitution, an infant and humble representation of the people gradually enlarging the sphere of its activity and importance, and finally reducing, as far as it seems to have wished, all the overgrown prerogatives of the other branches of the government. This power over the purse may, in fact, be regarded as the most complete and effectual weapon with which any constitution can arm the immediate representatives of the people, for obtaining a redress of every grievance, and for carrying into effect every just and salutary measure.

To those causes we are to ascribe the continual triumph of the British House of Commons over the other branches of the government, whenever the engine of a money bill has been employed.”⁵⁷

Alexander Hamilton, in *Federalist No. 66*, stated that “[t]he exclusive privilege of originating money bills will belong to the House of Representatives,”⁵⁸ as an argument against concerns that the Senate would have too much power given its lack of proportional representation.

Hamilton in *Federalist No. 72* noted that the executive’s functions included “the application and disbursement of the public moneys in conformity to the general appropriations of the legislature.”⁵⁹

In *Federalist No. 78*, Hamilton argued for an independent judiciary and mentioned the appropriations power of Congress:

“Whoever attentively considers the different departments of power must perceive that, in a government in which they are separated from each other, the judiciary, from the nature of its functions, will always be the least dangerous to the political rights of the Constitution; because it will be least in a capacity to annoy or injure them. The executive not only dispenses the honors but holds the sword of the community. The legislature not only commands the purse but prescribes the rules by which the duties and rights of every citizen are to be regulated. The judiciary, on the contrary, has no influence over either the sword or the purse”⁶⁰

iii. Contemporaneous Statements

In an early session of Congress, Madison stated “The constitution . . . places the power in the House of originating money bills.”⁶¹ He explained that “[t]he principal reason why the constitution had made this distinction was, because they were chosen by the People, and supposed to be best acquainted with their interests, and ability [to pay taxes].”⁶²

In New York, Chancellor Livingston reminded his hearers on June 27, 1788 “to keep in mind, as an important idea, that the accounts of the general government are “from time to time” to be submitted to the public inspection...Will not the representatives consider it essential to their popularity to gratify their constituents with full and frequent statements of the public accounts. There can be no doubt of it.”⁶³

iv. Immediate Financial Reporting

By the second session of the 1st Congress, the Treasurer of the United States was providing quarterly accounts of public expenditures.⁶⁴ As early as 1791, the House provided by resolution⁶⁵:

RESOLVED: that it shall be the duty of the Secretary of the Treasury to lay before the House of Representatives...an accurate statement and account of the receipts and expenditures of all public moneys...in which statement shall also be distinguished the expenditures which fall under each head of appropriation, and shall show the sums, if any, which remain unexpended, and to be accounted for the next statement of each and every of such appropriations.

The earliest statements and accounts of public expenditures were not more specific than each “head of appropriation.”⁶⁶

Early State of the Union Messages reveal that presidents routinely reported national budgets-as well as statements and accounts of receipts and expenditures.⁶⁷ President Washington concluded his first State of the Union Message by stating, “I have directed the proper officers to lay before you, respectively, such papers and estimates as regard the affairs particularly recommended to your consideration, and necessary to convey to you that information of the state of the union which it is my duty to afford.”⁶⁸

v. U.S. v. Richardson

William Richardson was a citizen who in 1967 made an effort to discover the size of the CIA’s “black budget” by writing a letter to the US Government Printing Office. He requested a copy of the CIA budget “published by the Government in compliance with Article I section 9 clause 7.”⁶⁹ Richardson was rebuffed by the US Treasury and started a court action. He argued that the CIA Act was repugnant to the Constitution since it operates to falsify the regular Statement and Account of all public money. After three years Richardson’s case was dismissed by Pittsburgh Federal Judge, Joseph P. Wilson who decided that Richardson did not have standing.

Richardson appealed and in 1971, succeeded in having his case heard before a full bench of the United States Court of Appeals in Philadelphia. In the Circuit Court all parties conceded that there is no prior decision which directly controlled the outcome of the case. The nine federal judges ruled in a 6-3 decision in 1972 that Richardson did have legal standing since the Court reasoned that a responsible and intelligent taxpayer and citizen of course wants to know how his tax money is spent because without this information he cannot intelligently follow the actions of the Congress or the Executive, nor could he properly fulfill his obligations as a member of the electorate. The Circuit Court majority and dissent both found that the intent behind the clause was that the citizenry should receive some form of accounting from the government.⁷⁰

The Federal Government appealed to the Supreme Court and in July 1974, the nine Supreme Court Justices ruled in a 5-4 decision, that Richardson did not have standing. The Court held that Richardson’s suit was nothing more than a generalized political grievance that needed to be dealt with through the political process. The Supreme Court concluded that it did not need to examine the merits of Richardson’s case.

Justice Douglas in his dissent in United States v. Richardson⁷¹ had numerous comments that illuminate the meaning of the Statement and Account Clause.

“The mandate runs to the Congress and to the agencies it creates to make a regular Statement and Account... The beneficiary-as is abundantly clear from the constitutional history-is the public.” “The Framers of the Constitution deemed financial information essential if the electorate was to exercise any control over its representatives and meet their new responsibilities as citizens of the Republic”⁷² “From the history of the clause it is apparent that the Framers inserted it in the Constitution to give the public knowledge of the way public funds are expended.”⁷³ “The sovereign in this Nation is the People, not the bureaucracy. The statement of accounts of public expenditures goes to the heart of the problem of sovereignty. If taxpayers may not ask that rudimentary question, their sovereignty becomes an empty symbol and a secret bureaucracy is allowed to run our affairs.”⁷⁴ “Secrecy was the evil at which Article I, Sec 9 Cl 7 was aimed.”⁷⁵

Judge Max Rosenn, the Circuit Judge in the Richardson case stated that

“[t]he debates at the Constitutional Convention in 1787 and the state ratifying conventions reveal that....the citizenry should receive some form of accounting from the Government....Article II, section 3 requires the President “from time to time to give Congress Information on the State of the Union,” and presumably the Framers could have utilized the same informal procedure with regard to the accounting if they had so wished. Instead, they chose to have the statement “published,” indicating that they wanted it to be more permanent and widely-circulated than the President’s message. The connotation must be that the statement was for the benefit and education of the public as well as coordinate branches of government.”⁷⁶

Judge Rosenn believed that the constitutional obligation to account to the public was supported by the Congressional enactment of 31 U.S.C. section 66b(a)⁷⁷ which provides:

The Secretary of the Treasury shall prepare such reports for the information of the President, the Congress, and the public as will present the results of the financial operations of the Government...(emphasis supplied)

In furtherance of this general duty, Congress enacted 31 U.S.C. sections 1027-1030 which provide for various specific reports, including the Combined Statement of Receipts and expenditures provided for in Section 1029.

Thus, Judge Rosenn reasoned that Congress’ own language indicates that the Secretary’s duty to present financial reports runs not only to the President and the

Congress, but also to the public at large. If these reports are misleading and inadequate, there is no reason why Richardson, as a taxpayer, should not be able to require the appropriate executive officer to perform his obligations.

Judge Rosenn also stated “The right of the taxpayer to receive reasonably complete reports of governmental expenditures is within the “zone of interest(s) protected...by the statute...in question” and one for which he may suffer a cognizable injury.”⁷⁸

Judge Adams, the Circuit Judge who authored a dissenting opinion that was joined by Judges Aldisert and Hunter wrote that:

“The argument that the duty to report the accounting runs to the public is based on a comparison of Article I, Section 9, Clause 7 with Article II, Section 3. The language of Article I, Section 9, Clause 7 mandates that “a regular Statement and Account***shall be published***”, whereas Article II, Section 3 requires that the President “shall from time to time give to the Congress information of the State of the Union**”. Thus, the impact of the distinction between “shall be published” and “shall from time to time give to the Congress” becomes apparent. Furthermore, the Articles of Confederation, drafted by many of the same persons as the Constitution, required only that Congress inform the states of its indebtedness, as opposed to the requirement of publication of the receipt and expenditures of all public money.”⁷⁹

St. George Tucker’s comments are also instructive with respect to the Statement and Account Clause.⁸⁰ “These provisions form a salutary check, not only upon the extravagance, and profusion, in which the executive department might otherwise indulge itself, and its adherents and dependents; but also against misappropriation, which a rapacious, ambitious or otherwise untruthful executive might be disposed to make.”⁸¹

Justice Joseph Story averred that “[t]he object is . . . to secure regularity, punctuality, and fidelity, in the disbursements of the public money . . . Congress is made the guardian of this treasure; and to make their responsibility complete and perfect, a regular account of the receipts and expenditures is required to be published, that the people may know, what money is expended, for what purposes, and by what authority.”⁸²

One of the key issues that has never been determined by the Supreme Court is what information is required by the Clause. Is limited financial reporting that includes a discrete number of consolidated figures all that is needed or are complete consolidated financial statements required?

vi. Appropriations Clause

The Appropriations Clause has been described as the single most important curb in the Constitution on Presidential power.⁸³ Control of government expenditures is among Congress' most important and immutable rights. It is also among Congress' indispensable duties. It means that no money can be paid out of the Treasury unless it has been appropriated by an act of Congress. The Constitution gives Congress the so-called "power of the purse" by providing that only it can appropriate money from the Treasury.⁸⁴

The "Appropriations" required by the Constitution are not only legislative specifications of money amounts, but also legislative specifications of the powers, activities and purposes-what we may call, simply, "objects"-for which appropriated funds may be used. As Alexander Hamilton explained, "no money can be expended, but for an object, to an extent, and out of a fund, which the laws have prescribed." The "extent" or amount of funding modifies and shapes the "object" funded.⁸⁵

There are two governing principles⁸⁶ of the power of the purse:

Principle of the Public Fisc: All funds belonging to the United States-received from whatever source, however obtained, and whether in the form of cash, intangible property, or physical assets-are public monies, subject to public control and accountability. This principle implies that all monies received by the United States are in "the Treasury," to use the language of the Constitution.

Principle of Appropriations Control: All expenditures from the public fisc must be made pursuant to a constitutional "Appropriation made by Law."

Together, the two principles prescribe that there may be no spending in the name of the United States except pursuant to legislative appropriation.

Two framework statutes originally enacted in the 19th and early 20th centuries-the Miscellaneous Receipts statute⁸⁷ and the Anti-Deficiency Act⁸⁸ are especially important in ascertaining Congress' historical understanding and application of the appropriations requirement. Although the Anti-Deficiency Act as such was not enacted until the early 20th century, the rule against deficiencies was contained in several 19th century statutes.

1. The Miscellaneous Receipts Statute⁸⁹

The Act of March 3, 1849 provided that all funds “received from customs, from the sale of public lands, and from all miscellaneous sources, for the use of the United States, shall be paid into the Treasury of the United States. As now codified in section 3302 of title 31 of the United States Code (“Money and Finance”), the statute provides that any “official or agent of the Government receiving money for the Government from any source shall deposit the money into the Treasury.”

Pursuant to the requirements of the Miscellaneous Receipts statute, all funds belonging to the United States-received “for the use of the United States” or “for the Government” –are part of the public fisc. All such funds must be deposited into the federal Treasury, from there to be appropriated by law.

2. The Anti-Deficiency Act⁹⁰

The Act defines the scope of public expenditure. The two major provisions of this Act-the rule against deficiencies and the rule against voluntary service-were enacted in response to federal agencies incurring “coercive” deficiencies and thereby circumventing amount limitations in appropriations legislation.

Congress may create permanent, substantive law through an appropriations bill only if it is clear about its intentions.⁹¹ This type of authorizing legislation controls mandatory spending. A distinctive feature of these authorizing laws is that they provide agencies with the authority or requirement to spend money without first requiring Appropriations Committees to enact funding. Mandatory spending includes Social Security, Medicare and Medicaid. Mandatory spending programs continue indefinitely.⁹²

Several commentators have made the point that Congress renders meaningless the principles of the public fisc and of appropriations control if it creates spending authority without amount or time limitations and fails to subject such authority to periodic legislative review.⁹³ However, the Supreme Court has been clear that Congress has the power to enact such legislation. In these decisions the Court has not ruled on is the impact that permanent appropriations or mandatory authorizing legislation has on the reporting requirements under the Statement and Account Clause. Presumably, such legislation raises the bar with respect to proper reporting. Given the fact that cash outlays associated with permanent appropriations and mandatory authorizing legislation comprises more than 50% of outlays and the total obligations for social insurance plus Medicaid exceed \$100 trillion it is hard to

imagine that the Supreme Court would rule that cash-based reporting achieves the appropriate level of disclosure required by the Constitution.

The complementary nature of the Appropriations and Statement and Account requirements is indicated not only by their placement and wording but also by their broader functions. Without statement and account review, executive agencies could evade the object and amount limitations of appropriations.⁹⁴ Hence, the appropriations requirement implements not only the idea of “no taxation without representation,” but also the foundational premise of a federal government which is limited to constitutionally authorized activities.⁹⁵ If there could be “public Money” that is not deposited in “the Treasury” prior to expenditure, then the scope of these complementary constitutional provisions would differ. As a matter of textural coherence, the two phrases should be regarded as synonymous.

In addition, although Congress holds the purse-strings, it may not exercise this power in a manner inconsistent with the direct commands of the Constitution.⁹⁶

vii. Tax and Spending Clause

There are several places in the Constitution that limit Congress’ power to tax and spend including the General Welfare Clause, the Uniformity Clause, the Apportionment of Direct Taxes, and other restrictions on spending.

The Supreme Court has indicated that there are five restrictions on spending: an exercise of the spending power must be in pursuit of the general welfare, conditions imposed on the use of federal funds must be reasonably related to the articulated goal; the intent of Congress to impose conditions must be authoritative and unambiguous; and the action in questions must not be prohibited by an independent constitutional bar.⁹⁷ A fifth restriction indicates that in some circumstances the financial inducement offered by Congress might be so coercive as to pass the point at which pressure turns into compulsion.

b. Federal Financial Reporting

i. Legislative History

1. Taft Commission and Prior Reform Efforts

Starting in the 1880s there were a series of investigations including the Cockrell Committee, Dockery-Cockrell Commission, Roosevelt’s Keep Commission and the Taft Commission on Economy and Efficiency (“Taft Commission”), that dealt with

the issue of how to improve Federal administration. These investigations were prompted by the increasing size and scope of the nation's business. The Dockery-Cockrell Commission, for example, had, in the 1890s, reiterated Congress' preeminent role in financial management based on the Constitution. Prior to the Taft Commission the results of these efforts were limited.

The Taft Commission was created in June 1910 with the purpose to investigate the business and methods of the Government. The Taft Commission is notable because it proposed that a budget for the U.S. Government be established. Subsequently, President Taft submitted the first consolidated budget. Congress ignored this budget but the Commission's recommendation ultimately led to the passage of the Budget and Accounting Act of 1921 described below. Many citizens were in favor of these changes as they believed that it would lead to better government.

2. Impact of Woodrow Wilson

Woodrow Wilson, the President from 1913 to 1921, thought that separation of powers was the product of an outmoded theory of politics. In particular, he had no use for separated powers. "No living thing can have its organs offset against each other as checks, and live," he declared. "There can be no successful government without leadership or without the intimate, almost instinctive, coordination of the organs of life and action."⁹⁸ His views stand in sharp contrast to the importance of separation of powers as described by James Madison in Federalist No. 51.⁹⁹

Although a longtime advocate of the budget system, he vetoed the bill ultimately passed in 1921, described below, rather than submit to its limitation of his removal power of the Comptroller General.

3. Sixteenth Amendment

The Sixteenth Amendment was ratified by the 36th state on February 13, 1913. Eight months later, in October the Congress enacted a new federal income tax law. By the end of WWI the federal government's revenue generating sources had changed dramatically. Prior to the war, tariffs and excise taxes supplied more than 90% of Federal revenues. After the war income taxes generated 58%.

4. Budget and Accounting Act of 1921¹⁰⁰

There was no unified Executive budget prior to the Act. Agency requests were simply packaged by the Treasury Department and transmitted to Congress without change. Following ten years of political maneuvering and debate after the Taft Commission first proposed a budget President Harding signed the Act in 1921.

Thereafter, requests from Executive agencies were funneled into the Bureau of the Budget (“BOB”), which functioned as a central clearinghouse.

The Act built on efforts to develop a new budget process and involved trade-offs with the Legislature and the Executive. The Act created the BOB, the forerunner of the Office of Management and Budget (“OMB”), and established presidential authority over the budget formulation process. As a counterweight to the enhancements of Executive power in the budget process, Congress established the General Accounting Office (“GAO”), now known as the General Accountability Office. The statute transferred to GAO auditing, accounting and claims functions previously carried out by the Department of the Treasury. The office was designed to be “independent of the executive departments,” which were placed under its audit and review powers.¹⁰¹

By the early 20th century it had become apparent that the removal power of the President had curtailed the effectiveness of Treasury officials monitoring executive compliance with appropriations limitations. By transferring the auditing function to an independent officer not answerable to the President and removable by legislation only for cause Congress sought better to ensure Executive compliance with spending legislation.

A major feature of the Act was that it gave the GAO power to “prescribe the forms, systems, and procedure for administrative appropriation and fund accounting in the several departments and establishments...”¹⁰² The Act specified that control of agency accounting systems and the pre-audit were also responsibilities of the GAO. The Act directed the Comptroller General to prescribe accounting principles and standards in executive agencies.¹⁰³ Later legislation enacted exceptions to GAO’s jurisdiction over executive branch and independent agencies including: (1) the CIA, (2) foreign operations and money market policies of the Federal Reserve¹⁰⁴ and (3) the President may proscribe GAO access to certain foreign intelligence and counterintelligence operations. To enforce access to information the Comptroller General has power to sue a non-complying agency.

By law, the Comptroller General cooperates with the Secretary of the Treasury and the Director of the OMB in developing for use by all federal agencies standardized systems, terminology, definitions, classifications, and codes for federal fiscal, budgetary and program related data and information.

More federal agencies ignored GAO’s guidance than complied in the years after the Act was passed.¹⁰⁵

5. Brownlow Committee

The Executive branch's perspective on the issue of which branch was in charge of determining accounting policies was articulated by the President's Committee on Administrative Management (the Brownlow Committee) during FDR's administration and reiterated by the later Hoover Commissions. The Brownlow Committee in 1937 called for a stronger BOB to help the President centralize fiscal management. It recognized that effective fiscal management required a good accounting system to control spending. Since the President's duty was to faithfully execute the law including appropriations laws the committee reasoned that accounting was an Executive function. The committee therefore advocated separating the GAO's accounting and audit functions. Specifically, it recommended the authority to prescribe and supervise accounting systems, forms and procedures in the Federal establishments should be transferred to and vested in the Secretary of the Treasury. This would limit the GAO to post audit functions. The Brownlow's assertion of accounting as an exclusive executive function was unacceptable to Congress.

6. Executive Reorganization Plan of 1939

The Bureau of the Budget was moved from Treasury into the Executive Office of the President pursuant to this Act. This further increased the Executive's power over the budget. The Executive Office of the President had originally been proposed by the Taft Commission and again by President Harding.

7. First Hoover Commission

The Hoover Commission, officially named the Commission on Organization of the Executive Branch of the Government was appointed in 1947 by President Truman. It took its name from former President Herbert Hoover who was appointed by Truman to chair it. In 1949 it made 273 recommendations of which over 100 were implemented in legislation over ensuing years. It recommended the use of accrual accounting by the federal government.

8. Joint Financial Management Improvement Program

The Joint Financial Management Improvement Program ("JFMIP") is a program authorized by the Budget and Accounting Procedures Act of 1950¹⁰⁶ to improve financial management practices. It was originally set up in 1948 by the Comptroller General, the Director of the OMB and the Secretary of the Treasury. It is a joint and cooperative action undertaken by the Treasury Department, GAO, OMB and

the Office of Personnel Management. The program name was originally the Joint Program for Improving Accounting in the Federal Government but it was changed in 1959.

9. Accounting and Auditing Act of 1950¹⁰⁷

The recommendations of the First Hoover Commission led to the passage of the Act. It was signed into law by President Truman in September 1950. The Act listed the accounting policies, principles and standards that were to be used by government agencies. After the Act, agencies had to use accrual accounting and cost-based budgeting. They also had to uniformly classify their accounting structures and keep up with an inventory of physical inventory.

The Act directed the Comptroller General to prescribe the principles, standards and related requirements for accounting to be observed by Executive agencies after consulting with the Secretary of the Treasury and the President. The use of accrual accounting, cost-based budgeting, consistent classification, simplification of allotment structure, and adequate control of property is required to establish and maintain adequate systems of accounting and internal control. Furthermore, accrual accounting enhances the ability of agencies to execute cost-based budgeting.¹⁰⁸

In response to the legislation, the GAO issued accounting standards in its Policy and Procedures Manual for Guidance to Federal Agencies (Title 2). Throughout the 1950s and 1960s the GAO reported to Congress that federal agencies had responded poorly to their guidance.

The Act governed the way all government agencies submitted and maintained financial information, including the Executive branch. This brought up a constitutional question as to whether Congress could pass a piece of legislation that governed the Executive branch. Some OMB officials asserted that the GAO standard setting provision was unconstitutional because it authorized a legislative agency to define accounting standards for executive agencies. As a result of the constitutional question of whether the legislative branch can issue standards for the Executive branch the GAO, OMB and Treasury never reached agreement.

10. Second Hoover Commission

The second Hoover Commission was created by Congress in 1953 during the Eisenhower administration. It sent its report to Congress in 1955. It recommended the continued use of performance budgeting, in addition to agencies formulating

and administering their budgets on a cost basis. The usefulness of formulating and administering budgets on a cost basis was recognized in 1956 amendments described below but it continues to be largely ignored.

11. Amendments to 1921 and 1950 Acts¹⁰⁹

Amendments to the Budget and Accounting Act, 1921 and the Budget and Procedures Act of 1950 were passed on August 1, 1956.

The Congress provided the following amendments to the 1921 Act:

Sec. 1

(b) The requests of the departments and establishments for appropriations shall, in such manner and at such times as may be determined by the President, be developed from cost-based budgets.

(c) For purposes of administration and operation, such cost-based budgets shall be used by all departments and establishments and their subordinate units. Administrative subdivisions of appropriations or funds shall be made on the basis of such cost-based budgets.”

Amendments to the Budget and Accounting Procedures Act of 1950 were as follows:

Sec. 113 of such Act is amended by adding at the end thereof the following new subsection:

(c) As soon as practicable after the date of enactment of this subsection, the head of each executive agency shall, in accordance with principles and standards prescribed by the Comptroller General, cause the accounts of such agency to be maintained on an accrual basis to show the resources, liabilities, and costs of operations of such agency with a view to facilitating the preparation of cost-based budgets as required by section 216 of the Budget and Accounting Act, 1921, as amended.

12. President's Commission on Budget Concepts

The President's Commission on Budget Concepts was established early in 1967 by President Johnson. Its task was to review the budget concepts and models of presentation then in use and to recommend appropriate changes. Its report was issued in October 1967 and it recommended accrual accounting and that the annual budget be presented on an accrued expenditure basis. This was endorsed by two administrations but not implemented.

13. Executive Reorganization Plan of 1970

Under President Nixon, a second Executive reorganization plan was passed. The Bureau of the Budget was renamed OMB. All functions assigned to the BOB were now delegated to the Director of the OMB. Most importantly, all Executive departments, agencies and other bureaucratic units had to funnel their budget requests through OMB and the President. If these had to depend on OMB and the President they would more likely follow the President's wishes. This further strengthened the Executive branches control over the budget.

Meanwhile in Congress, the budget was not treated as a single entity but as thirteen separate bills. Its budgetary process was uncoordinated and confusing.

14. Congressional Budget and Impoundment Control Act of 1974 ¹¹⁰

This law was enacted for two reasons: 1) Congress realized that it had no means to develop an overall budget plan and 2) there existed no framework for Congress to establish its own spending priorities before work began on specific spending and revenue bills. The Act created House and Senate Budget Committees and established the Congressional Budget Office ("CBO"). The Act also moved the government's fiscal year end from June 30 to September 30.

15. Arthur Andersen & Company Study¹¹¹

In the 1970s Arthur Andersen & Company ("AA") studied the government's financial reporting. In 1975 AA issued a report and proposed that the government prepare consolidated financial statements on an accrual basis for all entities in the Government and all programs which may require future taxes for present liabilities. AA reasoned that both Hoover Commissions had recommended accrual accounting, and this had led to the passage of Public Law 84-863. This law, supplemented by related Treasury Regulations, specifies that Government agencies must prepare business-type, accrual-basis financial reports. These laws and regulations were in existence since 1956 but had only been partially implemented.

AA recommended discounting the outlays and receipts of a number of transfer programs including social security, civil service retirement and disability, veterans' benefits, and military retirement. Changes in present values were recommended to be included in the budget.¹¹²

16. Prototype Consolidated Financial Statements

The first prototype Financial Report was produced by AA for 1973 and 1974. In 1975, the Treasury Department began issuing annual prototype government-wide financial statements on an accrual basis.

17. Reaction by CBO to AA Report

In response to the AA study the CBO prepared a Technical Analysis Paper “Federal Financial Reporting: Accrual Accounting and the Budget” (1977) that reflected the CBO’s reaction. Essentially, it argued that if the AA recommendations were implemented the unified budget would be useless. It described accrual accounting as undefined in the law and that Congress had left that responsibility to the Comptroller General.¹¹³ Furthermore, it attacked the AA recommendations regarding the discounting of transfer payment liabilities and the depreciation of assets. It reasoned that if transfer payments are discounted then everything in the budget should be as well.

18. Title 2 of the GAO Policy and Procedure Manual for Guidance of Federal Agencies

In 1984 GAO required audited agency statements on an accrual basis. Title 2 of the GAO Policy and Procedure Manual for Guidance of Federal Agencies was revised to require Federal agencies to prepare consolidated financial statements using the accrual basis of accounting.

19. Managing the Cost of Government: Building An Effective Financial Management Structure

In February 1985 then Comptroller General, Chuck Bowsher, put forth a detailed recommendation for a completely revised integrated approach for financial reporting for the Federal Government.¹¹⁴ The GAO called for accrual-based consolidated financial statements and recording social insurance obligations in all budgeting and financial reports. Arthur Andersen supported the GAO’s stance. OMB budget officials reacted very negatively.

20. Balanced Budget and Emergency Control Act of 1985

This law, commonly known as the Gramm-Rudman-Hollings Act, instituted rules designed to cut the budget deficit which at that time was the largest in history. The rules required automatic spending cuts if the deficit exceeded a set of fixed deficit targets.

21. Chief Financial Officers Act of 1990 (the “CFO Act”)

The CFO Act required for the first time in history that federal agencies prepare annual financial statements and that these statements be independently audited. It required compliance with applicable accounting principles, standards, requirements and internal control standards. However, the Act did not define the source or nature of the applicable standards. At this point in time, OMB officials still held to their point of view that the GAO standard setting provision of the 1950 Act was unconstitutional because it authorized a legislative agency to define accounting standards for Executive agencies. The Act also established an Office of Federal Financial Management (OFFM) headed by a controller within OMB.¹¹⁵

22. The Government Management Reform Act of 1994

The Act requires that the head of each Executive agency submit audited financial statements to the Director of the OMB. The Act also requires the Secretary of the Treasury and the Director of the OMB to submit to the President and the Congress annual Government-wide financial statements (now known as “The Financial Report of the United States Government” or the “Financial Report”) that contain the results of operations of the Executive branch.¹¹⁶

23. Federal Accounting Standards Advisory Board

a. Overview

In October 1990, three officials responsible for federal financial reporting established the FASAB (the “Board”) as a federal advisory committee. The officials were the Secretary of the Treasury, the Director of the Office of Management and Budget, and the Comptroller General of the United States (the “Sponsors”). The Sponsors created the FASAB to develop accrual accounting standards and principles for the United States Government.¹¹⁷ Please note that the FASAB and Congress have no input into the accounting principles used in creating the President’s Budget.

The FASAB was created to bridge the gap in constitutional interpretation between the Legislative and Executive branches. For the first time, the two branches agreed to work together in an agreed framework, with an open, public process, to determine the accounting standards that federal agencies should follow. The Memorandum of Understanding (“MOU”)¹¹⁸ cited the JFMIP and the Federal Advisory Committee Act, as amended (5 U.S.C. App) as the basis for establishing the Board. The creation of the FASAB does not appear to comply with the

Constitution's directive that Congress is responsible for publishing the Statement and Account. There is grave danger in this as Justices Scalia, Kennedy, Thomas and Alito have expressed as the Dissenters in the Obamacare litigation.

“Structural protections—notably, the restraints imposed by federalism and separation of powers—are less romantic and have less obvious a connection to personal freedom than the provisions of the Bill of Rights or the Civil War Amendments. Hence they tend to be undervalued or even forgotten by our citizens. It should be the responsibility of the Court to teach otherwise, to remind our people that the Framers considered structural protections of freedom the most important ones, for which reason they alone were embodied in the original Constitution and not left to later amendment. The fragmentation of power produced by the structure of our Government is central to liberty, and when we destroy it, we place liberty at peril.”

Under the Constitution Congress has primary responsibility for money and for publishing the Statement and Account. Therefore, it cannot outsource the determination of the proper accounting policies for the government to follow to a joint venture with the Executive branch. The reason that the FASAB was created was that the Comptroller General at the time of its creation was unwilling to either launch the required legal battle or use the power of the purse as Madison described in Federalist No. 58 to get the Executive branch to stop poaching Congress' constitutionally mandated responsibilities. The OMB's constitutional objections regarding accounting for Executive departments are a political power play that camouflages an unconstitutional intrusion by the Executive branch into accounting for the government's finances. It is understandable from a political standpoint why the legal battle between Congress and the Executive branch has never been fought. However, this does not mean that the resulting compromise is constitutional.

The word Advisory was included in the Board's name to signify the retention of legal authority by the Sponsors, whose approval would be required before the Board's standards became effective. The Board can only recommend standards to the Sponsors. Although the MOU indicates that the Sponsors have retained their authorities, separately and jointly, to establish and adopt accounting standards for the federal government this authority has never been used since the FASAB's inception. From a practical standpoint the Sponsors have bound themselves together. No accounting principle will be adopted unless all the Sponsors agree. Subsequently, provisions were included in the CFO Act that requires agency financial systems to comply with applicable accounting principles, standards and

requirements. The OFFM, an office within OMB, decides upon new principles, standards and requirements for OMB after considering FASAB's recommendations.

b. Board Membership, AICPA Approval and Social Insurance

The membership of the Board initially was a member from each of the Treasury Department, OMB, GAO and the CBO as well as two other members representing civilian and defense agencies and three public members. In 1999, FASAB sought and received designation from the AICPA as the GAAP standards-setter for the federal government (Rule 203 status).¹¹⁹ The government wanted the AICPA to bless the FASAB in order to have their pronouncements be viewed as GAAP. Approval by the AICPA was deemed critical by the Sponsors as it was viewed as "the Good Housekeeping seal of approval" and had real meaning in the private sector.

One of the AICPA's major concerns was independence.¹²⁰ Veto power, however, was retained.¹²¹ AICPA said that if veto was ever used it would rescind FASAB's status.¹²² At that time Robert Elliott, Chairman of the AICPA Board of Directors expressed confidence in FASAB's impartiality. "FASAB has committed to replace any members who are not materially independent and the AICPA can rescind its recognition if FASAB does not act independently. This small risk must be balanced against a probable larger gain: a better informed U.S. Government and citizenry."¹²³

In 2003, in order to persuade the AICPA to continue to designate the FASAB as a promulgator of GAAP, the board was reconstructed and given greater autonomy. The reorganization resulted in four Federal government members and six public members. However, as soon as the Board was reconstructed with real outside members the public members demanded that social insurance obligations be recorded in the government's consolidated financial statements. The Sponsors threatened to veto any such proposal and arranged for the balance of power to shift on the Board.

Social Insurance has been the most controversial issue for the Board since its inception. It has been considered and reconsidered. In May 2006 the Board voted 6 to 4 to proceed with an Exposure Draft that included a provision that some part of Social Security beyond the "due and payable" amount would be recognized on the federal balance sheet as a liability. All six public members voted in favor and all four federal members voted against. At the March 2006 Board meeting the Treasury representative, Ed Reid, said that "social insurance was more of a contractual obligation than a recordable liability. Getting a solid majority behind

this was essential. He said that he did not think the Board could survive having it go the way it is. He said he thought it would be very dangerous.” At the May 2006 meeting the Comptroller General indicated “the last thing in the world that I want is for a veto to be made on a standard...I hope it never happens, but feelings on this are pretty strong.”¹²⁴

Then one public Board member retired after 10 years and another Board member was not renewed. In subsequent votes the Board deadlocked at 5 to 5. The replacements had previously represented OMB. Once the Board was “re-adjusted” the FASAB killed the Social Insurance project.

Recently, the AICPA completed its second five-year review and Robert Harris Chairman of the AICPA conveyed the results to Tom Allen FASAB Chairman.¹²⁵ The result of the Council approval means that AICPA members, as preparers and auditors of federal entity financial statements, will continue to recognize accounting standards promulgated by the FASAB as GAAP for federal government financial reporting.

The AICPA Code of Professional Conduct prohibits members from expressing an opinion or stating affirmatively that financial statements or other data are in conformity with generally accepted accounting principles, if such information departs in any way from accounting principles promulgated by a body designated by the AICPA Council to establish such principles.

The ethical principles underlying the AICPA Code of Professional Conduct include the following: The Public Interest – Members should accept the obligation to act in a way that will serve the public interest, honor the public trust, and demonstrate commitment to the profession; Integrity – To maintain and broaden public confidence, members should perform all professional responsibilities with the highest sense of integrity; Objectivity and Independence – A member should maintain objectivity and be free of conflicts of interest in discharging professional responsibilities. A member in public practice should be independent in fact and appearance when providing auditing and other attestation services.

An argument can be made that the AICPA has violated both the Constitution and its ethical principles in recognizing the FASAB as the GAAP standards setter for the federal government under Rule 203. Has the AICPA aided and abetted in the publication of financial results that do not comply with the Constitution? Has the AICPA designated an unconstitutional entity, the FASAB, as the GAAP standard setter for the federal government? What public interest has been served by blessing a rule making body that assists in the publication of misleading/incomplete

financial results? What culpability does the AICPA have for the publication of financial statements that do not meet the requirements of the Constitution? What does it say about the AICPA's integrity that they have arguably assisted in misleading the citizens of the United States with respect to the nation's financial results and financial position? Given the public disputes at the FASAB between public official representatives and "independent" directors regarding proper accounting for the Nation's social insurance obligations how can the AICPA continue to designate FASAB as the GAAP standards setter? Is there anything that could lead the AICPA to withdraw its designation? How can one possibly debate whether the FASAB is an independent Board? It cannot be so by law and the facts that are publicly documented show that it has never acted in an independent manner.

It is important to make one last observation regarding the role that the AICPA will likely play in the not-too-distant-future. When the Nation's finances finally go "off the cliff" and Treasury yields skyrocket Congress will do what it does best, search for someone or something to blame besides itself. It is fairly predictable that politicians will find that the AICPA fills that role perfectly.

Other examples of how the FASAB has operated are informative. As a result of the veto power retained by the Sponsors, the Board has not included certain solutions to an issue because it knew those solutions would lead to a veto. For example, OMB was openly opposed to explicitly disclosing and labeling a Closed Group dollar amount for Social Insurance. As a result that option was not considered for SFFAS 17. Also, the Department of Defense ("DoD") was able to exercise near veto power with respect to certain specialized defense situations. The Board's deference was due to the fact that DoD had many powerful allies in Congress who might be willing to provide exemptions or bring into question the FASAB's role.¹²⁶

c. Accounting for Social Insurance

Historically, the FASAB has proclaimed the following with respect to the financial reporting of social insurance:

- 1) Statement of Federal Financial Accounting Standard ("SFFAS") 5 which was issued in 1995 established that social insurance programs were non-exchange transactions. Only due and payable amounts would be recognized as expenses or liabilities in the consolidated financial statements.
- 2) SFFAS 17 which was issued in 1999 required the information presented in the Statement of Social Insurance ("SOSI").

- 3) SFFAS 25 which was issued in 2003 required the SOSI to be reclassified as a basic financial statement.
- 4) SFFAS 28 which was issued in 2005 deferred the effective date for SFFAS 25.
- 5) SFFAS 37 which was issued in 2010 required additional information including a statement of changes in social insurance amounts.

However, it is important to understand the divisions within the Board on the issue and their rationale. This can be accomplished through a review of the Preliminary Views document published after the contentious Board meetings in the summer of 2006.¹²⁷

After the May 2006 Board meeting the FASAB issued a Preliminary Views document to solicit views rather than proceed with an Exposure Draft. The Preliminary Views document outlined both a Primary View and an Alternate View reflecting the split at the Board. As noted above six members believed that an expense is incurred and a liability arises for social insurance programs when participants meet eligibility requirements during their working lives in covered employment, and that some portion of the benefits accumulated at the balance sheet date should be recognized as a liability (Primary View). Three members believed that, consistent with current reporting requirements, an expense is incurred and a liability arises for social insurance programs when the participants have met all eligibility requirements and the benefit is “due and payable” (Alternative View). One member abstained from an expression of views but supported issuance of the preliminary views document so that responses can be considered.

The supporters of the Primary View believed that their proposed recognition and measurement standard would conform to the new definition for liability and expense proposed in the Exposure Draft of a Concepts Statement entitled Definition and Recognition of Elements of Accrual-Basis Financial Statements. Also, the Primary View would link the amounts reported for social insurance on the balance sheet and statement of net cost to the SOSI. Such linkage or “articulation” would illustrate how the amounts reported on these principal financial statements relate to the present values of the cash inflow and outflow over the next 75 years that are presented in the SOSI.

Members supporting the Alternative View saw a fundamental distinction in financial reporting of exchange transactions, which are voluntary market exchanges of goods and services for a price, and non-exchange transactions resulting from

decisions made collectively by the Congress and the President to levy taxes and to authorize programs.

The Alternative View is that social insurance programs comprise two separate non-exchange transactions – the compulsory payment of taxes during an individual’s working life and the Government’s payment of benefits after the individual has satisfied all eligibility criteria.¹²⁸ In the Alternative View expenses and liabilities are incurred for social insurance programs when the participants have met all eligibility requirements and the amount of the benefit is “due and payable” to or on behalf of beneficiaries. They put forth six reasons for excluding any future costs in its financial statements: 1) Congress can at any time make any changes it deems fit including termination, 2) the Supreme Court has ruled that citizens do not have a contractual right to any benefit, 3) recognition would result in a significant mismatch between costs recorded and services provided in any given year, 4) recognition would diminish the relative size and importance of other expenses and liabilities, 5) recording future benefits as expenses and liabilities may undermine needed reforms, and 6) given the un-sustainability of benefits with current financing the amount of benefit payments are uncertain and not reliably estimable.¹²⁹

The Alternative View proposed to maintain the recognition and measurement of expense and liability for social insurance programs required in SFFAS 17. That is, the entity would recognize a liability and a related expense for social insurance benefits when all eligibility criteria are met such that an individual beneficiary is entitled to receive a benefit (e.g., a cash payment, goods or services). At that point, those who supported the Alternative View believed the Government has a present obligation and the benefits become “due and payable.” Thus, under the Alternative View the amounts reported on the balance sheet and statement of net cost for social insurance benefits would not change from what was currently reported under SFFAS 17. Those supporting the Alternative View believed their proposed recognition and measurement standard was consistent with the proposed definition for liability and expense currently under consideration in the Elements exposure draft.

The counter-argument for inclusion is straightforward. Recognizing the full costs of the social insurance programs is the only way to have a Statement and Account that reflects the federal government’s economic reality. Congress has legally enacted these programs with permanent appropriations or mandatory authorizing legislation. Finally, almost every politician has publicly stated that these benefits will be paid.

As discussed above the Social Insurance project was terminated after the Board membership changed. The minutes for the September 19-20, 2007 meeting to discuss the Social Insurance project are illustrative of the divisions within the Board:

“Some members said the economic cost is the change in the statement of social insurance (SOSI) amounts during the reporting period. For example, if the net present value (NPV) of the social insurance commitments last year was \$44 trillion and this year it is \$45 trillion, then the economic cost would be \$1 trillion. Others defined it more narrowly as the change in the present value of future benefits attributed to work in covered employment already performed, exclusive of the present value of future benefits attributable to work in covered employment to be performed in the future.” Others had a different view.”¹³⁰

d. *Flemming v. Nestor*¹³¹

In this 1960 Supreme Court decision Nestor's denial of benefits was upheld even though he had contributed to the program for 19 years and was already receiving benefits. Under a 1954 law, Social Security benefits were denied to persons deported for, among other things, having been a member of the Communist party. Accordingly, Mr. Nestor's benefits were terminated. He appealed the termination arguing, among other claims, that promised Social Security benefits were a contract and that Congress could not renege on that contract. In its ruling, the Court rejected this argument and established the principle that entitlement to Social Security benefits is not a contractual right.

ii. Accounting in the Private Sector¹³²

Prior to the late 1800s there was little need for financial statements. Beginning in the 1820s the number of corporations expanded rapidly with the growth of railroads. This increased the demand for financial information. In addition, with the separation of management and ownership in corporations, there arose a need for an independent party to review the financial statements. Moreover, there was an expectation that the independent review would discover whether managers were violating their fiduciary duties to the owners.

The American Association of Public Accountants (AAPA) was incorporated in 1887. The AAPA was reorganized as the American Institute of Accountants (AIA). In 1921, the American Society of Certified Public Accountants (ASCPA) was established and became a rival. The ASCPA merged with the AIA in 1937. In 1957, the AIA became the American Institute of Certified Public Accountants (AICPA).

During the nineteenth century, the federal government generally allowed accounting to regulate itself. Then, in 1913, Congress established the Federal Reserve System and, one year later, the Federal Trade Commission (FTC). From this date forward, federal agencies have had an increasing impact on accounting.

The government's first major attempt at the formalization of authoritative reporting standards was in 1917 with the Federal Reserve Board's publication of Uniform Accounting. In 1918, the bulletin was reissued as Approved Methods for the Preparation of Balance Sheet Statements.

The impetus for stricter financial reporting was provided by the collapse of the securities market in 1929 and the revelation of massive fraud in a company listed on the New York Stock Exchange (NYSE). In 1933, the NYSE announced that companies applying for a listing on the exchange must have their financial statements audited by an independent public accountant. The scope of these audits had to follow the revised guidelines set forth by the Federal Reserve in 1929.

The Securities Act of 1933 conferred upon the FTC the authority to prescribe the accounting methods for companies. Under this act, accountants could be held liable for losses that resulted from material omissions or misstatements in registration statements they had certified. The Securities and Exchange Act of 1934 transferred the authority to prescribe the accounting methods to the newly established Securities and Exchange Commission (SEC) and required that financial statements filed with the SEC be certified by an independent accountant.

In 1938, the SEC delegated much of the authority to prescribe accounting practices to the AIA and its Committee on Accounting Procedures (CAP). In 1939, CAP issued the first of fifty-one Accounting Research Bulletins. In 1959, the AICPA replaced the CAP with the Accounting Principles Board (APB). The APB was designed to issue accounting opinions after it had considered previous research studies, and in 1962, the APB issued the first of thirty-one opinions. Although the SEC had delegated much of its standard setting authority to the AICPA, the commission exercised its right to approve all standards.

The Financial Accounting Standards Board (FASB) was established in 1973 to replace the APB. This board is independent of the AICPA and issued its first statement in 1973.

The SEC and the FASB, as well as its predecessors, have for many years indicated a preference for accrual-based accounting.¹³³

iii. Have Reporting Requirements Changed?

The U.S. Department of the Treasury was created by an Act of Congress on September 2, 1789. The Congress directed the Treasury to provide for the collection, safeguarding, and disbursement of public money, and to maintain a system of account for the government's collections and payments. Although the collection and control of money is critical to any government, the federal financial infrastructure remained very small for more than 100 years. The Register of the Treasury originally carried out the account-keeping functions. Individual departments and independent agencies conducted most disbursing functions without Treasury oversight. By modern standards the administration of federal finances was extremely loose, but then the federal government was much smaller than it is today, and its duties were far more limited. Other than during the few major wars, the government did not collect or spend very much money, and so the need to centralize or modernize its payment, collection, or accounting systems did not exist.

The first major financial management reform took place just after World War I. In late 1919, Treasury Secretary Carter Glass created the forerunners of the current fiscal operations bureaus, Financial Management Service ("FMS") and the Bureau of Public Debt, by approving the positions of the Commissioner of Accounts and deposits and the Commissioner of the Public Debt.

In the last 100 years Congress has created the Federal Reserve System, Fannie Mae and Freddie Mac, each a multi-trillion dollar enterprise. Yet, the Federal government's balance sheet does not consolidate these or other material controlled entities.¹³⁴

Over the last two hundred years the Statement and Account Clause requirements have increased as the federal government's finances have become exponentially more complex. This is true even if one assumes that there was no Congressional legislation on the matter. Arguably, a cash-based statement of receipts and expenditures was acceptable to fulfill the Statement and Account's Clause's required accountability when the government was small. However, once the government's finances grew in complexity and especially after the Sixteenth Amendment was ratified and Congress enacted social insurance programs that created substantial future obligations, the federal government should have begun publishing accrual-based financial statements to meet its Constitutional responsibility.

iv. Current Reporting

One must review three reports in order to understand the federal government's financial reporting practices. These include the Combined Statement of Receipts, Outlays, and Balances¹³⁵ (the "Combined Statement") which is the "official" Statement and Account, the President's Budget¹³⁶ and the Financial Report.¹³⁷

When the plaintiff in *United States v. Richardson* wrote to the Government Printing Office in 1967 and requested that he be provided with the documents published by the Government in compliance with Article I, section 9, clause (7) of the United States Constitution the Fiscal Service of the Bureau of Accounts of the Department of the Treasury replied, explaining that it published the document known as the Combined Statement of Receipts, Expenditures, and Balances of the United States Government (this was the document's previous name).¹³⁸

The federal government indicates that "Each year, the Administration issues two reports that detail financial results for the Federal Government: the President's Budget, which provides a plan for future initiatives and the resources needed to support them, as well as prior year fiscal and performance results; and th[e] Financial Report, which provides the President, Congress and the American people a broad, comprehensive overview of the cost on an accrual basis of the Government's operations, the sources used to finance them, its balance sheet and the overall financial outlook."¹³⁹

President's Budget – Prepared primarily on a 'cash basis'; Initiative-based and prospective: focus on current and future initiatives planned and how resources will be used to fund them. Receipts ("cash in"), taxes and other collections recorded when received. Outlays ("cash out"), largely recorded when payment is made.

Financial Report of the U.S. Government – "Treasury generally prepares the financial statements in th[e] Financial Report on an "accrual basis" of accounting as prescribed by U.S. GAAP for federal entities.¹⁴⁰ Agency-based and retrospective – prior and present resources used to implement initiatives. Revenue: Tax revenue (more than 90 percent of total revenue) recognized on modified cash basis. Remainder recognized when earned, but not necessarily received. Costs: recognized when owed; but not necessarily paid.

Broadly, there are two adjustments required to make financial reporting reflect the nation's true financial results and financial position. The financial statements need to include:

- i. all entities that, by law, should be included in the government's consolidated financial results (e.g. Federal Reserve System, Fannie Mae , Freddie Mac),
- ii. the full cost of the nation's social insurance programs including Medicaid.

The first adjustment is easy to understand while the second requires some explanation. The Congress has enacted permanent appropriations and mandatory authorizing legislation that provides permanent and never ending appropriations for the entitlement programs.¹⁴¹ This means that absent anything short of a change in legislation these benefits will be paid. However, note that by law, Congress at any time can make any changes that it deems fit including terminating these programs. Furthermore, the Supreme Court has ruled that citizens do not have a contractual right to any entitlement benefit.¹⁴² No one has the right to expect payment or the coverage of benefits until they have met all eligibility requirements.

The Government takes the fact pattern described above and concludes that the only expense that should be recorded in any financial statement is that year's cash outlay plus the amount of any payments that are payable but which have not yet been processed (the "Due and Payable" approach).¹⁴³ No obligation beyond this is recorded in the financial statements. This approach does not accurately reflect the legal obligations of the federal government as reflected in the permanent appropriations and mandatory authorizing legislation coupled with the likelihood of payment. (Note that the government labels entitlement programs as "Mandatory Spending").

1. Combined Statement ¹⁴⁴

The Commissioner's Transmittal letter dated December 3, 2012 indicates "In accordance with the provisions of Section 114(a) of the Act of September 12, 1950 (31 U.S.C. 3513(a)), I am transmitting herewith the Combined Statement of Receipts, Outlays, and Balances of the United States Government for the fiscal year ended September 30, 2012. This statement presents budget results and the cash-related assets and liabilities of the Federal Government with supporting details."

The Preface states "Financial Management Service – The Financial Management Service (FMS), which is a bureau of the Department of the Treasury, performs a critical role in fulfilling Treasury's mission as the Government's financial manager.

In its role as Federal financial agent, FMS publishes the “Combined Statement of Receipts, Outlays, and Balances of the United States Government.”

The Preface indicates under the heading “Legislative Requirement – The Constitution of the United States, Article 1, Section 9, clause 7, outlines requirements for a report on the receipts and outlays of the Government. It provides, in part, that “No Money shall be drawn from the Treasury, but in Consequence of Appropriations made by law; and a regular Statement and Account of the Receipts and Expenditures of all public Money shall be published from time to time.

31 U.S.C. 3513(a) provides in part, “The Secretary of the Treasury shall prepare reports that will inform the President, Congress, and the public on the financial operations of the United States Government.” This statement is recognized as the official publication of receipts and outlays.”

The Combined States indicates that “Several major Government bodies rely on data found in this report. The Congressional Budget Office uses it to serve the needs of Congress; the Office of Management and Budget uses the data to review the President’s Budget programs; the Governmental Accountability Office uses it to perform audit services; the various departments and agencies of the Government use it to reconcile their accounts; and the public uses it to review the operations of their Government.”

The Combined Statement is virtually unknown by the general public and for good reason. It is not referred to by any recent Congress or Administration with respect to the financial condition or results of the U.S. Government. It is not mentioned by any third party analysts that examine the government’s finances. The closest analogy of what role the report plays is that it is a cash disbursements summary journal book.

The government has clung to the practice of equating cash outlays with expenditures and continues to believe that the publication of the Combined Statement satisfies any obligation, assuming one exists, under the Clause.

2. President’s Budget

The President’s Budget is the only financial report that politicians discuss and the Budget Deficit is the single most important figure discussed with respect to the government’s finances.

A summary description of the President's Budget is found on page ii of "A Citizens Guide to the 2012 Financial Report of the U.S. Government" which is contained in the 2012 Financial Report of the United States Government.¹⁴⁵ It states "The Budget of the United States Government (Budget) is the Government's primary financial planning and control tool. It accounts for past Government receipts and spending, and presents the President's proposed receipt and spending plan. The Budget compares receipts, or cash received by the Government, with outlays, or payments made by the Government to the public, to derive a budget surplus (excess of receipts over outlays) or deficit (excess of outlays over receipts). Receipts and outlays are measured generally based on when the Government receives or dispenses cash.

David Mosso, who was Chairman of the FASAB for the ten years ending in 2006, made the following remarks about the President's Budget and by implication the Combined Statement at the "Representation Without Accountability" conference held at Fordham Law School in 2012.

"[T]he Office of Management and Budget ("OMB") and the Congressional appropriations committees have been unwilling to change the accounting basis of the federal budget to the accrual basis....The Budget's cash basis accounting, selectively applied, hollows out the fiscal body of the federal government...The accounting underlying the President's Budget....obfuscates federal financial accountability..... [It] understate[s] ...the headline numbers that dominate Congressional and public discussion and that form perceptions of the government's financial health. It seems to be an incontrovertible conclusion that the ship of state is being steered with a severely broken compass.....That false picture nurtures financial profligacy....Cash basis accounting in the President's Budget is the spearhead of reckless fiscal policy, whether intentionally reckless or just bumbling along with inadequate and misunderstood information about federal financial health....As an accountability report, the President's Budget woefully shortchanges the American public."¹⁴⁶

Schedule 1 depicts the federal government's financial results for the last decade under budget accounting. (All Schedules can be found near the back of this memorandum.) Please note the nation's gross domestic product ("GDP") for 2012 was \$15.8 trillion. The Budget Deficit for the last four years has been relatively flat at \$1.1 to \$1.4 trillion.

The simplest way to think about our government's recent financial results is to add up all the expenditures and revenues over the last decade and divide the total expenditures by total revenues. This produces a "dollar spent per dollar of revenue" figure which everyone that manages a household can understand. Total outlays were \$29.4 trillion and total revenues were \$22.3 trillion so the long division yields a result of 1.32. Using budget accounting, the federal government has spent \$1.32 for every \$1 of revenue it has received.

3. Financial Report

A summary description of the Financial Report is found on page ii of A Citizens Guide to the 2012 Financial Report of the U.S. Government.¹⁴⁷ It states "The Financial Report of the United States Government (Report) focuses on the Government's revenues and costs (what came in and what went out), assets and liabilities (what it owns and owes), and other important financial information. It compares revenues (what the Government has collected and expects to collect, but has not necessarily received), with its costs (what the Government has incurred, but has not necessarily paid) to derive net operating cost.

Management's Discussion and Analysis – Introduction - The fiscal year (FY) 2012 Financial Report of the United States Government (Report) provides the President, Congress and the American people with a comprehensive view of the Federal Government's finances, i.e., its financial position and condition its revenues and costs, assets and liabilities, and other obligations and commitments. The Report also discusses important financial issues and significant conditions that may affect future operations, including the need to achieve fiscal sustainability over the medium and long-term.¹⁴⁸

Pursuant to 31 U.S.C. sec 331 (e)(1), the Department of the Treasury (Treasury) must submit the Report, which is subject to audit by the Government Accountability Office (GAO), to the President and Congress no later than six months after the September 30 fiscal year end. To encourage timely and relevant reporting, the Office of Management and Budget (OMB) accelerated both individual agency and government-wide reporting deadlines. The Report is prepared from audited financial statements of specifically designated Federal agencies, including the Cabinet departments and many smaller, independent agencies.

As it has for the past fifteen years, GAO issued a "disclaimer" of opinion on the accrual-based, consolidated financial statements, for the fiscal years ended September 30, 2012 and 2011. GAO also issued disclaimers of opinion on the 2012,

2011 and 2010 Statements of Social Insurance (SOSI), following unqualified opinions on the 2008 and 2009 SOSI, and a disclaimer of opinion on the 2012 and 2011 Statement of Changes in Social Insurance Amounts (SCSIA).

Schedule 2 just adds to the Budget Deficit amounts accrued expenses for federal and veterans benefits that are payable in the future. The Financial Report over the last decade indicates that \$1.42 has been spent for every \$1.00 of revenue. The 2012 Financial Report's balance sheet as of September 30, 2012 on Schedule 3 indicates that the nation's reported net liability is about the size of the nation's GDP.

Some readers might ask where are the Social Security and Medicare trust fund balances on the Financial Report's Balance Sheet. They have been eliminated in consolidation as they are merely IOUs from one government pocket to another.

“When asked about the inability of his trust funds to effect genuine savings, [President Roosevelt] once answered, “Those taxes were never part of the economics. They are politics all the way through. We put those payroll taxes there so as to give the contributors a legal, moral and political right to collect their pensions....With those taxes there, no damn politician can ever scrap my social security program.”¹⁴⁹

David Mosso, former Chairman of the FASAB commented about the Financial Report.

“The US Financial Report is the off-budget vehicle for reporting more fully, with business type accounting, on federal financial accountability but it suffers from the syndrome “out of Budget, out of mind.” Nobody pays attention to the US Financial Report in political discourse and decision making because its accruals are not integrated into the budget process.”¹⁵⁰

4. Statement of Social Insurance

The Statement of Social Insurance (“SOSI”) shows the present values of estimated future revenues and expenditures for scheduled benefits over the next 75 years for the Social Security, Medicare, Railroad Retirement programs and through September 30, 2040 for the Black Lung program. The estimates are based on the economic and demographic assumptions presented in the Financial Report footnote on Social Insurance, in the relevant Social security and Medicare trustees' reports and in the agency financial report of HHS and in the relevant agency performance and accountability reports for SSA and RRB and the annual financial report for DOL. The projections are based on the continuation of program provisions contained in current law. The estimates in the consolidated SOSI of the open group measures

are for persons who are participants or eventually will participate in the programs as contributors (workers) or beneficiaries (retired workers, survivors, and disabled) during the 75-year projection period.

Actuarial present values of estimated future revenue (excluding interest) and estimated future expenditures for the Social Security, Medicare, and Railroad Retirement social insurance programs are presented for three different groups of participants: (1) current participants who have attained eligibility age, (2) current participants who have not attained eligibility age, and (3) future participants who are new entrants expected to become participants in the future. Current participants in the Social Security and Medicare programs form the “closed group” of taxpayers and/or beneficiaries who are at least 15 years of age at the start of the projection period. Since the projection period for the Social Security, Medicare, and Railroad Retirement social insurance programs consists of 75 years, the period covers virtually all of the current participants’ working and retirement years, a period that could be greater than 75 years in a relatively small number of instances. Future participants for Social Security and Medicare include births during the projection period and individuals below age 15 as of January 1 of the valuation year.

The present values of future expenditures in excess of future revenue are calculated by subtracting the actuarial present values of future scheduled contributions and dedicated tax income by and on behalf of current and future participants from the actuarial present value of the future scheduled benefit payments to them or on their behalf. To determine a program’s funding shortfall over any given period of time, the starting trust fund balance is subtracted from the present value of expenditures in excess of revenues over the period.

The financial projections for the Medicare program reflect substantial, but very uncertain, cost savings deriving from provisions of the ACA. The Medicare Board of Trustees, in their annual report to Congress, references an alternative scenario to illustrate when possible, the potential understatement of Medicare costs and projection results. This alternative scenario assumes that the productivity adjustments are gradually phased down during 2020 to 2034 and that the physician fee reductions are overridden. These examples were developed for illustrative purposes only; the calculations have not been audited; no endorsement of the illustrative alternative to current law by the Trustees, CMS, or the CMS Office of the Actuary, should be inferred; and the examples do not attempt to portray likely or recommended future outcomes. Thus the illustrations are useful only as general indicators of the substantial impacts that could result from future legislation affecting the productivity adjustments and physician payments under Medicare and of the broad range of uncertainty associated with such impacts.

The SOSI became a principal financial statement of the Financial Report in 2006. The nominal rate used to discount future revenues and expenditures is roughly 2% for the next decade and 5.7% thereafter.

Schedule 4 only includes the net present value cost of Social Security and Medicare for the social insurance programs. The total net obligation per the SOSI as of January 1, 2012 is \$48.5 trillion. Please note that the GAO could not certify the 2010, 2011 and 2012 SOSI for Medicare so the trustees developed an alternate scenario for Medicare's future cost and this amount was reported in the notes to the Financial Reports for the applicable years.

Schedule 4 includes the alternate scenario amounts for Medicare for 2010, 2011 and 2012. Also, added to the schedule are all available net present cost figures that have been published for Medicaid. This brings the total net obligation for the three major entitlement programs to \$74.6 trillion. It is obvious that the increase in net obligations is overstated for 2010 as a result of the inclusion of Medicaid in the schedule.

The federal government believes that Medicaid and Medicare should be accounted for differently as Medicaid is a "general assistance" program and not a social insurance program like Medicare.¹⁵¹ An average accountant might react to the government's position with the observation the distinctions between the programs are without a difference from an accounting perspective. A cynical accountant might remark that treating the two programs differently is confusing to the public and intended only to obfuscate financial reality by significantly reducing the total amount of obligations that would otherwise appear on the SOSI.¹⁵² Furthermore, this approach has allowed the federal government to justify, to itself, not publishing any figure for the net present value cost of the federal government's share of the Medicaid program until the 2010 Financial Report and not prominently mentioning this inconvenient fact to the Supreme Court in the Obamacare litigation. From a political standpoint it is clear why the Administration did not want to have a net present value cost figure for Medicaid available both before and after enactment because this would prevent political posturing with respect to the cost of the Medicaid expansion component of the ACA.

The federal government has never reported the full costs of the Medicaid program in any of its primary financial reports since the program's inception. The only cost recorded by the federal government or any state in their financial statements for that matter is current year cash expenditures. The federal government published a \$24.2 trillion estimate of the present value of the future net cost of the program for the first time in the 2010 Financial Report.¹⁵³ This figure was based on savings assumptions associated with the ACA similar to those used to generate the \$22.8

trillion Medicare figure published simultaneously.¹⁵⁴ However, the assumptions were so unrealistic that the Trustees of Medicare created an alternate scenario which indicated a cost of \$35.2 trillion. Medicare projections in the 2010 SOSI were based on full implementation of the provisions of the ACA including a significant decrease in the projected Medicare costs from the 2009 SOSI related to:

- 1) Reductions in physician payment rates totaling 30 percent over the next three years, and
- 2) Productivity improvements for most other categories of Medicare providers.

Legislation has been enacted that overrode the scheduled reductions in physician payments and reduced non-Medicare outlays by limiting a health insurance tax credit. The scheduled reductions in physician payments have been overridden since 2003. No alternate figure was published for Medicaid. The Medicaid figure reported in the 2011 Financial Report was \$24.0 trillion and this figure increased to \$26.1 trillion in the 2012 Financial Report.¹⁵⁵

The Medicaid figures for 2010, 2011 and 2012 are materially understated for two reasons. First, they are calculated based on assumptions that the Trustees of the Medicare fund continue to believe are unrealistic. The Trustees created alternate assumptions for purposes of calculating realistic estimates of the net present value obligation for Medicare for the years 2010, 2011 and 2012. Second, they are calculated based on a 75-year life which the government acknowledges significantly understates its obligations as permanent appropriations/mandatory authorizing legislation have an infinite time horizon.¹⁵⁶ It should be noted that all figures on Schedule 4 for Social Security, Medicare and Medicaid are based on a 75-year life.

As indicated on Schedule 4 the federal governments latest published estimate of the net present value cost of Medicare (alternate scenario) and Social Security is \$48.5 trillion.¹⁵⁷ Please note that the net present value cost that should be recorded in the federal government's books is limited to the amounts that have been appropriated by Congress. The fact that both programs will run out of appropriated funds in coming years is discussed below. However, the government provides no analysis of what this limitation would have on the net present value cost figures published in the SOSI. When the \$48.5 trillion amount is added to the unrealistically low Medicaid estimate it yields a total off-balance sheet obligation of \$74.6 trillion. See Schedule 4.

The 2012 Social Security Trustees Report indicates that the combined assets of the Old-Age and Survivors Insurance and Disability Insurance trusts will be exhausted in 2033. The two trust funds are often considered on a combined basis and are

designated as OASDI. Once the funds are exhausted, there will only be sufficient resources coming in to pay out about 75 percent of the scheduled Social Security benefits, unless changes are made to the program.¹⁵⁸

The 2012 Medicare Trustees Report indicates that the Medicare HI Trust Fund will be exhausted in 2024. Once the funds are exhausted, there will only be sufficient resources coming in to pay out unless changes are made to the program. The share of HI expenditures that can be financed with HI dedicated revenues is projected to decline slowly to 69 percent.¹⁵⁹

5. Commentary

Currently, it is impossible to determine the truth about the government's financial results as the “official” Statement and Account as well as the President’s Budget and the Financial Report individually and in the aggregate are grossly misleading. An accounting of “all public Money” is required, yet the Government continues to use the cash basis of accounting which equates expenditures with cash outlays. It knows that this approach is substantially misleading, yet uses it to prepare the Combined Statement and the President’s Budget.

The President’s Budget is cash-based and has little to do with economic reality. Under budget accounting rules, outlays are recorded only when bills are paid. Americans know that real expense is incurred when one makes spending commitments. This is the reason why every publicly traded company is required to use accrual accounting. The Financial Report is accrual-based yet has significant flaws. The Financial Report, a little-known alternative, does not consolidate numerous material government controlled entities or include the full costs of entitlement programs.

The only costs associated with the entitlement programs that are included in any of these reports are current cash outlays. The government calls this the Due and Payable approach.¹⁶⁰ Therefore, all three of the Government’s financial reports do not include the multi-trillion dollar annual increases in the net present value cost of our major entitlement obligations.¹⁶¹ Everyone that has a credit card knows that the amount that you spent in any year is equal to the amount that you paid the credit card company plus or minus the increase or decrease in your yearend balance. The government conveniently ignores the second half of the calculation. In addition the federal government does not consolidate in its cash-based or accrual-based financial statements material controlled enterprises.

No state records the full cost of its share of Medicaid costs in its “income statement” or records its share of the long-term obligation associated with Medicaid on its balance sheet. “Medicaid has long been the largest federal program of grants to the States.”¹⁶² Between 2005 and 2008 federal contributions toward the care of beneficiaries averaged 57% and States contributions averaged 43%.¹⁶³ Since the State portion of Medicaid contributions averaged 43% of total expenditures this means that, roughly speaking, based on the \$26.1 trillion federal obligation published in the 2012 Financial Report there is an additional aggregate \$19.7 trillion net present value obligation that should be recorded in total on the state’s balance sheets as of the end of fiscal 2012. Please note that the state’s calculation of its obligation may differ somewhat from the federal government’s calculation but for purposes of this memorandum it is a reasonable rough estimate of the enormous obligation that should be but is not recorded in the state’s financial statements.

Therefore, Medicaid in total is a \$45.8 trillion program (\$26.1 trillion federal net present value cost and \$19.7 state’s total net present value cost). The fact that none of the states are recording any expense or liability for the increase in the net present value cost of the program in their financial statements means that all of the states’ financial statements are fraudulent under the standards recently endorsed by the Supreme Court and used by the Securities and Exchange Commission and the States of Illinois and New Jersey in their respective settlements.¹⁶⁴ See Appendices A and B.

It is instructive to focus on the \$2.1 trillion increase in the net present value cost of Medicaid recorded by the federal government in 2012.¹⁶⁵ This staggering increase is equal to approximately 84% of all of the federal government’s revenue for the year. Even more astonishing, since it only represents 57% of the increase in the net present value cost increase for the Medicaid program states should have recorded in total an increase of approximately \$1.6 trillion. This amount represents approximately% of total state revenues for 2010. Please also note that the increase is likely significantly understated for reasons already discussed.

Schedule 5 depicts an estimate of the federal government’s actual financial results over the last decade. It records the full cost of Medicare, Social Security and Medicaid by adding the increase in the annual balance. No attempt has been made to adjust the financials for any of the material entities that should be consolidated in the financial statements (e.g. Federal Reserve System, Fannie Mae and Freddie Mac). The bottom line is that the federal government has spent approximately \$4.00 for every \$1.00 of revenue taken in.

The balance sheet in the 2012 Financial Report indicates that the federal government’s net liability is \$16.1 trillion.¹⁶⁶ When the \$74.6 trillion of off-balance sheet obligations is added the total obligation rises to approximately \$90.7 trillion.

See Schedule 6. This obligation represents a multiple of 36 times total revenue of approximately \$2.5 trillion¹⁶⁷ for 2012.

Schedule 7 depicts the total social insurance obligations under the infinite horizon for Social Security and Medicare. Please note that infinite horizon figures are not available for the alternate scenario so the schedule reflects costs under existing laws. Also, there are no infinite horizon figures available for Medicaid so the 75-year horizon figures are used. On balance, the infinite horizon figures portrayed in Schedule 7 are significantly understated. Schedule 8 merely adds the total social insurance obligations plus Medicaid to the government's reported net liability in the 2012 Financial Report.

For independent corroboration of the veracity of the analysis presented please read David Mosso's analysis presented at the Representation Without Accountability conference held at Fordham Law School on January 23, 2012. See <http://fordhamcorporatecenter.org/files/2012/01/David-Mosso-Conference-Remarks-1.23.122.pdf>.

Also, please read Wall Street Journal op-ed pieces "*Why \$16 Trillion Only Hints at the True U.S. Debt*" written by Chris Cox and Bill Archer and published on November 26, 2012 and "*Medicare by the Scary Numbers*" written by John C. Goodman and Laurence J. Kotlikoff and published on June 24, 2013.

v. Psychological Factors¹⁶⁸

The Supreme Court in *Caperton v. A.T. Massey Coal Co.* asks not whether the judge is actually, subjectively biased, but whether the average judge in his position is "likely" to be neutral, or whether there is an unconstitutional "potential for bias."...."In defining these standards the Court has asked whether "under a realistic appraisal of psychological tendencies and human weakness," the interest "poses such a risk of actual bias or prejudgment that the practice must be forbidden if the guarantee of due process is to be adequately implemented."¹⁶⁹

There are several important psychological factors that have influenced and continue to influence financial reporting for the federal government. This section attempts to explain how and why Congress has put the nation into a situation where financial reporting is so distorted from economic reality? This analysis suggests that there are very significant, some would say insurmountable barriers, to changing our current circumstance through the legislative process and therefore, the only resolution is through the judiciary. The framework for the analysis is inspired by a talk given by Charlie Munger, *The Psychology of Human Misjudgment*.¹⁷⁰ Mr. Munger is the long time business partner of Warren Buffett.

Congress and the Executive have created a set of circumstances that takes advantage of multiple psychological tendencies that affects all parties interested in

the electoral process. These psychological factors, which are generally well documented in psychology literature, ensure that political accountability is significantly diminished and that the competitiveness of the electoral process is materially degraded. It is hard not to view the creation and alignment of these psychological factors as “corruption”. Mr. Munger calls the alignment of multiple psychological tendencies all working in the same direction as the “Lollapalooza Tendency”.

Let’s begin with “incentives”. B.F. Skinner, the famous Harvard psychology professor, proved that incentives could cause significant behavioral change.¹⁷¹ His experiments proved that bad behavior is intensely habit-forming when it is rewarded. When choosing between different outcomes, elected representatives can be expected to consider which course of action is most likely to contribute to their own reelection and, which course of action is most consistent with the ideological commitments and policy goals of their constituents.

As Hamilton famously wrote when explaining the benefits of a public official making decisions with an eye toward reelection, “the desire of reward is one of the strongest incentives of human conduct...[and] the best security for the fidelity of mankind is to make their interest coincide with their duty.”¹⁷² In Pennsylvania, elected trial court judges sentence criminal defendants to longer and longer prison sentences as an impending election gets closer and closer. In Chicago, criminal defendants convicted of murder are 15% more likely to receive the death penalty if their trial occurs during an election year for the presiding judge. And across the nation, in cases between one in-state party and one out-of-state party, elected state court judges are more likely to decide cases in favor of the in-state litigant than appointed judges.¹⁷³

Since entitlement programs were first created, Democrats and Republicans have had a significant incentive to be less than forthright with respect to their cost. They get elected by promising that benefits are guaranteed and that additional entitlements are possible. Yet, they do not permit any expense or liability associated with promises that must be paid in the future included in any financial statement to which they could be held accountable. Doing so would reveal massive deficits far exceeding our current Budget Deficit that would be impossible to justify and would likely lead to many elected officials losing their “jobs”.

Punishments strongly influence behavior which is why politicians are very familiar with the Persian Messenger Syndrome. In ancient times Persians killed some messengers whose sole transgression was that they brought home truthful bad

news. This is why no politician at any level wants to take the lead on informing the electorate as to the true state of the nation's finances. George Washington hanged deserters forty feet high as an example to others.¹⁷⁴ Unfortunately, over the years there have never been any negative repercussions for any of the politicians responsible for the nation's deficient financial reporting.

The population's tendency to reciprocate favors and disfavours is well known to politicians. They know that their constituents want to hear about better benefits and nothing about increased costs. Politicians fully understand how the world works. You enact legislation that provides better benefits for me or lowers taxes and I will vote for you. You take away my benefits or raise my taxes and I will vote you out of office. This reciprocation tendency has stopped wars for considerable periods of time. It is also the reason why there are periods when no prisoners are taken. It is why purchasing agents at most large commercial establishments are not allowed to take anything from a vendor. The reciprocation tendency coupled with other tendencies discussed below ensures that a political candidate for office challenging an incumbent cannot use the fraudulent financial reporting issue to win over the electorate. It is a losing political strategy in all cases. One may inform voters but the candidate will never get elected.

Successful politicians are very good at voter psychology and pursue strategies to take advantage of the Liking/Loving Tendency and the Disliking/Hating Tendency. It will surprise no one that politicians prefer being liked by their constituents. Hence, they exhibit behavior to maintain this state of affection which involves ignoring the facts as they relate to the nation's financial condition and making sure that the true state of the nation's finances is not made public. Similarly, the electorate likes getting additional benefits especially if it does not cost them anything.

"Politics is the art of marshalling hatreds."¹⁷⁵ One of the most important factors that has led to a significantly distorted electoral process is that the electorate does not want to know the truth about the poor condition of the nation's finances. Everyone likes a "free lunch" but as economics texts instruct, there are no "free lunches". Not surprisingly, the people do not want to know any bad facts associated with the cost of their benefits. Politicians have used and continue to use people's dislike for any negative facts associated with any of the nation's social insurance programs to their advantage, particularly in negative advertising. The electorate hates being told bad news especially if it entails a possible bill for them.

The Social-Proof Tendency is the tendency for a person to think and act as others around him are thinking and acting. It tends to be triggered in periods of stress. Given that no one in the Congress or the Administration is pointing out the fact that the government's financial reports fail to reflect economic reality this is social proof that the statements must be correct. If a politician dared to raise the issue his reception among his colleagues and the electorate would be similar to the reception that the corrupt New York police division gave to Frank Serpico.¹⁷⁶ The corruption in the New York police was driven by social proof plus incentives.

It is highly likely that the dysfunctional behavior surrounding financial reporting by Congress and the Executive will continue as significant stress causes dysfunction (the "Stress Influence Tendency"). The noted researcher, Pavlov realized that extreme stress created unanticipated extreme changes in behavior. During the great Leningrad Flood of the 1920s, Pavlov had many dogs in cages. As the waters rose many dogs reached a point where they had almost no airspace at the top of their cage they were subjected to maximum stress. This changed the behavior of many dogs.¹⁷⁷ To a certain extent this explains some of the dysfunctional behaviors that our politicians exhibited in dealing with the fiscal cliff crisis and it is a precursor of more dysfunctional behavior to come with the budget deficit and debt ceiling debates.

Politicians know that rational or reasonable explanations increase compliance with orders/requests. The Reason-Respecting Tendency is the reason that there is an enormous bureaucracy associated with the President's Budget. This bureaucracy ensures that there will always be reasons supporting the figures presented.

When confronted with the nation's fiscal distress most politicians talk about our ability to deal with the issue by growing our economy. This displays man's excessive optimism (the "Overoptimism Tendency"). The right approach is to focus on the hard numbers, something that Congress and the Executive are loath to do.

Politicians know that if reality is too painful to bear, they should distort the facts until they become bearable. This "psychological denial" could explain at least one of the arguments for maintaining the current accounting for social insurance. "Recognition of future social insurance benefits on the financial statements would diminish significantly the relative size and importance of other expenses and liabilities shown on the financial statements" ¹⁷⁸

When's steps are taken towards disaster but each of these steps are small and barely discernible, a person's Contrast-Misreaction Tendency will often let the person go too far. The reason is that each step is such a small contrast from the

person's current position. Ben Franklin said "A small leak will sink a great ship."¹⁷⁹ In the case of financial reporting it is so because over the last 75 years politicians and the electorate have intentionally hidden or ignored the leak.

The Authority-Misinfluence Tendency explains how authority figures (the "Executive") can lead ordinary people into gross misbehavior. Stanley Milgram conducted experiments to show how far authority figures could lead people into such misbehavior.¹⁸⁰ The Framers of the Constitution distrusted the Executive. Distrust of the Executive is what led the Framers to put financial responsibility solely in Congress' hands.

One of the truths about the electorate is that, on the whole, they exhibit the Excessive Self-Regard Tendency (the "Endowment Effect"). Once owned, or thought to be owned, social insurance benefits become worth more to a citizen than if they were offered for sale to the person and the person didn't own them. The Excessive Self-Regard Tendency is illustrated by a Tolstoy passage: "According to Tolstoy, the worst criminals don't appraise themselves as all that bad. They come to believe either (1) that they didn't commit their crimes or (2) that, considering the pressures and disadvantages of their lives, it is understandable and forgivable that they behaved as they did and became what they became."¹⁸¹ One could easily substitute our politicians into this story in place of criminals.

A final truth about the electorate is that loss seems to hurt much more than gain adds to man's pleasure (the "Deprivation-Supereaction Tendency"). Therefore, it is not surprising that the electorate will react with almost irrational intensity to any loss or threatened loss, however small, of social insurance benefits.

c. Impact on Private Rights

The federal government's grossly inadequate financial disclosure violates several private rights granted to citizens by the Constitution including the right to vote,¹⁸² free speech, due process, equal protection¹⁸³, right to financial information (not yet recognized by the Court but required by the Constitution) and political accountability. This violation of private rights is important and relevant in the context of the Medicaid expansion issue in the Obamacare litigation¹⁸⁴ as the Supreme Court has struck down spending conditions in *Legal Services Corp. v. Velasquez*¹⁸⁵ and *American Civil Liberties Union v. Moneta*¹⁸⁶ on First Amendment grounds.

The primary reason why our rights have been infringed upon is that the Legislative and Executive branches have an interest in expenditure amounts being under-reported. Both branches have controlled financial reporting and thereby public

opinion to minimize their accountability for spending. Proper reporting would lead to spending cutbacks, tax increases and/or recriminations for overspending, all of which are likely to cause voter dissatisfaction and changes at the polls.

i. Right to Vote

Given that the framers wanted voters to have accurate information about government spending at what point does the government's publication of false and misleading financial information render a citizen's vote meaningless? When the government is spending at twice the level that it reports to its citizens? Three times? Four times?

In *Federal Election Commission (FEC) v. Akins*¹⁸⁷, the Court was dealing with an attempt on the part of a group of voters to compel the FEC to regulate the American Israel Public Affairs Committee (AIPAC) as a "political committee" within the meaning of federal election law.¹⁸⁸ The voters sought information that AIPAC would have to disclose (lists of donors, contributions, and expenditures) if it were so regulated. The FEC opposed regulation, and argued that the voters lacked standing. In analyzing the issue, the Court found that the plaintiffs had satisfied the injury requirement by showing that a decision to regulate would produce information valuable to their roles as informed citizens and voters.¹⁸⁹

In *Akins*, the plaintiffs identified concrete injury because they claimed "informational injury" that directly affected voting rights. The court explained that the plaintiffs had suffered injury because they were deprived of information and, without the sought information, they were less able, "to evaluate candidates for public office" and "to evaluate the role" that the financial assistance to candidates "might play in a specific election."¹⁹⁰

Based on the *Akins* decision, the lack of a complete and accurate Statement and Account is an informational injury directly affecting voting rights.

ii. Freedom of Speech¹⁹¹

On January 21, 2010, in *Federal Election Commission (FEC) v. Citizens United*¹⁹², the Supreme Court resolved a First Amendment challenge to the Bipartisan Campaign Reform Act of 2002. In a 5-4 decision, the Court "rejected the argument that political speech of corporations or other associations should be treated differently under the First Amendment simply because such associations are not 'natural persons.'" The Court held that political speech is "indispensable to decision-making in a democracy, and this is no less true because the speech comes

from a corporation rather than an individual.” Furthermore, “[s]peech is an essential mechanism of democracy, for it is the means to hold officials accountable to the people [P]olitical speech must prevail against laws that would suppress it whether by design or inadvertence.” Laws burdening political speech are “subject to strict scrutiny,” which requires the Government to prove that the restriction “furthers a compelling interest and is narrowly tailored to achieve that interest.”

In 2008, Citizens United released a documentary about Presidential candidate Hillary Clinton and produced television ads for video-on-demand of the film scheduled to be available within 30 days of the election. The non-profit corporation was concerned about possible civil and criminal penalties for violating Section 441b which prohibits corporations and unions from making independent expenditures for speech that is an “electioneering communication” (“any broadcast, cable, or satellite communication” that “refers to a clearly identified candidate for Federal office”) or for speech that expressly advocates the election or defeat of a candidate. Citizens United sought declaratory and injunctive relief, arguing that 441b is unconstitutional as applied to its documentary. The District Court denied Citizens United a preliminary injunction and granted the FEC summary judgment.

The Supreme Court overruled the District Court stating that Section 441b’s prohibition on corporate independent expenditures is thus a ban on speech. As a ‘restriction on the amount of money a person or group can spend on political communication during a campaign,’ that statute ‘necessarily reduces the quantity of expression by restricting the number of issues discussed, the depth of their exploration, and the size of the audience reached.’” Were the Court to uphold these restrictions, the Government could repress speech by silencing certain voices at any of the various points in the speech process.

The Court noted that “[i]n a republic where the people are sovereign, the ability of the citizenry to make informed choices among candidates for office is essential.” The right of citizens to inquire, to hear, to speak, and to use information to reach consensus is a precondition to enlightened self-government and a necessary means to protect it. The First Amendment “has its fullest and most urgent application’ to speech uttered during a campaign for political office.” Furthermore, “[d]iscussion of public issues and debate on the qualifications of candidates are integral to the operation of the system of government established by our Constitution.”

“Under the Constitution it is ‘We The People’ who are sovereign. The people have the final say. The legislators are their spokesmen. The people determine through their votes the destiny of the nation. It is therefore important – vitally important –

that all channels of communication be open to them during every election, that no point of view be restrained or barred, and that the people have access to the views of every group in the community.” The worth of speech “does not depend upon the identity of its source, whether corporation, association, union or individual.” [T]he concept that government may restrict the speech of some elements of our society in order to enhance the relative voice of others is wholly foreign to the First Amendment.”

Given that the report is required by the Constitution, the Statement and Account is clearly “political speech.” Arguably, it is equal to or greater in importance than the President’s required State of the Union Address. It is inconceivable that the government’s current financial reporting can withstand strict scrutiny. The notion that cash-based accounting coupled with not consolidating material government-controlled entities furthers a compelling interest and is narrowly tailored to achieve that interest does not withstand even the slightest scrutiny as it is clear from the legislative history that it serves the re-election interests of politicians.

As Justice Kennedy stated “The Constitution... confers upon voters, not Congress, the power to choose the Members of the House of Representatives, Art I, sec 2, and it is a dangerous business for Congress to use election laws to influence the voters’ choices”. The fact that Congress is using the laws governing the publication of the Statement and Account to influence voters’ choices does not make it any less dangerous. The First Amendment is premised on a mistrust of governmental power and provides that “Congress shall make no law...abridging the freedom of speech. The laws that Congress has put in place that have led to current federal financial reporting clearly violate the people’s freedom of speech.

iii. Due Process¹⁹³

On June 8, 2009, the U.S. Supreme Court in a 5-4 decision found that campaign expenditures made in support of West Virginia Supreme Court Justice Brent Benjamin violated the Due Process Clause of the Fourteenth Amendment. *Caperton v. A.T. Massey Coal Co.*¹⁹⁴, a case that inspired a best-selling novel and two editorials in the New York Times, started in 1998 when Caperton filed suit against Massey in the circuit court of Boone County, West Virginia. After the jury found Massey liable for fraudulent misrepresentation, concealment, and tortuous interference with existing contractual relations and awarded Caperton \$50 million in damages, West Virginia held its 2004 judicial elections. Massey CEO Don Blankenship contributed \$3 million to Brent Benjamin’s campaign knowing that the State Supreme Court of Appeals would consider the appeal.

Before Massey filed its appeal, Caperton moved to disqualify Justice Benjamin under the Due Process Clause and the State's Code of Judicial Conduct, based on the conflict caused by Blankenship's campaign contributions. Justice Benjamin denied the motion, indicating that he found nothing showing bias for or against any litigant. Ultimately, Benjamin cast the deciding vote to overturn the \$50 million verdict. During the rehearing process, Justice Benjamin refused twice more to recuse himself, and the court once again reversed the verdict. Several months later, Justice Benjamin filed a concurring opinion, defending the court's opinion and his recusal decision.

On appeal, the U.S. Supreme Court found that the \$3 million spent on Benjamin's behalf created a risk of actual bias sufficient to violate Caperton's Fourteenth Amendment right to an impartial adjudicator. In doing so, the Court recognized for the first time that campaign expenditures could create a due process violation.

Justice Kennedy in his Opinion of the Court cited several cases including *Tumey v. Ohio*¹⁹⁵. "The *Tumey* Court concluded that the Due Process Clause incorporated the common-law rule that a judge must recuse himself when he has "a direct, substantial, pecuniary interest" in the case. This rule reflects the maxim that "[n]o man is allowed to be a judge in his own cause; because his interest would certainly bias his judgment, and, not improbably, corrupt his integrity."¹⁹⁶

In *Tumey*, "the mayor of a village had the authority to sit as a judge (with no jury) to try those accused of violating a state law prohibiting the possession of alcoholic beverages. Inherent in this structure were two potential conflicts. First, the mayor received a salary supplement for performing judicial duties, and the funds for that compensation derived from the fines assessed in a case. No fines were assessed upon acquittal. The mayor-judge thus received a salary supplement only if he convicted the defendant.¹⁹⁷ Second, sums from the criminal fines were deposited in the village's general treasury fund for village improvements and repairs.¹⁹⁸

The Court held that the Due Process Clause required disqualification "both because of [the mayor-judge's] direct pecuniary interest in the outcome, and because of his official motive to convict and to graduate the fine to help the financial needs of the village."¹⁹⁹ The Court articulated the controlling principle: "Every procedure which would offer a possible temptation to the average man as a judge to forget the burden of proof required to convict the defendant, or which might lead him not to hold the balance nice, clear and true between the State and the accused, denies the latter due process of law."²⁰⁰

If we apply the Court's logic to Congress' responsibility to publish the Statement and Account several notions become obvious. First, while the Constitution is clear that Congress is responsible for publishing the Statement and Account it cannot unilaterally determine whether it is complying with the Clause. This would violate the maxim cited by the Court that no man is allowed to be a judge in his own cause. James Madison in Federalist No. 10 extended this concept beyond a single judge, "With equal, nay with greater reason, a body of men are unfit to be both judges and parties at the same time". Second, it can be argued that Congress has "a direct, personal, substantial, pecuniary interest" in the determination of whether it is complying with Constitution as it is in their interest to under-report expenses in an effort to endear themselves with the electorate, protect incumbents and degrade the competitiveness of the electoral process.

If the Court were to determine that Congress did not have "a direct, personal, substantial, pecuniary interest" the Court would then proceed to its analysis of the more general concepts of bias. Justice Kennedy stated that the Tumey Court was also concerned with a more general concept of interests that tempt adjudicators to disregard neutrality. ... As new problems have emerged that were not discussed at common law...., the Court has identified additional instances which, as an objective matter, require recusal. There are circumstances "in which experience teaches that the probability of actual bias on the part of the judge or decisionmaker is too high to be constitutionally tolerable."²⁰¹

This concern was discussed in Ward v. Monroeville²⁰², which invalidated a conviction in another mayor's court. In Monroeville the mayor received no money. The fines the mayor assessed went to the town's general fisc. The Court held that "[t]he fact that the mayor [in Tumey] shared directly in the fees and costs did not define the limits of the principle."²⁰³ The principle, instead, turned on the "possible temptation" the mayor might face; the mayor's executive responsibilities for village finances might make him partisan to maintain a high level of contribution [to those finances] from the mayor's court."²⁰⁴ As the Court reiterated in Gibson v. Berryhill, another case that Term, "the [judge's] financial stake need not be as direct or positive as it appeared to be in Tumey."²⁰⁵

The Court in Caperton stated that the facts of the case were "exceptional," "extreme," "rare" and "extraordinary." If \$3 million in campaign contributions to a state supreme court's judge's campaign is critical to the Court's analysis of whether due process has been violated then what would the Court consider Congress keeping over \$74.6 trillion of entitlement expenses and numerous multi-trillion enterprises

that the federal government controls off the governments' books as its members seek re-election.

It is significant to note that the Supreme Court does not have to conclude that the Congress intentionally published misleading or fraudulent financial statements. The Court merely has to conclude that there would be a possible temptation for the average Congress to not hold the balance nice, clear and true in determining the methodology of compiling the Statement and Account and its content. If it so concluded, the probability of actual bias on the part of Congress is too high to be constitutionally tolerable as the arbiter of whether it is complying with the Constitution.

In defining these standards the Court in Caperton asked whether "under a realistic appraisal of psychological tendencies and human weakness," the interest "poses such a risk of actual bias or prejudgment that the practice must be forbidden if the guarantee of due process is to be adequately implemented."²⁰⁶

Since entitlement programs were first created, Democrats and Republicans have had a significant incentive to be less than forthright with respect to their cost. They get elected by promising that benefits are guaranteed and that additional entitlements are possible. Yet, they do not permit any expense or liability associated with promises that must be paid in the future included in any financial statement to which they could be held accountable. Doing so would reveal massive deficits far exceeding our current Budget Deficit that would be impossible to justify and would likely lead to many elected officials losing their "jobs".

Using the Court's analysis in Caperton it is impossible to conclude that either Congress including the GAO, CBO or the Comptroller General or the Executive branch including the Treasury or OMB is the appropriate body to determine whether Congress or the Executive is complying with the Statement and Account Clause. This conclusion flies in the face of Chief Justice Burger's dictum in *United States v. Richardson* that "it is clear that Congress has plenary power to exact any reporting and accounting it considers appropriate in the public interest." This is so unless one reads the Justice's remarks to be targeted solely to the amount of detail that Congress must publish.

iv. Equal Protection²⁰⁷

The Supreme Court in *South Dakota v. Dole*,²⁰⁸ indicated that this spending power is of course not unlimited but is instead subject to several restrictions. The fourth restriction by Dole is that "other constitutional provisions may provide an

independent bar to the conditional grant of federal funds.”²⁰⁹ The Court used the example of a grant of federal funds conditioned on a state’s infliction of cruel and unusual punishment to clarify the types of conditions that would be unacceptable under the restriction.²¹⁰

Financial reporting by the federal government, on which states rely effectively forces a state to participate in action that violates the equal protection clause. For the Medicaid program the government reports no costs in any of its financial statements for the obligations that must be paid in the future. This has the effect of disguising a very substantial wealth transfer from future generations to pay for the current generation’s health care. This wealth transfer is an equal protection violation as it is unlikely that funds will exist to cover future generation’s same costs. An accurate statement and account of the nations operations would reveal this violation.

The Comptroller General recently stated "the federal government continues to face an unsustainable fiscal path."²¹¹ The Citizens Guide to the 2011 Financial Report states "The Nation must bring social insurance expenses and resources into balance before the deficit and debt reach unprecedented heights. Delays will only increase the magnitude of the reforms needed and will place more of the burden on future generations."²¹²

v. Right to Financial Information

Truthful financial reporting by our government is critical for the operation of our democracy. An informed electorate is the cornerstone of our democracy. Liberty cannot be preserved without a general knowledge among the people of the character and conduct of their rulers. Their use of public money is central to this general knowledge. The right to financial information must exist if our democracy is to work properly. If we assume that citizens have no right to receive reasonably correct information about the nation’s finances this would limit or abrogate entirely citizens’ right to vote and freedom of speech and also violate their due process and equal protection rights. Finally, it eliminates required political accountability.

A review of statements made by three of our early Presidents conveys the importance of information to the operation of our democracy.

“A popular Government, without popular information, or the means of acquiring it, is but a Prologue to a Farce or a tragedy; or, perhaps both. Knowledge will forever govern ignorance. And a people who mean to be their own Governors, must arm themselves with the power which knowledge gives.”²¹³

“If a nation expects to be ignorant and free, in a state of civilization, it expects what never was and never will be.”²¹⁴

“Liberty cannot be preserved without a general knowledge among the people, who have a right, from the frame of their nature, to knowledge, as their great Creator, who does nothing in vain, has given them understandings, and a desire to know; but besides this, they have a right, an indisputable, unalienable, indefeasible, divine right to that most dreaded and envied kind of knowledge; I mean, of the characters and conduct of their rulers.”²¹⁵

The Statement and Account Clause is found in Article I which defines the powers and limitations of Congress. Hence, Congress has the duty to produce the Statement and Account and the Executive Branch does not have any authority in defining the information required to be published. Using this analysis it is hard to understand why the FASAB exists except as an unconstitutional political accommodation. Furthermore, it is inconceivable that Congress or the Executive could publish and discuss as relevant to the nation’s financial condition figures that materially differ from the required Statement and Account.

The Right to Financial Information is consistent with the importance of information in our democracy and the principles upon which our nation was founded. The distinction between cash-based accounting versus accrual accounting is irrelevant for purposes of the right. The public is entitled to an accounting that reflects the economic reality of the government’s finances under the Constitution. If accrual accounting more accurately reflects economic reality then this is what is required.

The right to financial information is a texturally enumerated right. There is no other meaning that one, at any point in time, could ascribe to the text of second part of Article I, Section 9, Clause 7 then it creates a right for the public to receive revenue and expense information and imposes a concurrent affirmative duty on the government’s part to publish this financial information.

“As we have explained, “the framers of the Constitution were not mere visionaries, toying with speculations or theories, but practical men, dealing with the facts of political life as they understood them, putting into form the government they were creating, and prescribing in language clear and intelligible the powers that government was to take.” *South Carolina v. United States*, 199 U. S. 437, 449 (1905).”²¹⁶

Both the majority and dissenting Court of Appeals judges in the Richardson case referred to the right to financial information.²¹⁷ Justice Douglas focused on this fact

in his dissent when the case reached the Supreme Court. He thought that Chief Justice Burger's interpretation effectively read the Statement and Account Clause out of the Constitution.

Given the explicit language of the Statement and Account Clause the only reasonable interpretation is that citizens/voters have a right to financial information. This private right must give the electorate standing in the courts to challenge the government if it believes that Congress is not providing the required financial information. Otherwise, there is no check on Congress' obligation to publish the Statement and Account.

Justice Rehnquist has famously characterized the implied private right of action under Rule 10b-5 of the securities laws as "a judicial oak which has grown from little more than a legislative acorn."²¹⁸ It would appear that the country would receive like benefits if the Court were to adopt a similar posture with respect to citizens' ability to challenge the federal government's financial reporting under the Statement and Account Clause. Recognizing a private right of action by citizens will result in the federal government most closely fulfilling its obligations under the Clause.²¹⁹

The judiciary has sometimes indicated that public access is a matter for executive and legislative discretion. The Court averred in *Houchins v. KQED, Inc.* that "[t]he Constitution itself," in Justice Stewart's words, "is neither a Freedom of Information Act nor an Official Secrets Act." The two reasons typically given to deny an affirmative right to information are that the judiciary lacks easily ascertainable standards for specifying the content of any access guarantee and that alternative methods are available for the public to access the information. However, as will be discussed, the Court has already determined the relevant standard. With respect to the second reason the concept that a citizen/voter can piece together consolidated financial information from the data that is published today is laughable as sophisticated financial executives who pore over the data for years can only get a sense for what these figures would actually be. Furthermore, in addressing the argument denying an affirmative right to financial information the Court must confront the Supremacy Clause and the Statement and Account Clause.

It is the duty of the Judiciary to interpret the legal meaning of the Constitution. If the Court does not acknowledge the right of financial information it is effectively saying that the Constitution does not permit anyone to challenge Congress with respect to its self-proclaimed adherence to a Constitutional requirement. This is so

even when Congress' non-adherence benefits its incumbents to the detriment of the electorate. The Court should not invoke the political question doctrine as this would nullify an important check on power that the Framers explicitly made a part of the Constitution. Furthermore, as previously noted, the lack of an interpretation of the Statement and Account Clause has dire implications for the right to vote, freedom of speech and equal protection. Finally, if the Court refuses to interpret the Clause it will remain susceptible to making errant decisions based on false and incomplete economic data as it did with its ACA decision last summer.

vi. Political Accountability

The Court in *New York v. United States*,²²⁰ sought to protect "the accountability of both state and federal officials" to their electorate.²²¹ Employing this rationale, the Court held unconstitutional a federal statute that commanded the states either to remove radioactive nuclear waste or to take title to it. If Congress' scheme were permitted state and federal officials could engage in a kind of political shell game where each level of government might disclaim responsibility by pointing fingers at the other. There was a danger, then, that accountability would wither. Arguably, this case introduced the accountability rationale into the jurisprudence supporting constitutional federalism.

In key language explaining why the State could not consent to being commandeered by Congress, Justice O'Connor relied on the accountability rationale:

"[I]t is likely to be in the political interest of each individual official to avoid being held accountable to the voters for the choice of location. If a federal official is faced with the alternatives of choosing a location or directing the States to do it, the official may well prefer the latter, as a means of shifting responsibility for the eventual decision. If a state official is faced with the same set of alternatives-choosing a location or having Congress direct the choice of a location-the state official may also prefer the latter, as it may permit the avoidance of personal responsibility....[F]ederalism is hardly being advanced."

The federal and state governments did not publish any financial results with respect to Medicaid other than current year cash outlays until 2010. At that time the federal government indicated that the net present value obligation related to its portion was \$24.2 trillion. The states have still not acknowledged their obligation's net present value cost of \$19.7 trillion in their financial statements. What aspect of this fact pattern meets the accountability requirement set forth by Justice O'Connor? It would appear that accounting for Medicaid is a political shell game.

James Madison was prescient. “I believe that there are more instances of the abridgement of the freedom of the people by gradual and silent encroachments of those in power than by violent and sudden usurpations.”²²²

The dissent in *Citizens United* (Justices Stevens, Ginsburg, Breyer and Sotomayor) believes that Congress’ “careful legislative adjustment of the federal election laws...warrants considerable deference,..” and that “we should instead start by acknowledging that “Congress surely has both wisdom and experience in these matters that is far superior to ours.” However, “[t]his is not to say that deference would be appropriate if there was a solid basis for believing that a legislative action was motivated by the desire to protect incumbents or that it will degrade the competitiveness of the electoral process.”²²³ This approach appears warranted for examining financial reporting laws.

Over the last one hundred years Congress has abdicated its financial reporting responsibility. Today, the Executive branch dominates federal financial reporting and this reporting is completely politically motivated. The President’s Budget is prepared by OMB without input from Congress. Congress enacted legislation in the 1950s requiring the Executive branch to complete the President’s Budget using cost-based accrual accounting.²²⁴ The Executive branch has refused to comply with this legislation. The Financial Report is prepared by Treasury and OMB without input from Congress other than through the agreed directives of the FASAB.

An example of the irrelevance of Congressional input today is the treatment of Fannie Mae and Freddie Mac. After the U.S. government assumed control in 2008 of these two federally chartered institutions the CBO concluded that the institutions had effectively become government entities whose operation should be included in the federal budget. However, OMB felt differently, and the Combined Statement reflected the Budget’s approach.²²⁵ Given the CBO’s position it should be surprising if it does not file an objection to the Exposure Draft.

The bottom line is that Supreme Court deference is wholly inappropriate to a Legislative branch that has abdicated its financial reporting responsibility in an effort to diminish its political accountability. This effort has significantly degraded the electoral process as citizens must vote without the benefit of financial information required to be published by the Constitution.

There are two other critical facts with respect to financial reporting and political accountability. The first is that the Legislative and Executive branches have a

direct conflict of interest in not having expenditures reported correctly as they have been elected by promising to maintain or increase spending levels. Proper financial reporting would lead to spending cutbacks, tax increases and/or recriminations for overspending, all of which are likely to cause voter dissatisfaction and changes at the polls. The second is that Social Security, Medicare and Medicaid have either permanent appropriations or mandatory authorizing legislation.²²⁶

Chief Justice Roberts in questioning General Verrilli in oral argument in the Obamacare case came close to understanding the likely outcome of the under-reporting of expenses by both the federal and state governments with the following exchange.

Chief Justice Roberts: Well, the Secretary has the discretion. We're talking about something else. We're talking about fiscal realities and whether or not the Federal Government is going to say we need to lower our contribution to Medicaid and leave it up to the States because we want the people to be mad at the States when they have to have all these budget cuts to keep it up, and not at the Federal Government.

General Verrilli: But that would be true, Mr. Chief Justice, whether this Medicaid expansion occurred or not. So –

Chief Justice Roberts: I know, but you've been emphasizing that the Federal Government is going to pay 90 percent of this, 90 percent of this. And it's not something you can take to the bank, because the next day or the next fiscal year, they can decide we're going to pay a lot less, and you, States, are still on the hook, because you don't – you say it's not an easy choice. We can say – ask whether it's coercion. You're not going to be able to bail out of Medicaid. You just have to pay more because we're going to pay less.

The Supreme Court's dissenters (Justices Scalia, Kennedy, Thomas and Alito) in the National Federation of Independent Business v. Sebelius case put forth the following argument about accountability.

“Taxes have never been popular, see, *e.g.*, Stamp Act of 1765, and in part for that reason, the Constitution requires tax increases to originate in the House of Representatives. See Art. I, §7, cl. 1. That is to say, they must originate in the legislative body most accountable to the people, where legislators must weigh the need for the tax against the terrible price they might pay at their next election, which is never more than two years off. The Federalist No. 58 “defend[ed] the decision to give the origination power to the House on the ground that the Chamber that is more accountable to the people should have

the primary role in raising revenue.” *United States v. Munoz-Flores*, 495 U. S. 385, 395 (1990).”

Under-reporting expenses by Congress is directly related to the desire by members of Congress to get re-elected. The under-reporting is aimed at putting off the day of reckoning regarding spending until some other politician is in office, presumably long after the present politician is gone.

Medicaid has mandatory authorizing legislation. A distinctive feature of authorizing legislation for mandatory spending is that it provides agencies with the authority or requirement to spend money without first requiring committees to enact funding. This is critical in the context of accountability because current members of Congress can and do wash their hands of any responsibility with respect to mandatory spending.²²⁷

When you couple permanent appropriations or mandatory authorizing legislation with inadequate financial disclosure political accountability disappears altogether. Voters have no idea what the level of expenditures are and they cannot send the responsible representatives packing because they have retired years ago. Their current representatives’ stance is that their hands are tied and they have nothing to do with mandatory spending.

Let’s not forget the role of the GAO, the federal government’s auditor. In every financial fraud or reporting failure in the private sector, the SEC always asks the question, “Where were the accountants?” All too often they find accountants and even outside auditors who, at best, closed their eyes to the problem and in some cases were even complicit. The GAO has refused to use its power to force the Executive branch to comply with its accounting directives. Furthermore, they were the key sponsor in setting up the FASAB.

The AICPA has also played an integral role in the massive accounting fraud that has been perpetrated on the American citizenry. It has designated two organizations (FASAB and the Governmental Accounting Standards Board (“GASB”)) as GAAP standards setters. These entities have promulgated rules that result in misleading and/or fraudulent financial statements that violate the Constitutional rights of Americans. Nevertheless, both federal and state governments’ publish financial statements are “U.S. GAAP compliant.” One can argue that there could be is no greater attempt by Congress at diminishing its accountability, degrading the competitiveness of the electoral process and protecting

incumbents than to have the accounting mess that it created be effectively blessed by the leading “independent” accounting entity.

d. Antifraud Provisions of the Securities Laws

There is a crucial parallel between federal financial disclosures and those by corporations issuing securities. Federal securities laws consist of six separate statutes and corresponding implementing regulations enacted between 1933 and 1940.²²⁸ The broad goal of securities regulation and the Statement and Account Clause is the same, to ensure full and fair disclosure. Louis Brandeis, whose ideas were a major influence on disclosure philosophy of securities regulation, stated “publicity is justly commended as a remedy for social and industrial diseases. Sunlight is said to be the best of disinfectants; electric light the most efficient policeman.”²²⁹

The essence of the disclosure philosophy of securities regulation and the Statement and Account Clause is that, when armed with information, investors or voters are well-positioned to evaluate investment opportunities or candidates for public office and to allocate their capital or vote as they see fit. The crux of our federal securities laws and the Statement and Account Clause is that all material information must be disclosed. What other reasonable interpretation can there be for the Clause, particularly the “all Public Money” language?

On March 22, 2011, the Supreme Court issued a unanimous decision written by Justice Sotomayor in the matter of *Matrixx Initiatives v. Siracusano* (2011)²³⁰. The importance of the case is that the Court reaffirmed the traditional tests it laid out in *Basic, Inc. v. Levinson*²³¹ and *TSC Industries v. Northway, Inc.*²³² “Section 10(b) of the Securities and Exchange Act makes it unlawful for any person to “use or employ, in connection with the purchase or sale of any security...any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.”²³³ Sec Rule 10b-5 implements this provision by making it unlawful to, among other things, “make any untrue statement of a material fact or omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading.”²³⁴

To prevail on a section 10(b) claim, a plaintiff must show that the defendant made a statement that was “misleading as to a material fact.”²³⁵ In *Basic*, the Supreme Court held that this materiality requirement is satisfied when there is “a substantial likelihood that the disclosure of the omitted fact would have been

viewed by the reasonable investor as having significantly altered the “total mix” of information made available.”²³⁶ The Court was “careful not to set too low a standard of materiality,” for fear that management would “bury the shareholders in an avalanche of trivial information.”²³⁷

Moreover, it bears emphasis that sec10(b) and Rule 10b-5(b) do not create an affirmative duty to disclose any and all material information. Disclosure is required under these provisions only when necessary “to make...statements made, in the light of the circumstances under which they were made, not misleading.”²³⁸²³⁹

In TSC Industries the Court considered a claim of fraud in connection with a proxy solicitation and concluded that “[a]n omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote.”²⁴⁰ The Court does not require proof of a substantial likelihood that disclosure of the omitted fact would have caused the reasonable investor to change his vote. What the standard requires is a showing of a substantial likelihood that, under the circumstances, the omitted fact would have assumed actual significance in the deliberations of the reasonable shareholder.

The Supreme Court has been quite clear and consistent in its use of the reasonable investor standard in the materiality context.²⁴¹ Furthermore, materiality is a mixed question of law and fact, ordinarily determined by the fact finder.²⁴² It would seem that a reasonable citizen/voter standard and a fact-based approach to materiality with respect to meeting the Clause’s “all Public Money” reporting requirement are necessary.

When discussing financial reporting, a government’s financial statements are the critical item. If the numbers in the financial statements cannot be trusted to provide relevant and reliable financial information about the government, citizens have no basis for making voting decisions. In the private sector a defendant cannot rebut a charge of having omitted a necessary material fact by pointing to facts that, while disclosed and technically sufficient to alert the investor to the truth, are buried or hidden within the relevant document as to be practically non-disclosed. ²⁴³ Under the “buried facts” doctrine, a disclosure is deemed inadequate if it is presented in a way that conceals or obscures the information sought to be disclosed. The doctrine applies when the fact in question is hidden in a voluminous document or is disclosed in a piecemeal fashion which prevents a reasonable shareholder from realizing the “correlation and overall import of the various facts interspersed throughout” the document.²⁴⁴

It is in this context that one need to examine the federal government's financial reporting. Prior to 2010 the government did not release any estimate of the net present value cost of Medicaid and starting in 2010 it released a single figure as a single line item in the Required Supplementary Information in the back of a roughly two hundred fifty page Financial Report. The net present value cost of Medicare and Social Security are included in a required financial statement, the Statements of Social Insurance, but this statement does not inter-relate with the government's consolidated financial statements. Furthermore, the government did not and does not consolidate material government-controlled entities.

Only if the established omissions are "so obviously important to an investor, that reasonable minds cannot differ on the question of materiality" is the ultimate issue of materiality appropriately resolved "as a matter of law" by summary judgment.²⁴⁵ Given the facts if the federal government were an entity subject to SEC rules there can be no doubt that it's financial reporting would be materially deficient as a matter of law.

If we apply the Court's logic in *FEC v. Akins* and the *Matrixx*, *Basic* and *TSC* securities law disclosure standard to the Statement and Account Clause the information that a reasonable citizen/voter would want/require the government to produce are financial statements that consolidate all material entities and accrue for all costs associated with legally enacted programs for which Congress has appropriated funds. What facts give rise to this conclusion? First, these statements are the only information that will provide a voter with an accurate account of the financial results and financial position of the United States Government. Second, the Sarbanes-Oxley Act of 2002²⁴⁶ requires registered companies to disclose "all material off-balance sheet transactions."²⁴⁷ A reasonable voter would require the government to follow this requirement because to not comply would render the financial statements misleading.

Given the unanimity on the Supreme Court with respect to the antifraud provisions of the securities laws it appears likely that the Court will ultimately rule that our securities laws antifraud provisions are inherent in the Statement and Account Clause. If a reasonable voter is not supplied with the information described it would appear that the voter does not have the political information required by the Constitution to properly evaluate candidates for public office.

e. Congress' Plenary Power

In its 1974 5-4 decision in *United States v. Richardson*,²⁴⁸ the Court declined to opine on the meaning of the Statement and Account Clause as it found that the plaintiff lacked standing. Chief Justice Burger's opinion included dictum that appears to have become the gospel for the Court to ignore the provision.

“[I]t is clear that Congress has plenary power to exact any reporting and accounting it considers appropriate in the public interest.”²⁴⁹ “Not controlling, but surely not unimportant, are nearly two centuries of acceptance of a reading of cl 7 as vesting in Congress plenary power to spell out the details of precisely when and with what specificity Executive agencies must report the expenditure of appropriated funds and to exempt certain secret activities from comprehensive public reporting.”²⁵⁰

While these statements are clearly true as it relates to details associated with the nation’s financial reports and most assuredly information related to national security matters, Congress has a Constitutional obligation to report truthful and complete information with respect to total receipts and expenditures.

The reference to “two centuries of acceptance” is hollow as the government’s finances have become exponentially more complex after the ratification in 1913 of the 16th amendment permitting income taxes and the Medicare and Medicaid programs are less than fifty years old.

4) Medicaid Expansion Issue in Obamacare Litigation²⁵¹

a. Federal Government’s Inadequate Disclosure

Does the federal government’s failure to properly advise the States or their citizens of its financial results and condition through the publication of an accurate and complete Statement and Account render acceptance of the Medicaid “contract” null and void as there could not be any meeting of the minds? Also, did the litigants in the case adequately represent the interests of the sovereign or did the legislative and executive branches and the states direct conflict of interest in not having expenditures reported correctly bias their entire approach to the case?

On June 28, 2012 the Supreme Court resolved constitutional challenges to two provisions of the ACA: the individual mandate and the Medicaid expansion.²⁵² The individual mandate requires most Americans to maintain a “minimum essential” health insurance coverage.²⁵³ For many this requires purchasing insurance.²⁵⁴ Those who do not comply must pay a penalty to the IRS.²⁵⁵ With respect to the individual mandate the Court decided that while it is not a valid exercise of Congress’ power under the Commerce Clause and the Necessary and Proper Clause it may be upheld as within Congress’s power under the Taxing Clause.²⁵⁶ This section is focused solely on the second provision resolved by the Court, the Medicaid expansion.

Seven members of the Supreme Court agreed that the Medicaid expansion in the Act is unconstitutional.²⁵⁷ Each of the opinions issued by the Court, Justice Ginsburg and the Dissenters (Justices Scalia, Kennedy, Thomas and Alito) contains economic and political accountability analysis that are seriously flawed and incomplete. All of the Justices ignored important facts associated with entitlement program spending and the federal government's financial results. None addressed the Statement and Account Clause, a directly applicable Constitutional provision. Not surprisingly, the Court's remedy is clearly in error.

We will begin by summarizing certain facts highlighted by the Justices, the Court's analysis and remedy. "Medicaid has long been the largest federal program of grants to the States."²⁵⁸ By 1982 every State had chosen to participate in Medicaid. Federal funds received through the Medicaid program have become a substantial part of state budgets, now constituting over 10 percent of most States' total revenue. Between 2005 and 2008 federal contributions toward the care of beneficiaries averaged 57% and States contributions averaged 43%.²⁵⁹ For the States, "Medicaid spending accounts for over 20 percent of the average State's total budget See Nat. Assn. of State Budget Officers, Fiscal Year 2010 State Expenditure Report, p. 11, Table 5 (2011); 42 U. S. C. §1396d(b)."²⁶⁰ "The Act increases federal funding to cover the States' costs in expanding Medicaid coverage. But if a State does not comply with the Act's new coverage requirements, it may lose not only the federal funding for those requirements, but all of its federal Medicaid funds."²⁶¹

"We have repeatedly characterized . . . Spending Clause legislation as 'much in the nature of a contract.'²⁶² Furthermore, "Congress may use its spending power to create incentives for States to act in accordance with federal policies. But when 'pressure turns into compulsion,' the legislation runs contrary to our system of federalism."²⁶³ "In this case, the financial 'inducement' Congress has chosen is much more than 'relatively mild encouragement'— it is a gun to the head."²⁶⁴ "The threatened loss of over 10 percent of a State's overall budget . . . is economic dragooning that leaves the States with no real option but to acquiesce in the Medicaid expansion."²⁶⁵

Furthermore, "[p]ermitting the Federal Government to force the States to implement a federal program would threaten the political accountability key to our federal system."²⁶⁶ "When Congress compels the States to do its bidding, it blurs the lines of political accountability."²⁶⁷ By that, Justice Ginsburg believes, the Court means "voter confusion: Citizens upset by unpopular government action . . . may ascribe to state officials blame more appropriately laid at Congress' door."²⁶⁸

The Court believes that the constitutional violation and the political accountability issue are fully remedied by precluding the Secretary of Health and Human Services from applying the Act to withdraw existing Medicaid

funds from the States for their failure to comply with the requirements set out in the expansion.²⁶⁹

Let us review key economic facts regarding Medicaid not discussed by the parties or the Court. First, since Medicaid's inception, the federal government has never reported its full costs in either the President's Budget or the Financial Report. Justice Roberts quoted the impact of the ACA on the federal government. "In light of the expansion in coverage mandated by the Act, the Federal Government estimates that its Medicaid spending will increase by approximately \$100 billion per year, nearly 40 percent above current levels. Statement of Douglas W. Elmendorf, CBO's Analysis of the Major Health Care Legislation Enacted in March 2010, p. 14, Table 2 (Mar.30, 2011)." "The Federal Government estimates that it will pay out approximately \$3.3 trillion between 2010 and 2019 in order to cover the costs of *pre*-expansion Medicaid. Brief for United States 10, n. 6."²⁷⁰ Despite this huge increase in spending the litigants and the Court did not review any overall financial data for the federal government.

The federal government published a \$24 trillion estimate of the present value of the future net cost of the program for the first time in the 2010 Financial Report.²⁷¹ This figure was based on savings assumptions associated with the ACA similar to those used to generate the \$22.8 trillion Medicare figure published simultaneously. However, the assumptions were so unrealistic that the Administration published an alternate more realistic scenario which indicated a cost of \$35.2 trillion.²⁷² No alternate figure was published for Medicaid. The only costs recorded by the federal government or any state for Medicaid are current year cash expenditures. Second, since the State portion of Medicaid contributions averaged 43% of total expenditures this means that there is an additional \$19.7 trillion present value obligation. Therefore, Medicaid in total is a \$45.8 trillion program. No State records the full cost of its share of Medicaid costs in its financials.

The government knows that it cannot possibly fund its existing entitlement programs. The Comptroller General stated in 2011 "the federal government continues to face an unsustainable fiscal path."²⁷³ The Citizens Guide to the 2011 Financial Report states "The Nation must bring social insurance expenses and resources into balance before the deficit and debt reach unprecedented heights. Delays will only increase the magnitude of the reforms needed and will place more of the burden on future generations."²⁷⁴ "... the federal government faces long-term challenges resulting from large and growing structural deficits that are driven primarily by rising health-care costs and known demographic trends. This unsustainable path must be addressed soon by policymakers. The longer actions are delayed, the more difficult adjustments are likely to become." These words in the 2009 Financial Report of the U.S. Government were written by Gene L. Dodaro, acting comptroller general. It is hard to square these comments with Justice Ginsburg's assertion that "Thus there can be no objection to the ACA's expansion of

Medicaid as an ‘unfunded mandate.’ Quite the contrary, the program is impressively well funded.”²⁷⁵

The Court’s analysis is focused on the Act’s economic impact on the State’s income statements as opposed to the financial results of both parties. In commercial joint ventures it is typical for the parties to represent and warrant that they have the financial wherewithal to hold up their end of the bargain. These are often tied to audited financials. However, the states have no need for these because they and their citizens can rely on the Statement and Account.

The States cannot knowingly accept the full terms of the Medicaid contract if a fundamental assumption or condition on which they rely is materially in error. The ability of the federal government to provide financing is a key determinant whether a State wants to continue taking the money. Federal financial reporting is coercive because it significantly overstates the ability to continue providing funding. The failure to so advise the States through the publication of a truthful and accurate Statement and Account renders acceptance of the "contract" null and void as there could not be any meeting of the minds.

If threatening to withdraw over 10% of a State’s budget is a gun to the head then what is underreporting expenditures by over two thirds of total expenditures? Is it reasonable that those practical Framers that drafted the Statement and Account Clause thought it appropriate for the government to be able to spend at a level three times the amount that it publicly reported?

Finally, the grossly inadequate disclosure violates several private rights granted to citizens by the Constitution including the right to financial information (not yet recognized by the Court but required by the Constitution), the right to vote,²⁷⁶ free speech and equal protection.²⁷⁷ This violation of private rights is important as the Court has previously struck down spending conditions in *Legal Services Corp. v. Velasquez*²⁷⁸ and *American Civil Liberties Union v. Moneta*²⁷⁹ on First Amendment grounds.

b. State Government’s Inadequate Disclosures

Does a state’s failure to properly advise their citizens of its financial results and condition through the publication of accurate and complete financial statements render acceptance of the Medicaid “contract” null and void as state representatives cannot accept the federal government’s offer because they were elected without the electorate being adequately informed about the existing financial implications of the program?

The quotes below summarize the massive nature of the impact of the ACA on both federal and state spending.

As the Dissenters have noted:

“Medicaid has long been the largest federal program of grants to the States. See Brief for Respondents in No. 11– 400, at 37. In 2010, the Federal Government directed more than \$552 billion in federal funds to the States. See Nat. Assn. of State Budget Officers, 2010 State Expenditure Report: Examining Fiscal 2009–2011 State Spending, p. 7 (2011) (NASBO Report). Of this, more than \$233 billion went to pre-expansion Medicaid. See *id.*, at 47.¹⁴ *This amount equals nearly 22% of all state expenditures combined.* See *id.*, at 7. The States devote a larger percentage of their budgets to Medicaid than to any other item. *Id.*, at 5. Federal funds account for anywhere from 50% to 83% of each State’s total Medicaid expenditures, see §1396d(b) (2006 ed., Supp. IV); most States receive more than \$1 billion in federal Medicaid funding; and a quarter receive more than \$5 billion, NASBO Report 47. These federal dollars total nearly two thirds—64.6%—of all Medicaid expenditures nationwide.¹⁵ *Id.*, at 46.”

The Brief of State Petitioners on Medicaid indicates that:

“To finance that massive expansion, the federal government anticipates that its share of Medicaid spending will increase by \$434 billion by 2020. CBO Estimate, Table 4 (Mar. 20, 2010). It further estimates that state spending will increase by at least \$20 billion over the same timeframe. CBO Estimate, Table 4 n.c (Mar. 20, 2010). Other estimates suggest that both federal and state costs will be significantly higher. Kaiser Comm’n on Medicaid & the Uninsured, *Medicaid Coverage & Spending in Health Reform: National and State-by-State Results for Adults at or Below 133% FPL* 23 (May 2010) (estimating that increased costs could be as high as \$532 billion for federal government and \$43.2 billion for States).”

State spending on Medicaid is not recorded in the States financial statements except for current cash outlays. The massive increases in the present value of future spending obligations for the States under the Medicaid program are not recorded anywhere. Given that the States obligation in total is \$19.7 trillion, this lack of reporting constitutes fraud under the securities laws as enforced by the Securities and Exchange Commission. See Appendices A and B for examples of SEC enforcement actions against the states of Illinois and New Jersey.

If the fifty states are committing fraud in publishing their financial statements how can the electorate of these states be the informed voters that our Constitution requires? Furthermore, given the length of time that Medicaid has been in existence and the lack of financial reporting how can the state’s politicians accept the federal government’s money. There cannot be a meeting of the minds as both sides are significantly under-reporting expenses related to Medicaid.

5) Conclusion

Accounting and financial reporting standards are essential for public accountability and for an efficient and effective functioning of our democratic system of government. Our Declaration of Independence's closing sentence reads "And for the support of this Declaration, with a firm reliance on the protection of divine Providence, we mutually pledge to each other our Lives, our Fortunes and our sacred Honor. It is time for Congress to find its Honor but it is unlikely to do so.

Therefore, the nation needs the Supreme Court most when the other two branches of government have clearly failed to fulfill their Constitutional duties. As Chief Justice Roberts has clearly pointed out:

"Proper respect for a co-ordinate branch of the government" requires that we strike down an Act of Congress only if "the lack of constitutional authority to pass [the] act in question is clearly demonstrated." *United States v. Harris*, 106 U. S. 629, 635 (1883). Members of this Court are vested with the authority to interpret the law; we possess neither the expertise nor the prerogative to make policy judgments. Those decisions are entrusted to our Nation's elected leaders, who can be thrown out of office if the people disagree with them. It is not our job to protect the people from the consequences of their political choices.

Our deference in matters of policy cannot, however, become abdication in matters of law. "The powers of the legislature are defined and limited; and that those limits may not be mistaken, or forgotten, the constitution is written." *Marbury v. Madison*, 1 Cranch 137, 176 (1803). Our respect for Congress's policy judgments thus can never extend so far as to disavow restraints on federal power that the Constitution carefully constructed. "The peculiar circumstances of the moment may render a measure more or less wise, but cannot render it more or less constitutional." Chief Justice John Marshall, A Friend of the Constitution No. V, Alexandria Gazette, July 5, 1819, in John Marshall's Defense of *McCulloch v. Maryland* 190–191 (G. Gunther ed. 1969). And there can be no question that it is the responsibility of this Court to enforce the limits on federal power by striking down acts of Congress that transgress those limits. *Marbury v. Madison*, *supra*, at 175–176.²⁸⁰

Unless the Judiciary restores the rule of law the lack of proper financial reporting ensures that our electorate remains uninformed and that the nation will go off the proverbial "financial cliff" with the concomitant severe economic disruption and civil unrest. As a graduate of Fordham Law School I hope that readers will judge this

memorandum as consistent with the Jesuit tradition of searching for the truth in the world, even if that truth is not what you want to find.

SCHEDULES

1. The President's Budget
2. The Financial Reports
3. Financial Report Balance Sheet
4. Total Social Insurance Credit Card
5. Revised Financial Reports
6. Revised Financial Report Balance Sheet
7. Total Social Insurance Credit Card – Infinite Horizon
8. Infinite Horizon Balance Sheet

The President's Budget Under Budget Accounting \$1.32 Has Been Spent for Every \$1.00 of Revenue

(Trillions of Dollars)

| Fiscal Year Ended 9/30 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 |
|--|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| GDP (Quarterly-Current Dollars per BEA) | \$11.3 | \$11.9 | \$12.7 | \$13.4 | \$14.1 | \$14.4 | \$13.9 | \$14.6 | \$15.2 | \$15.8 |
| President's Budget | | | | | | | | | | |
| Revenues | 1.8 | 1.9 | 2.2 | 2.4 | 2.6 | 2.7 | 2.1 | 2.2 | 2.3 | 2.5 |
| Outlays | 2.2 | 2.3 | 2.5 | 2.7 | 2.7 | 3.1 | 3.5 | 3.5 | 3.6 | 3.5 |
| Budget Deficit | (0.4) | (0.4) | (0.3) | (0.2) | (0.2) | (0.5) | (1.4) | (1.3) | (1.3) | (1.1) |

Show \$1.42 Has Been Spent for Every \$1.00 of Revenue

(Trillions of Dollars)

Statements of Net Cost

| Fiscal Year Ended 9/30 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 |
|--|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| GDP (Quarterly-Current Dollars per BEA) | \$11.3 | \$11.9 | \$12.7 | \$13.4 | \$14.1 | \$14.4 | \$13.9 | \$14.6 | \$15.2 | \$15.8 |
| President's Budget | | | | | | | | | | |
| Revenues | 1.8 | 1.9 | 2.2 | 2.4 | 2.6 | 2.7 | 2.1 | 2.2 | 2.3 | 2.5 |
| Outlays | 2.2 | 2.3 | 2.5 | 2.7 | 2.7 | 3.1 | 3.5 | 3.5 | 3.6 | 3.5 |
| Budget Deficit | (0.4) | (0.4) | (0.3) | (0.2) | (0.2) | (0.5) | (1.4) | (1.3) | (1.3) | (1.1) |
| Additional Accrued Expenses Recorded in Financial Report | (0.1) | 0.2 | 0.4 | 0.2 | 0.1 | 0.6 | (0.2) | 0.8 | 0.0 | 0.2 |
| Net Operating Cost | (0.3) | (0.6) | (0.8) | (0.4) | (0.3) | (1.0) | (1.3) | (2.1) | (1.3) | (1.3) |

Financial Report Balance Sheet

Reported Net Liability is about the Size of the Nation's GDP

as of September 30, 2012

(Trillions of Dollars)

| Assets | |
|-----------------------------|------------|
| Cash | \$0.2 |
| Receivables | 1.0 |
| Inventories | 0.3 |
| Property, plant & equipment | 0.9 |
| Other | 0.4 |
| Total Assets | 2.7 |

| Liabilities | |
|---|-----------------|
| Federal debt securities held by the public and accrued interest | (11.3) |
| Federal employee and veteran benefits payable | (6.3) |
| Other | (1.2) |
| Total Liabilities | (18.8) |
| Net Liability (Net Position) | (\$16.1) |

Total Social Insurance Credit Card

Statements of Social Insurance Plus Medicaid

Present Value of Obligation as of January 1 for Open Group Alternative Scenario For Medicare for 2010, 2011 & 2012

(Trillions of Dollars)

| | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 |
|--|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| Social Security | \$4.9 | \$5.2 | \$5.7 | \$6.5 | \$6.8 | \$6.6 | \$7.7 | \$7.9 | \$9.2 | \$11.3 |
| Medicare | | | | | | | | | | |
| Part A | 6.2 | 8.5 | 8.8 | 11.3 | 12.3 | 12.7 | 13.8 | 7.3 | 8.5 | 9.9 |
| Part B | 9.7 | 11.4 | 12.4 | 13.1 | 13.4 | 15.7 | 17.2 | 20.6 | 21.0 | 20.6 |
| Part D | | 8.1 | 8.7 | 7.9 | 8.4 | 7.9 | 7.2 | 7.2 | 7.5 | 6.8 |
| Total Medicare | 15.8 | 28.1 | 29.9 | 32.3 | 34.1 | 36.3 | 38.1 | 35.2 | 37.0 | 37.2 |
| Total Net Obligation Per SOSI | 20.7 | 33.3 | 35.6 | 38.8 | 40.8 | 42.9 | 45.8 | 43.1 | 46.2 | 48.5 |
| Medicaid | | | | | | | | 24.2 | 24.0 | 26.1 |
| Total Social Insurance Net Obligation | \$20.7 | \$33.3 | \$35.6 | \$38.8 | \$40.8 | \$42.9 | \$45.8 | \$67.3 | \$70.2 | \$74.6 |
| Increase in Net Obligation (a) | \$2.9 | \$12.5 | \$2.3 | \$3.2 | \$2.1 | \$2.0 | \$2.9 | \$21.5 | \$2.8 | \$4.5 |

Adjusted Financials Show the Feds Spent \$3.96 for Every \$1.00 of Revenue

Adjusted Statements of Net Cost

Open Group - (Alternative Scenario for Medicare for 2010, 2011 & 2012)

(Trillions of Dollars)

| Fiscal Year Ended 9/30 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 |
|---|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| GDP (Quarterly-Current Dollars per BEA) | \$11.3 | \$11.9 | \$12.7 | \$13.4 | \$14.1 | \$14.4 | \$13.9 | \$14.6 | \$15.2 | \$15.8 |
| President's Budget | | | | | | | | | | |
| Revenues | 1.8 | 1.9 | 2.2 | 2.4 | 2.6 | 2.7 | 2.1 | 2.2 | 2.3 | 2.5 |
| Outlays | 2.2 | 2.3 | 2.5 | 2.7 | 2.7 | 3.1 | 3.5 | 3.5 | 3.6 | 3.5 |
| Budget Deficit | (0.4) | (0.4) | (0.3) | (0.2) | (0.2) | (0.5) | (1.4) | (1.3) | (1.3) | (1.1) |
| Additional Accrued Expenses Recorded in Financial Report | (0.1) | 0.2 | 0.4 | 0.2 | 0.1 | 0.6 | (0.2) | 0.8 | 0.0 | 0.2 |
| Net Operating Cost | (0.3) | (0.6) | (0.8) | (0.4) | (0.3) | (1.0) | (1.2) | (2.1) | (1.3) | (1.3) |
| Increase in Present Value of Social Insurance Obligations | 2.9 | 12.5 | 2.3 | 3.2 | 2.1 | 2.0 | 2.9 | 21.5 | 2.8 | 4.5 |
| Operating Deficit | (3.2) | (13.2) | (3.1) | (3.6) | (2.4) | (3.0) | (4.1) | (23.6) | (4.1) | (5.8) |

Current Total Net Obligation is 5.7x the Size of Nation's GDP

Balance Sheet as of September 30, 2012

(Trillions of Dollars)

| Assets | |
|-----------------------------|------------|
| Cash | \$0.2 |
| Receivables | 1.0 |
| Inventories | 0.3 |
| Property, plant & equipment | 0.9 |
| Other | 0.4 |
| Total Assets | 2.7 |

| Liabilities | |
|---|-----------------|
| Federal debt securities held by the public and accrued interest | (11.3) |
| Federal employee and veteran benefits payable | (6.3) |
| Other | (1.2) |
| Total Liabilities | (18.8) |
| Net Liability (Net Position) | (\$16.1) |
| Present Value of Social Insurance Obligations ⁽⁴⁷⁾ | (74.6) |
| Total Net Obligation | (\$90.7) |

Total Social Insurance Credit Card – Infinite Horizon

Statements of Social Insurance Plus Medicaid

Present Value of Obligation as of January 1 for Infinite Horizon

For Social Security and Medicare; 75 Year Horizon for Medicaid

(Trillions of Dollars)

| | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 |
|--|------|--------|--------|--------|--------|--------|--------|----------|--------|--------|
| Social Security | | \$11.9 | \$12.8 | \$15.2 | \$15.7 | \$15.9 | \$17.5 | \$18.7 | \$20.5 | \$23.2 |
| Medicare | | | | | | | | | | |
| Part A | | 22.1 | 24.3 | 28.4 | 30.5 | 34.7 | 36.7 | (0.3) | 0.2 | 5.1 |
| Part B | | 23.2 | 25.8 | 26.2 | 26.8 | 34.0 | 37.2 | 21.1 | 22.4 | 23.7 |
| Part D | | 16.5 | 18.3 | 16.0 | 17.1 | 17.2 | 15.6 | 15.8 | 16.2 | 14.3 |
| Total Medicare | | 61.8 | 68.4 | 70.6 | 74.4 | 85.9 | 89.5 | 36.6 | 38.8 | 43.1 |
| Total Net Obligation Per SOSI | | 73.7 | 81.2 | 85.8 | 90.1 | 101.8 | 107.0 | 55.3 | 59.3 | 66.3 |
| Medicaid | | | | | | | | 24.2 | 24.0 | 26.1 |
| Total Social Insurance Net Obligation | | 73.7 | 81.2 | 85.8 | 90.1 | 101.8 | 107.0 | 79.5 | 83.3 | 92.4 |
| Increase in Net Obligation (a) | | | \$7.5 | \$4.6 | \$4.3 | \$11.7 | \$5.2 | (\$27.5) | \$3.8 | \$9.1 |

Infinite Horizon Balance Sheet

Current Total Net Obligation is

6.9x the Size of Nation's GDP

Balance Sheet as of September 30, 2012

(Trillions of Dollars)

| Assets | |
|-----------------------------|------------|
| Cash | \$0.2 |
| Receivables | 1.0 |
| Inventories | 0.3 |
| Property, plant & equipment | 0.9 |
| Other | 0.4 |
| Total Assets | 2.7 |

| Liabilities | |
|---|------------------|
| Federal debt securities held by the public and accrued interest | (11.3) |
| Federal employee and veteran benefits payable | (6.3) |
| Other | (1.2) |
| Total Liabilities | (18.8) |
| Net Liability (Net Position) | (\$16.1) |
| Present Value of Social Insurance Obligations ⁽⁴⁷⁾ | (92.4) |
| Total Net Obligation | (\$108.5) |

APPENDICES

- a. SEC v. State of New Jersey
- b. SEC v. State of Illinois

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9135 / August 18, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-14009

In the Matter of

STATE OF NEW JERSEY,

Respondent.

**ORDER INSTITUTING CEASE-AND-
DESIST PROCEEDINGS PURSUANT TO
SECTION 8A OF THE SECURITIES ACT
OF 1933, MAKING FINDINGS, AND
IMPOSING A CEASE-AND-DESIST
ORDER**

I.

The Securities and Exchange Commission (“Commission”) deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 (“Securities Act”), against the State of New Jersey (the “State,” “New Jersey” or “Respondent”).

II.

In anticipation of the institution of these proceedings, the State has submitted an Offer of Settlement (the “Offer”) which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission’s jurisdiction over it and the subject matter of these proceedings, which are admitted, the State consents to the entry of this Order Instituting Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933, Making Findings, and Imposing a Cease-and-Desist Order (“Order”), as set forth below.

III.

On the basis of this Order and the State’s Offer, the Commission finds that:

Summary

1. This matter involves New Jersey’s violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act in connection with the offer and sale of over \$26 billion in municipal bonds from August 2001 through April 2007. In 79 municipal bond offerings, the State misrepresented and failed to disclose material information regarding its under funding of New Jersey’s two largest

pension plans, the Teachers' Pension and Annuity Fund ("TPAF") and the Public Employees' Retirement System ("PERS"). More specifically, the State did not adequately disclose that it was under funding TPAF and PERS, why it was under funding TPAF and PERS, or the potential effects of the under funding.

2. In disclosure documents prepared in connection with each of the bond offerings, including preliminary official statements, official statements,¹ and Treasurer's Annual Reports² (collectively, "disclosure documents" or "bond offering documents"), the State made material misrepresentations and omissions regarding: (1) legislation adopted in 2001 (the "2001 legislation") which increased retirement benefits for employees and retirees enrolled in TPAF and PERS; (2) special Benefit Enhancement Funds ("BEFs") created by the 2001 legislation initially intended to fund the costs associated with the increased benefits; (3) the State's use of the BEFs as part of a five-year "phase-in plan" to begin making contributions to TPAF and PERS; and (4) the State's alteration and eventual abandonment of the five-year phase-in plan. These misrepresentations and omissions created the fiscal illusion that TPAF and PERS were being adequately funded and masked the fact that New Jersey was unable to make contributions to TPAF and PERS without raising taxes or cutting other services, or otherwise impacting the budget. Accordingly, disclosure documents failed to provide adequate information for investors to evaluate the State's ability to fund TPAF and PERS or the impact of the State's pension obligations on the State's financial condition.

Respondents and Related Entities

3. New Jersey possesses all powers, functions, rights, privileges and immunities authorized by the New Jersey Constitution and the State's laws, including the power to issue debt. The State has approximately 8.7 million residents, and is the second wealthiest State based on per capita personal income.

4. Teachers' Pension and Annuity Fund is a defined benefit plan³ operated by the

¹ An official statement is a document prepared by an issuer of municipal bonds that discloses material information regarding the issuer and the particular offering. A preliminary official statement is a preliminary version of the official statement which is used to describe the proposed new issue of municipal securities prior to the determination of the interest rate(s) and offering price(s). The preliminary official statement may be used to gauge interest in an issue and is often relied upon by potential purchasers in making their investment decisions.

² Treasurer's Annual Reports are continuing disclosures filed by the State with the Municipal Securities Rulemaking Board's Electronic Municipal Market Access system ("EMMA") under Rule 15c2-12 of the Securities Exchange Act of 1934 ("Exchange Act").

³ A defined benefit plan is a pension plan that specifies the amount of pension benefits to be provided at a future date based on various factors, including age, years of service, and compensation.

State to provide retirement, death, and disability benefits to its members.⁴ TPAF is the State's largest pension plan, and, as of June 30, 2009, had an actuarial value of assets of more than \$34 billion. As of June 30, 2009, TPAF had an active membership of 157,109 as well as 78,782 retirees and beneficiaries receiving annual pensions totaling more than \$2.8 billion.

5. Public Employees' Retirement System is a defined benefit plan operated by the State to provide retirement, death, and disability benefits to its members. PERS is the State's second largest pension plan, and, as of July 1, 2009, had an actuarial value of assets of more than \$28 billion. In addition to the State, local governments within New Jersey participate as employers. As of July 1, 2009, the State portion of PERS had assets of more than \$10 billion. As of July 1, 2009, PERS had an active membership of 316,849⁵ as well as 136,957 retirees and beneficiaries⁶ receiving annual pensions totaling more than \$2.2 billion.

State Law Requires Certain Annual Calculations and Measures of New Jersey's Pension Plans

6. State law regulates the administration of New Jersey's pension plans. The Division of Pensions and Benefits ("DPB"), a division of New Jersey's Department of the Treasury ("Treasury"), administers all aspects of TPAF and PERS, except the investment of pension plan assets. Plan assets consist of contributions by employers, including the State, contributions by TPAF's and PERS' members, and investment returns. Liabilities of the plans consist of pension benefits owed to current and retired TPAF and PERS members based on past years of service and the plans' administrative expenses.

7. State law requires that TPAF and PERS engage actuaries to conduct actuarial valuations at the end of each fiscal year – June 30. These valuations include calculating the "annual required contribution" and the "statutory contribution." While the annual required contribution is governed by industry standards,⁷ the statutory contribution is calculated in accordance with State law. According to State law and as disclosed in bond offering documents, employers are required to contribute to TPAF and PERS at an actuarially determined rate.

8. In addition to calculating both the annual required contribution and the statutory contribution, an actuarial valuation also calculates the actuarial accrued liability and the actuarial

⁴ Plan members include employees in active service, terminated employees who have accumulated benefits but are not yet receiving them, and retired employees and beneficiaries currently receiving benefits.

⁵ This includes 93,283 State employees and 223,566 employees from local employers.

⁶ This includes 43,764 State employees and 93,193 employees from local employers.

⁷ The annual required contribution is calculated in accordance with Statements 25 and 27 of the Governmental Accounting Standards Board ("GASB").

value of assets of each of the pension plans.⁸ The actuarial accrued liability estimates on the basis of demographic and economic assumptions the present value of pension benefits TPAF and PERS owe to their active and retired members based on past years of service. The actuarial value of assets is the value of cash, investments, and other property belonging to a pension plan using a five-year smoothing method that smoothes the difference between the market value of assets and the actuarial value of assets over a five-year period to prevent short-term fluctuations that may result from economic and market conditions. For each year, this method recognizes 20 percent of the investment gains or losses for the prior five years.

9. The actuarial valuations compare the actuarial accrued liability with the actuarial value of assets for TPAF and PERS and any excess of that liability over the assets forms an unfunded actuarial accrued liability (“UAAL”). The UAAL is the State’s unfunded obligation to TPAF’s and PERS’ members for past service. The actuarial valuations also express the percentages that the plans are funded through a “funded ratio” which represents the quotient obtained by dividing the actuarial value of assets of TPAF and PERS by the actuarial accrued liability of each plan. The trend in the funded ratio provides information as to whether the financial strength of a pension plan is improving or deteriorating over time. The financial strength of a pension plan is generally improving if the funded ratio is increasing. During the relevant time period, New Jersey’s funded ratio decreased significantly. As of June 30, 2001, TPAF had a funded ratio of 108 percent and the State portion of PERS had a funded ratio of 112.5 percent. As of June 30, 2009, TPAF had a funded ratio of 63.8 percent and an unfunded actuarial accrued liability of \$18.7 billion, and the State portion of PERS had a funded ratio of 56.4 percent and an unfunded actuarial accrued liability of \$8.2 billion.⁹

10. The statutory contribution for TPAF and PERS consists of two main components: (1) the normal cost, which represents the portion of the present value of pension benefits that are allocated to active members’ current year of service, and (2) an amortized portion of the UAAL. TPAF and PERS use a statutorily set closed 30-year amortization period¹⁰ for calculating the amount of the UAAL that is included in the statutory contribution.¹¹

⁸ The actuarial valuations calculate the actuarial accrued liability and actuarial value of assets in accordance with New Jersey statutes and Statements 25 and 27 of GASB.

⁹ Although contributions by State and local governments to PERS are invested together, PERS segregates the actuarial accrued liabilities between the State and local governments.

¹⁰ As of the June 30, 2006 actuarial valuations, the State used an open 30-year amortization period.

¹¹ The State’s amortization method amortizes the UAAL over a 30-year period as a level percentage of the projected payroll or “level percent of pay.” Under this method, the UAAL amortization payments are calculated so that they are a constant percentage of the projected payroll of active members over the 30-year period. Because the actuarial valuations assume a payroll growth rate of 4 percent each year, the amortization payments increase over time.

11. Although bond offering documents disclosed that the State was required to contribute to TPAF and PERS at an actuarially determined rate and discussed the budget process generally, bond offering documents did not adequately disclose that the amount actually contributed to the pension plans is subject to the Governor's budget request and annual appropriations by the State legislature. Each year, the Governor, based on recommendations received from Treasury, presents a budget request to the legislature, which may include a request for the State's pension contribution. Once the legislature adopts the budget, it is signed into law as the Appropriations Act for the coming fiscal year. In adopting the budget, the legislature is not required to follow the recommendations of the actuaries or the Governor in determining the State's contribution to the pension plans. The appropriations for the State contribution to the pension plans are credited to "Contingent Reserve Funds," existing funds within TPAF and PERS.

12. State law requires members of TPAF and PERS to contribute annually to the pension plans. Member contributions are based on a percentage of compensation. The State legislature must approve any changes to employer or member contributions. State law also provides that any changes in the pension benefits for TPAF's and PERS' members or any changes in the funding methods of the plans must be approved by the State legislature. In addition, each pension related bill submitted to the State legislature must be accompanied by a fiscal note stating the cost of the proposal.

New Jersey Has Access to the National Public Markets through Municipal Bond Offerings

13. From August 2001 through April 2007, New Jersey issued over \$26 billion in municipal bonds in approximately 79 offerings. The State's preliminary official statements and official statements contained an appendix with several subsections, three of which provided information relating to the State's funding of TPAF and PERS (the "State Appendix"). Appendix I provided financial and other information relating to the State, including a section titled "Financing Pensions." The Financing Pensions section provided a description of the State's pension plans, a description of pension related legislation, a summary of the State's contributions to its pension plans for the current and upcoming fiscal years, and a table setting forth the actuarial accrued liability and the actuarial value of assets from the most recent actuarial valuations for each of the State's pension plans. Appendix I-A, which was an excerpt from the State's most recent Comprehensive Annual Financial Report ("CAFR"),¹² contained a footnote to the financial statements titled "Retirement Systems" that provided general information regarding the State's pension plans, including significant legislation and contribution requirements, as well as a table setting forth statistical information relating to the pension plans. Appendix I-D, an unaudited appendix found in the back of the State's disclosure documents, contained statistical tables for each of the State's three largest pension plans, including TPAF and PERS, that provided the actuarial value of assets and accrued liabilities, and the funded ratio for the previous six years.

14. Various divisions and offices within Treasury were responsible for the pension funding disclosures in the State Appendix. The updating of the pension funding sections generally

¹² The State's CAFR included audited financial statements prepared pursuant to standards established by GASB.

occurred three times a year – following the issuance of the Governor’s budget message, after the passage of the Appropriations Act, and following the issuance of the actuarial valuations. At these times, various divisions and offices within Treasury updated their sections of the State Appendix. They viewed the updating of the pension funding sections as a routine process, requiring the insertion of new numbers or facts into an existing document. The DPB updated the pension disclosures at the request of the Office of Public Finance (“OPF”), another office of the Treasury. The OPF inserted the new information into the State Appendix without verifying the information. The Office of Management and Budget (“OMB”) included in the State’s CAFR the pension fund related excerpts which were also found in the State Appendix.

15. Prior to the release of an official statement, the State Treasurer, or his designee, signed a Rule 10b-5 certification, certifying that the official statement did not contain any material misrepresentations or omissions. During the relevant time period, the Treasurers did not read official statements, and relied on their staff to ensure the accuracy of information contained in the documents.

16. Treasury had no written policies or procedures relating to the review or update of the bond offering documents. In addition, Treasury did not provide training to its employees concerning the State’s disclosure obligations under the accounting standards or the federal securities laws. Accordingly, the State’s procedures were inadequate for ensuring that material information concerning TPAF and PERS or the State’s financing of TPAF and PERS was disclosed and accurate in bond offering documents.

New Jersey Did Not Adequately Disclose the Creation of the BEFs

17. On June 29, 2001, the State legislature approved legislation (P.L. 2001, c. 133) that, effective November 1, 2001, increased retirement benefits for employees and retirees enrolled in TPAF and PERS by 9.09 percent. In order to fund the enhanced benefits, without increased costs to the State or taxpayers, the legislation revalued TPAF and PERS assets to reflect their full market value as of June 30, 1999, near the height of the bull market.¹³ Bond offering documents did not disclose the retroactive mark-to-market revaluation of the pension assets under the 2001 legislation until March 2003 or the reason for the reevaluation. More specifically, bond offering documents did not disclose that the State used the market value as of June 30, 1999 in order to make it appear that the State could afford the benefit improvements.

18. The legislation contemplated that the increased assets resulting from the retroactive mark-to-market revaluation would be used to offset the additional liabilities created by the increased benefits. The additional liabilities included the accrued liability resulting from providing the increased benefits to existing members and retirees as well as the normal cost to ensure that the future liability for the benefit enhancement was funded.

¹³ In the actuarial valuations as of June 30, 1999 for TPAF and PERS, the actuarial value of assets was replaced with the market value of assets. Subsequent actuarial valuations, including actuarial valuations as of June 30, 2000 and June 30, 2001, applied the five-year smoothing method.

19. The legislation created “benefit enhancement funds” or BEFs in TPAF and PERS to set aside a portion of the increased assets or “excess valuation assets”¹⁴ to pay the future annual normal cost associated with the enhanced benefits. After the increased assets were used to fund the accrued liability, a portion of the remaining excess valuation assets were placed in the BEFs to cover the future costs associated with the enhanced benefits. Bond offering documents did not disclose the creation of the BEFs until March 2003.

20. The BEFs were special accounts within TPAF and PERS. Each of the BEFs was credited with excess valuation assets, from the Contingent Reserve Funds, which are existing funds within TPAF and PERS used to hold employer contributions, which excess valuation assets resulted from the revaluation in 2001.

21. On July 11 and 13, 2001, approximately two weeks after the passage of the 2001 legislation, the Office of Legislative Services (“OLS”)¹⁵ issued fiscal notes analyzing the impact of the Assembly and Senate bills which had been adopted as the 2001 legislation. The fiscal notes acknowledged that valuing the pension assets as of June 30, 1999 did not reflect recent market losses in TPAF and PERS. The fiscal notes further acknowledged that, had the 2001 legislation revalued the pension assets as of April 30, 2001 rather than June 30, 1999, the remaining balance of excess assets in TPAF and PERS would have been \$2.4 billion less. Bond offering documents did not disclose the \$2.4 billion decline in the market value of the pension assets used to create the BEFs.

22. Bond offering documents did not disclose the reason for and impact of the retroactive mark-to-market revaluation of the pension assets. By revaluing TPAF and PERS assets and creating the BEFs to fund the ongoing costs of the benefit enhancements, the State gave the false appearance that it could afford the increased benefits. The revaluation of the pension assets to reflect their full market value as of June 30, 1999 resulted in a significant difference between the actuarial value and market value of assets in TPAF and PERS. Because the State’s contributions to TPAF and PERS are based on the actuarial value of assets, the revaluation created the false appearance that the plans were “fully funded” and allowed the State to justify not making contributions to the pension plans despite the fact that the market values of the plans’ assets were rapidly declining.

23. On May 25, 2005, the State’s Acting Governor created the Benefits Review Task Force to examine and make recommendations regarding employee benefits. On December 1, 2005, the New Jersey Benefits Review Task Force issued its final report (the “Benefits Review Task Force Report”) which offered strong criticism of the State’s pension funding practices. In particular, the report recommended that the State stop using actuarial and valuation “gimmicks,” like the State’s alteration of the valuation method in the 2001 legislation. The report advised that

¹⁴ Excess valuation assets is a term defined by New Jersey statute (P.L. 1997, c. 115), which refers to the difference between the valuation assets and the actuarial accrued liability, and other enumerated deductions.

¹⁵ OLS is a nonpartisan agency of the State legislature that provides support services to the legislature and its members.

“[m]ethodologies for determining pension fund values and contribution requirements should not again be changed in order to mask the true cost of benefit enhancements.” The Benefits Review Task Force Report also concluded that the State must regularly contribute to its pension plans and end its use of “pension holidays” – not contributing to its pension plans.

24. The Benefits Review Task Force Report was publicly available and published on the Benefit Review Task Force’s website. New Jersey, however, did not disclose the existence of, or the findings from, the Benefits Review Task Force Report in its bond offering documents.

**New Jersey Faced Financial Challenges Due, in Part, to Its
Historical Failure to Contribute to TPAF and PERS**

25. During fiscal year 2002, the State learned from the actuaries for TPAF and PERS that New Jersey would be required to begin contributing to the State’s pension plans in fiscal year 2004 based on the actuaries’ calculations.¹⁶ Between fiscal years 1997 and 2003, the State had made no or only minimal contributions to TPAF and PERS because based upon the actuarial value of assets, both plans were fully or over funded prior to fiscal year 2003. From 1997 through 2003, the State did not contribute approximately \$916.4 million and \$487.4 million to TPAF and PERS, respectively. During this period and continuing through 2006, in the context of the State’s budgetary process, the State viewed monies not contributed to pension funds as “savings” in that any monies not contributed could be used for other budgetary purposes.

26. Beginning in fiscal year 2003, TPAF and PERS experienced a significant increase in each plan’s UAAL and a decrease in the funded ratios. TPAF and the State portion of PERS went from being over funded to having UAALs of \$2.7 billion and \$1.1 billion, respectively. TPAF’s funded ratio decreased from 103.9 percent in fiscal year 1997 to 92.7 percent in fiscal year 2003. The funded ratio for the State portion of PERS decreased from 105.8 percent in fiscal year 1997 to 90.7 in fiscal year 2003. The significant change in the financial health of TPAF and PERS was due to a variety of factors, including, the State’s failure to contribute to the plans since 1997, market declines, and the enactment of various benefit enhancements, including the 2001 legislation.

27. After a seven-year pension holiday, during which virtually no monies were appropriated in the State’s budget for pensions, the State recognized that it would have to begin contributing to TPAF and PERS. The State, however, now faced significant budget pressures which made it difficult for New Jersey to fund its pension plans absent cutting other programs and services, or raising taxes. Following Treasury’s recommendation, the Governor requested and the legislature provided in the annual Appropriations Act that the BEFs be used in lieu of the State contributing to TPAF and PERS.

¹⁶ Actuarial valuations of TPAF and PERS are completed approximately 6 to 8 months after the end of a fiscal year. Because of the delay, the statutory contribution calculated by the actuaries applies not to the fiscal year immediately following the fiscal year covered by the actuarial valuations, but to the second fiscal year. For example, the statutory contribution in the actuarial valuations as of June 30, 2003 applied to the fiscal year ended June 30, 2005.

**New Jersey Continued to Forego Making Contributions to
Its Pension Plans Through the Use of the BEFs and the Five-Year Phase-In Plan**

28. In 2003, while preparing the 2004 fiscal year budget, the State, faced with increased UAALs and declining funded ratios, had to choose between making contributions to the pension plans, or raising taxes or reducing spending in other areas. Accordingly, Treasury recommended, and the State announced, a five-year phase-in plan, in conjunction with using the BEFs, designed to gradually put New Jersey on track to making the State's full statutory contributions to its pension plans. Under the initial five-year phase-in plan, the State would contribute, subject to Constitutional provisions restricting each legislature's ability to mandate spending by future legislatures, 20 percent of the required statutory contribution to its pension plans in fiscal year 2004, 40 percent in fiscal year 2005, 60 percent in fiscal year 2006, 80 percent in fiscal year 2007, and 100 percent in fiscal year 2008. Beginning with fiscal year 2008, the State would be making the full statutory contribution to its pension plans.

29. Disclosures in bond offering documents regarding the State's five-year phase-in plan and use of the BEFs likely falsely led investors to believe that: (1) the State would be contributing to TPAF and PERS in fiscal years 2004, 2005, and 2006; (2) the State had a plan for making its full statutory contributions; and (3) the State would begin making full statutory contributions in fiscal year 2008.

30. Rather than making phase-in contributions to the pension plans, beginning in fiscal year 2004, the State began using the BEFs in conjunction with the five-year phase-in plan. The State continued to use the BEFs as part of the phase-in plan in fiscal years 2005 and 2006. As a result, the State did not contribute any monies to TPAF and PERS in fiscal years 2004 and 2005. In fiscal year 2006, the State did not contribute to PERS, but did contribute a minimal amount to TPAF to cover the portion of the State's contribution not covered by the BEF.

31. Bond offering documents did not disclose that the State was not contributing to TPAF and PERS during this time. When assets from the BEFs were used to fund the State's pension contributions in fiscal years 2004, 2005, and 2006, funds were transferred from the BEFs back to the Contingent Reserve Funds, the original source of the assets in the BEFs. These inter-fund transfers created the false appearance that the State was making contributions to TPAF and PERS, when no actual contributions were being made. Bond offering documents did not disclose that the BEFs allowed the State to forego making contributions to TPAF and PERS. Rather, disclosures in bond offering documents created the false impression that the BEFs were being used to make New Jersey's pension contributions even though no incremental funds were being received by TPAF and PERS. Disclosure documents misleadingly referred to the BEFs as "reserves" that were being utilized to fund the State's contributions to TPAF and PERS which created the misleading impression that the State was making cash contributions to its pension plans.

32. Although bond offering documents referenced the BEFs in connection with the State's contributions, they never disclosed what they were, how they were being used, or why they

were being used. Bond offering documents did not disclose that the State was using the BEFs in conjunction with a five-year phase-in plan because of significant budgetary constraints, and was unable to contribute to TPAF and PERS. In addition, bond offering documents did not disclose the impact of using the BEFs as part of the five-year phase-in plan. The State recognized that delaying the resumption of the State's contributions could result in substantially increasing the pension plans' unfunded liabilities in the future. The State also recognized that by depleting the BEFs, the State would now be faced with paying the normal costs of the enhanced benefits granted by the 2001 legislation. More than \$704.2 million was used from the BEFs to fund the State's fiscal year 2004, 2005, and 2006 pension obligations, and thus this amount was no longer available to offset the future costs of the benefit enhancement legislation.

33. By the end of fiscal year 2006, the State had depleted the BEFs. Bond offering documents did not disclose that the State, during each budget cycle, intended to forego making contributions to TPAF and PERS until it had exhausted the BEFs. By disclosing that the State had adopted a five-year phase-in plan, the bond offering documents gave the impression that the State would be contributing its full statutory contributions to TPAF and PERS by fiscal year 2008.

**New Jersey Altered and Then Abandoned
the Five-Year Phase-In Plan Because of Financial Difficulties**

34. Although New Jersey's bond offering documents referenced the five-year phase-in plan, the State treated the phase-in plan as a flexible plan that could be altered on a year-to-year basis depending on other budgetary demands. Because other budgetary priorities existed, the State's contributions to TPAF and PERS were reduced to 30 percent of the statutory contribution in fiscal year 2005 and 40 percent in fiscal year 2006. Bond offering documents did not disclose the changes to the phase-in plan or the reasons for the State's reduced contributions. These reduced contributions increased, in part, the UAALs for TPAF and the State portion of PERS by \$8.2 billion and \$3 billion, respectively.

35. Funding for TPAF and PERS was governed by the annual Appropriations Act. The Appropriations Act for fiscal years 2004, 2005, and 2006 also set forth the State's use of the BEFs. In fiscal year 2004, the Appropriations Act specified the amounts to be used from the BEFs in lieu of the State's contributions to TPAF and PERS. However, the Appropriations Act for fiscal years 2005 and 2006 did not identify the amounts to be used from the BEFs or the phase-in percentages. Rather, for those years, the Appropriations Act provided that the Treasurer would determine the amount to be used from the BEFs.

36. The language in the Appropriations Act for fiscal years 2005 and 2006 gave the Treasurer the flexibility to alter the amount of the BEFs to be used to cover the State's contributions to TPAF and PERS, up until the last day of the fiscal year when the contributions were due. In addition, this language gave the Treasurer the ability to alter the phase-in percentages under the phase-in plan. This was particularly important, since by adjusting the amount of the BEFs to be used in fiscal year 2005 and the phase-in percentage, the Treasurer was able to ensure that there were sufficient assets in the BEFs in fiscal year 2006 to cover all or almost all of the State's contributions to TPAF and PERS. In fiscal year 2005, the Treasurer exercised his authority

under the Appropriations Act by reducing the amount of the State's contributions to TPAF and PERS, and thus the phase-in percentage, following the enactment of the Appropriations Act. This change in the phase-in plan, however, was not disclosed in bond offering documents.

37. The State recognized that because of severe budgetary constraints, it would not be able to achieve full funding of its pension plans by fiscal year 2008 without cutting State services or finding other sources of revenue. In fact, the State only contributed 57.5 percent of the required statutory contribution to its pension plans in fiscal year 2007 and 50 percent in fiscal year 2008.

38. The State abandoned its five-year phase-in plan in approximately May 2006. Bond offering documents did not disclose that the State had abandoned the five-year phase-in plan. Rather, the State stopped using the term "five-year" when referring to the phase-in plan in disclosure documents. The State's continued use of the term "phase-in plan" gave the false impression that New Jersey still had a plan to achieve full statutory contributions. Moreover, bond offering documents did not disclose that New Jersey was unable to fully implement the five-year phase-in plan without causing New Jersey to suffer severe economic hardship.

New Jersey Failed to Provide Certain Present and Historical Financial Information Regarding Its Pension Funding

39. The State's bond offering documents contained inadequate information regarding the State's present and historical contributions to TPAF and PERS. Statistical tables for TPAF and PERS found in Appendix I-D set forth the amount of the State's contributions for the most recent fiscal year and the prior five fiscal years. This information, however, was misleading to investors because the amounts set forth included pension contributions, if any, as well as payments made by the State to members of TPAF and PERS for post-retirement medical benefits.¹⁷ This contribution information conflicted with other statistical information found in the Retirement Systems footnote of Appendix I-A, which showed the actual pension contributions made by the State, but did not include payments for post-retirement medical benefits, for the most recent fiscal year as well as the two prior fiscal years. In addition, the State's bond offering documents lacked sufficient information for investors to understand the State's historical failure – since 1997 – to contribute to TPAF and PERS.

40. Appendix I-A of the State's disclosure documents also excluded a key statistical table from the State's CAFR called the "Required Supplementary Information Schedule of Funding Progress" ("RSI Schedule"), which is defined by GASB. The RSI Schedule is designed to provide a long-term actuarial perspective on the State's funding of its pension plans. The RSI Schedule provided important financial information regarding TPAF and PERS for the three prior fiscal years, including the UAAL and the UAAL as a percentage of covered payroll.¹⁸ The ratio of

¹⁷ Under statutes for TPAF and PERS, the State's contributions for post-retirement medical benefits flowed through the pension plans.

¹⁸ Covered payroll includes all elements of compensation paid to active employees on which contributions to the pension plans are based.

UAAL to covered payroll is a measure of the significance of the UAAL relative to the capacity to pay it. The trend in the ratio provides information as to whether the financial strength of the pension plan is improving or deteriorating over time. The financial strength of a pension plan is generally improving if the ratio of UAAL to covered payroll is decreasing. In fact, from 2002 through 2007, the UAAL as a percentage of covered payroll steadily increased. The UAAL and the UAAL to covered payroll for TPAF and PERS is shown below.

TPAF

| Fiscal Year | UAAL | UAAL as a Percentage of Covered Payroll |
|-------------|------------------|---|
| 2002 | \$(1,654,591) | 0.0% |
| 2003 | \$2,731,906,950 | 35.5% |
| 2004 | \$5,813,899,790 | 72.2% |
| 2005 | \$9,178,537,424 | 108.6% |
| 2006 | \$11,008,573,863 | 125.8% |
| 2007 | \$12,446,668,618 | 137.1% |

PERS (State Portion)

| Fiscal Year | UAAL | UAAL as a Percentage of Covered Payroll |
|-------------|-----------------|---|
| 2002 | \$(312,599,482) | (8.9)% |
| 2003 | \$1,112,345,981 | 31.1% |
| 2004 | \$1,926,870,843 | 51.4% |
| 2005 | \$2,801,180,057 | 69.5% |
| 2006 | \$4,129,039,284 | 97.1% |
| 2007 | \$5,004,619,993 | 112.8% |

41. The bond offering documents failed to provide information regarding the actuarial methodology used by the State to calculate the actuarial value of assets, and the impact of using this methodology on the State's funding of its pension plans. The bond offering documents did not disclose the effect of the State's use of a five-year smoothing method to measure the actuarial value of assets. As a result of the 2001 legislation and market declines, the actuarial value of assets exceeded the market value of assets for TPAF and PERS, resulting in net unsmoothed losses in both plans beginning in fiscal year 2002. The ratio of the actuarial value of assets to market value of assets for TPAF and PERS is shown below.

**Actuarial Value as a
Percent of Market Value**

| Fiscal Year | TPAF | PERS |
|-------------|--------|--------|
| 2002 | 129.5% | 126.8% |
| 2003 | 131.0% | 127.7% |
| 2004 | 121.0% | 118.3% |
| 2005 | 117.4% | 113.9% |
| 2006 | 112.8% | 106.7% |

| | | |
|------|--------|--------|
| 2007 | 104.7% | 101.9% |
|------|--------|--------|

Since the State's contributions to TPAF and PERS are based on the actuarial value of assets, the significant difference between the actuarial value of assets and the market value of assets reduced the State's statutory contributions to the pension plans.

42. The bond offering documents also failed to provide information regarding the actuarial methodology used by the State to calculate the actuarial accrued liabilities of TPAF and PERS, and the impact of using this methodology on the State's funding of its pension plans. The bond offering documents did not disclose the effect of the State's use of a closed 30-year amortization period¹⁹ based on a level percent of pay for measuring the actuarial accrued liability. Under this recognized actuarial method, the UAALs of TPAF and PERS will continue to rise indefinitely even if the State were to contribute the full statutory contribution to the pension plans. Under New Jersey statute, if the UAALs for TPAF and PERS increase from one year to the next, the actuarial valuations will continue to use the full 30-year amortization period. As a result, the State has been unable to and will continue to be unable to effectively amortize TPAF's and PERS' UAALs.

43. In addition, although available in actuarial reports for TPAF and PERS, the bond offering documents did not provide asset and funded ratio information on a market value basis. Because of the significant difference between the actuarial value and market value of assets in TPAF and PERS, the actuarial value did not accurately present the current value of the pension plans. Rather, the actuarial value of assets for TPAF and PERS provided a limited measure of the pension plans' financial health since they did not fully reflect the effects of the 2001 legislation or market declines. Investors lacked sufficient information to assess the current financial health of TPAF and PERS as a result of the absence of asset and funded ratio information on a market value basis. New Jersey's historical funded ratios using actuarial value of assets and market value of assets are shown below:

TPAF

| Fiscal Year | Actuarial Value of Assets | Market Value of Assets | Funded Ratio (actuarial value) | Funded Ratio (market value) |
|-------------|---------------------------|------------------------|--------------------------------|-----------------------------|
| 2002 | \$35,148,246,433 | \$27,121,744,264 | 100.0% | 77.2% |
| 2003 | \$34,651,825,932 | \$26,447,330,285 | 92.7% | 70.7% |
| 2004 | \$34,633,790,549 | \$28,618,463,144 | 85.6% | 70.8% |
| 2005 | \$34,789,389,875 | \$29,610,249,605 | 79.1% | 69.0% |
| 2006 | \$35,531,294,790 | \$31,495,000,296 | 76.4% | 69.3% |
| 2007 | \$36,714,578,745 | \$35,070,757,170 | 74.7% | 72.9% |

¹⁹ As of the June 30, 2006 actuarial valuations, the State used an open 30-year amortization period.

PERS (State Portion)

| Fiscal Year | Actuarial Value of Assets | Market Value of Assets | Funded Ratio (actuarial value) | Funded Ratio (market value) |
|-------------|---------------------------|------------------------|--------------------------------|-----------------------------|
| 2002 | \$11,073,156,965 | \$8,727,927,022 | 102.9% | 81.1% |
| 2003 | \$10,829,953,189 | \$8,479,326,527 | 90.7% | 71.0% |
| 2004 | \$10,693,508,592 | \$9,038,299,523 | 84.7% | 71.6% |
| 2005 | \$10,631,348,826 | \$9,325,929,009 | 79.1% | 69.4% |
| 2006 | \$10,668,645,162 | \$9,996,185,459 | 72.1% | 67.6% |
| 2007 | \$11,024,255,608 | \$10,817,111,560 | 68.8% | 67.5% |

New Jersey Enhances Its Pension Funding Disclosures

44. Subsequent to an April 2007 news article that raised questions regarding disclosures in the State's bond offering documents relating to New Jersey's funding of its pensions, the State hired disclosure counsel to advise the State on an on-going basis regarding its disclosure obligations under the federal securities laws. During 2007 and early 2008, the State, with the assistance of disclosure counsel, reviewed its bond offering documents and enhanced its disclosures.

45. With the assistance of disclosure counsel, the State has reviewed, evaluated, and enhanced its disclosure process by instituting formal, written policies and procedures. In its written policies and procedures, among other things, the State established a committee comprised of senior Treasury officials, representatives from the Attorney General's Office, and disclosure counsel to oversee the entire disclosure process and to review and make recommendations regarding the State's disclosures and disclosure practices. In addition, the State has implemented an annual mandatory training program conducted by disclosure counsel for the State's employees involved in the disclosure process to ensure compliance with the State's disclosure obligations under the federal securities laws.

Legal Discussion

46. Municipal securities represent an important part of the financial markets available to investors. At the end of 2009, individual investors held approximately 35 percent of outstanding municipal securities directly and up to another 34 percent indirectly through money market funds, mutual funds, and closed end funds. There is also substantial trading volume in the municipal securities market — almost \$3.8 trillion of long and short-term municipal securities were traded in 2009 in over 10 million transactions. Issuers of municipal securities have an obligation to ensure that financial information contained in their disclosure documents is not materially misleading. Proper disclosure allows investors to understand and evaluate the financial health of the state or local municipality in which they invest.

47. New Jersey, as an issuer of municipal securities, is subject to the antifraud provisions of the federal securities laws. In addition, the Commission has promulgated a broker-dealer rule, Exchange Act Rule 15c2-12, which in general limits market access for certain municipal securities issues to those offerings in which the issuer agrees to file annual disclosures of

specified financial and operating information as well as notices of certain events, if material, and notices of any failures to file with certain repositories designated by the Commission.²⁰ The antifraud provisions apply to such disclosure and to any other statements made to the market.

48. Section 17(a) of the Securities Act prohibits the making of any untrue statement of material fact or omitting to state a material fact in the offer or sale of securities. A fact is material if there is a substantial likelihood that its disclosure would be considered significant by a reasonable investor. Basic Inc. v. Levinson, 485 U.S. 224, 231-32 (1987); TSC Industries, Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976). Violations of Sections 17(a)(2) and (3) may be established by showing negligence. SEC v. Hughes Corp., 124 F.3d 449, 453-54 (3d Cir. 1997); SEC v. Steadman, 967 F.2d 636, 643 n.5 (D.C. Cir. 1992).

Violations

49. As a result of the negligent conduct described above, the State violated Sections 17(a)(2) and 17(a)(3) of the Securities Act. Specifically, the State made material misrepresentations and omissions in preliminary official statements, official statements, and continuing disclosures regarding the State's under funding of TPAF and PERS. TPAF and PERS represent a significant and growing obligation for New Jersey. The State's misrepresentations and omissions were material in that they failed, over the course of an almost six-year period, to provide investors with adequate information regarding the State's funding of TPAF and PERS as well as the financial condition of the pension plans. Information regarding the State's under funding of TPAF and PERS and their financial health was important to investors in evaluating New Jersey's overall financial condition and future financial prospects.

50. The State was aware of the under funding of TPAF and PERS and the potential effects of the under funding. However, due to a lack of disclosure training and inadequate procedures relating to the drafting and review of bond disclosure documents, the State made material representations and failed to disclose material information regarding TPAF and PERS in bond offering documents.

Remedial Efforts

51. In determining to accept the State's Offer, the Commission considered the cooperation afforded the Commission's staff during the investigation and remedial acts taken by the State, referenced in paragraphs 44 and 45.

²⁰ On December 5, 2008, the Commission amended Rule 15c2-12 to require issuers to agree to file annual disclosures of specified financial and operating information as well as notices of certain events, if material, and notices of any failures to file with the Municipal Securities Rulemaking Board. Issuers are no longer permitted to use other repositories. Rule 15c2-12 was further amended on May 27, 2010 to eliminate the materiality determination for certain types of events and to make other changes to improve the quality and timeliness of municipal securities disclosure.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in the State's Offer.

Accordingly, it is hereby ORDERED that pursuant to Section 8A of the Securities Act, the State shall cease and desist from committing or causing any violations and any future violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act.

By the Commission.

Elizabeth M. Murphy
Secretary

Service List

Rule 141 of the Commission's Rules of Practice provides that the Secretary, or another duly authorized officer of the Commission, shall serve a copy of the Order Instituting Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933, Making Findings, and Imposing a Cease-and-Desist Order ("Order"), on the Respondent and its legal agents.

The attached Order has been sent to the following parties and other persons entitled to notice:

Honorable Brenda P. Murray
Chief Administrative Law Judge
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-2557

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UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9389 / March 11, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15237

In the Matter of

STATE OF ILLINOIS,

Respondent.

**ORDER INSTITUTING CEASE-AND-
DESIST PROCEEDINGS PURSUANT
TO SECTION 8A OF THE
SECURITIES ACT OF 1933, MAKING
FINDINGS, AND IMPOSING A CEASE-
AND-DESIST ORDER**

I.

The Securities and Exchange Commission (“Commission”) deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 (“Securities Act”), against the State of Illinois (the “State,” “Illinois,” or “Respondent”).

II.

In anticipation of the institution of these proceedings, the State has submitted an Offer of Settlement (the “Offer”) which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission’s jurisdiction over it and the subject matter of these proceedings, which are admitted, the State consents to the entry of this Order Instituting Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933, Making Findings, and Imposing a Cease-and-Desist Order (“Order”), as set forth below.

III.

On the basis of this Order and the State’s Offer, the Commission finds that:

Summary

1. In connection with multiple bond offerings raising over \$2.2 billion from approximately 2005 through early 2009, the State of Illinois misled bond investors about the

adequacy of its statutory plan to fund its pension obligations and the risks created by the State's underfunding of its pension systems.¹

2. The State omitted to disclose in preliminary and final official statements material information regarding the structural underfunding of its pension systems and the resulting risks to the State's financial condition. Enacted in 1994, the Illinois Pension Funding Act (the "Statutory Funding Plan") established a pension contribution schedule that was not sufficient to cover both (1) the cost of benefits accrued in the current year and (2) a payment to amortize the plans' unfunded actuarial liability. This methodology structurally underfunded the State's pension obligations and backloaded the majority of pension contributions far into the future. The resulting systematic underfunding imposed significant stress on the pension systems and on the State's ability to meet its competing obligations.

3. During this same time period, the State also misled investors about the effect of changes to the Statutory Funding Plan, including substantially reduced pension contributions in 2006 and 2007 ("Pension Holidays"). Although the State's preliminary and final official statements disclosed the fact of the Pension Holidays and other legislative amendments to the plan, Illinois did not disclose the effect of those changes on the contribution schedule or on the State's ability to meet its pension obligations.

Respondent

4. Illinois possesses all powers, functions, rights, privileges, and immunities authorized by the United States Constitution, the Illinois Constitution, and the State's laws, including the power to issue debt.

Pension Funding in Illinois

5. The pension systems of Illinois currently are among the lowest-funded plans in the nation. As of 2011, the systems collectively were underfunded by \$83 billion, and system assets covered only 43 percent of system liabilities. The State's current funding deficit was created in significant part by the State's historical failure to fund its pension systems in a manner to avoid the growth of the unfunded liability.

6. The State of Illinois provides funding for five retirement systems that pay pension benefits upon retirement, death, or disability to public employees and their beneficiaries. The five systems are the Teachers' Retirement System of the State of Illinois, the State Universities Retirement System of Illinois, the State Employees' Retirement System of Illinois, the Judges' Retirement System of Illinois, and the General Assembly Retirement System, State of Illinois. Generally speaking, the systems are all defined-benefit plans that require contributions by employees and employers, with a significant portion funded by the State.

¹ These bonds are general obligation bonds, which are backed by the full faith and credit of the State.

7. Until 1981, the State funded pensions by covering the out-of-pocket costs associated with benefits as they came due. Employee contributions and investment income funded a reserve for future benefits. This approach had no relation to actuarial calculations of liability and was abandoned in 1982 during a period of fiscal stress. Without a remedial plan in place, state contributions were held relatively constant from 1982 to 1995. As a result of level contributions and rising costs, by 1995 the pension systems were significantly underfunded. In the aggregate, system assets covered only 50 percent of actuarial accrued liabilities, which had grown to approximately \$20 billion.

8. In an effort to address this imbalance, the Illinois General Assembly enacted the Statutory Funding Plan in 1994. Effective in 1995, this Statutory Funding Plan established a fifty-year schedule intended to achieve a 90 percent funded ratio for each system by 2045.² The Statutory Funding Plan called for the State to meet this target by contributing a level percentage of payroll each year sufficient to reach this goal. Under the level percentage of payroll method, amortization payments are calculated so that they are a constant percentage of the projected payroll of active plan members over a given number of years. Each year, actuaries for each pension system would use demographic and other data and various assumptions to calculate actuarial value of assets, actuarial accrued liability, and the State's contributions based on the statutory requirements and objectives. Rather than requiring the immediate funding of plan contributions calculated in this manner, the legislature phased in the State's contribution over a fifteen-year "ramp" period. During the ramp period, the Statutory Funding Plan required that the percentage of payroll increase each year such that, by 2010, the State would be contributing the level percentage of payroll required under the plan for 2011 to 2045. At the conclusion of the ramp period in 2010, the Statutory Funding Plan required the State to contribute a level percentage of state payroll in order to achieve the 2045 target.

9. Rather than controlling the State's growing pension burden, the Statutory Funding Plan's contribution schedule increased the unfunded liability, underfunded the State's pension obligations, and deferred pension funding. This resulting underfunding of the pension systems ("Structural Underfunding") enabled the State to shift the burden associated with its pension costs to the future and, as a result, created significant financial stress and risks for the State.

a. For the majority of the years under the Statutory Funding Plan, the State's annual required contributions were insufficient to prevent the growth of its unfunded liability. Specifically, the statutory contributions were not sufficient to cover both (1) the cost of pension benefits earned by public employees by virtue of their service in the current year ("the normal cost") and (2) a payment to amortize the accumulated amount of pension liabilities that have been deemed earned but are not funded (the unfunded actuarial accrued liability, or "UAAL") for an identified group of plan participants. The normal cost and amortization payment collectively are referred to as the actuarially required contribution ("ARC"). The State's pension contributions were calculated in accordance with State law, not in accordance with the ARC, and therefore the

² The funded ratio, which is one measure of the financial health of a pension plan, is the actuarial value of assets expressed as a percentage of the actuarial accrued liability. A 100 percent funded ratio means that existing assets cover the present value of future benefits to be paid by the systems.

Statutory Funding Plan deferred funding of the State's pension obligations and compounded its pension burden.

b. The 90 percent funding target allowed the State to amortize the UAAL in a manner that would not eliminate it entirely. By failing to amortize the UAAL completely, the State was able to lower its contributions. However, by assuring that some portion of the UAAL would remain outstanding, it also increased the economic cost of the pensions and delayed the cash outlays necessary to fulfill its pension obligations.

c. The State's plan also spread costs over fifty years, in contrast to the thirty-year amortization period adopted by the pension plans of most other states. The longer amortization period extended the amount of time required to pay down the UAAL, reducing the State's annual statutory contributions while increasing the real cost of the pensions over time.

d. The State's phased contributions during the fifteen-year ramp period accelerated the growth of the UAAL during this time period and amplified the burden and risk associated with the State's plan.

e. In contrast to the ARC, which typically is calculated using the closed group approach, contributions under the Statutory Funding Plan are calculated using an open group method, which spreads the cost of providing benefits over existing and new entrants. The Illinois approach requires actuaries to estimate pension benefits for employees to be hired far into the future, particularly given the State's use of a 2045 target date.

f. The State's use of the projected unit credit ("PUC") actuarial cost method compounded the risk of the Statutory Funding Plan. The PUC method, used by Illinois and a minority of states, allocates a higher portion of retirement costs closer to retirement, while the entry age normal ("EAN") method, used by a substantial majority of public sector plans, averages those same costs evenly over the pensioner's period of employment. Compared to an EAN approach, the PUC method results in less funding for active employees, accumulates assets more slowly, produces more volatile measures of contribution rates, and results in rising rather than level contribution rates.

10. From 1996 to 2010, the State's unfunded liability increased by \$57 billion. The State's insufficient contributions under the Statutory Funding Plan were the primary driver of this increase, outweighing other causal factors, such as market performance and changes in benefits. This Structural Underfunding created significant financial risks for the State:

a. Although the most significant effects of this Structural Underfunding materialize in the future, the pension shortfall already has imposed a severe strain on the finances of the Illinois government, and pension costs are affecting the State's ability to manage other significant obligations. In April 2012, the State acknowledged that the pension shortfall is "one of the most difficult problems that Illinois government has faced for more than three decades," and "[u]nsustainable pension costs are squeezing core programs in education, public safety, and human services, in addition to limiting [the State's] ability to pay [its] bills."

b. The State understood that the Structural Underfunding put the plan at serious risk and that the State likely would not be able to afford the level of contributions required to reach

90 percent funding. As explained by one of the system's actuaries in 2009, "[t]he perpetual underfunding puts the plan at serious risk for ultimate exhaustion of the trust, leaving the responsibility for the payment of benefits elsewhere." He observed further that "[t]he plan is in significant funding peril unless the contributions recommended under the actuarially required contribution can be made." Similarly, a pension consultant retained by the Governor's Office of Management and Budget ("GOMB") wrote in August 2009 that "the Illinois pension system is now so underfunded that the State likely [would] never be able to afford the level of contributions required to ever reach 90 percent funding." Other documents generated by GOMB reflected serious concerns about the financial strain produced by the State's unfunded pension obligations. This information was not disclosed to bond investors in bond offering documents.

c. The Structural Underfunding of the pension systems and the State's increasing inability to afford contributions created the significant risk that the State would be unable to satisfy its competing obligations. This underfunding also compromised the creditworthiness of the State and increased the State's financing costs.

Underfunding of the State's Pension Obligations

11. In its bond offering documents from 1995 to 2010, the State disclosed that Illinois funded its pension obligations through the Statutory Funding Plan, which according to the State provided for funding "necessary" or "sufficient" to achieve 90 percent funding of liabilities in 2045. Specifically, official statements disclosed that the Statutory Funding Plan "created a 50-year funding schedule of the Retirement Systems which requires the State to contribute each year, starting with Fiscal Year 2011, the level percentage of payroll sufficient to cause the assets of the Retirement Systems to equal 90 percent of the total accrued liabilities by the end of Fiscal Year 2045. In Fiscal Years 1997 through 2010, contributions as a percentage of payroll are increased each year such that by Fiscal Year 2010, the contribution rate is at the same level as required for years 2011 through 2045."

12. The State also disclosed statistics regarding the systems' assets and liabilities and other information. Among other things, the State provided, for an historical five-year period, the actuarial assets and liabilities for each of the pension systems, as prescribed by state law; the UAAL, which is one measure of the funded status of pension plans; the funded ratio, which is the actuarial value of assets as a percentage of the actuarial accrued liability; and summary financial statements for each of the pension systems. The State's official statements also reviewed recent legislation affecting pension funding and demographic data for participants in the pension systems.

13. The State did not disclose that contributions required by the Statutory Funding Plan significantly underfunded the State's pension obligations and deferred pension funding into the future.

a. The State did not disclose in its official statements its failure to contribute to the full amount of the ARC and the consequences of not funding the full amount of the ARC.³

³ The State's comprehensive annual financial reports ("CAFRs"), which the official statements incorporated by reference, compared the calculation of the contribution under the

b. The State also did not disclose that multiple aspects of the Statutory Funding Plan deferred pension contributions and increased the burden associated with the pension plans. For instance, the State did not explain the implications of its decision to spread costs over fifty years, the fifteen-year ramp period, and 90 percent funding target.

c. The State did not inform investors that other aspects of the State's funding method, such as the State's use of the PUC method, delayed contributions and increased the unfunded liability.

d. In its official statements, the State cited a number of factors that, in the past, contributed to the increase in unfunded pension liability, such as statutory benefit enhancements and market performance, but did not disclose that the State's insufficient contributions were the primary driver of the increase.

e. The State disclosed that its UAAL could increase in the future by virtue of a variety of factors, such as a decrease in the performance of investments and changes in legislation, actuarial assumptions, inflation, benefits, or the State's contribution rate. However, the State misleadingly omitted to disclose the primary driver of the increase—the insufficient contributions mandated by the Statutory Funding Plan.

14. The State also failed to disclose the risks created by the Structural Underfunding.

a. The State failed to disclose the effect of its unfunded pension systems on the State's ability to manage other obligations. The State also did not inform investors that rising pension costs could continue to affect its ability to satisfy its commitments in the future. In contrast, the State included multiple metrics to assist potential investors' evaluation of the burden associated with the State's bond offerings and obligations.

b. Although the State understood that the Structural Underfunding could risk the eventual exhaustion of the pension systems' funds and that the State likely would not be able to afford the level of contributions required by the Statutory Funding Plan, it did not disclose that the State's inability to make its contributions increased the investment risk to bondholders. The State did not identify or discuss how this underfunding compromised the State's creditworthiness or increased its financing costs.

Failure to Adhere to the Statutory Funding Plan

15. As described above, the Statutory Funding Plan set contribution requirements at a level that failed to control the growth of the unfunded liability until the latter years of the plan. Nevertheless, the State did not meet the requirements of the plan as enacted in 1995. Beginning in 2005, the State amended the Statutory Funding Plan, lowering these already deficient contributions, or borrowed to cover its payments. This modification to the original Statutory

Statutory Funding Plan to a contribution calculated in accordance with generally accepted accounting principles. However, the CAFR disclosures did not describe the risks and implications of the Statutory Funding Plan and deviations from that plan.

Funding Plan created further risk to the pension systems and the financial condition of the State. The State misled investors about the effect of these changes on the State's financial condition and, in particular, the impact of the Pension Holidays instituted in 2006 and 2007.

16. On June 1, 2005, the State legislatively enacted Pension Holidays, lowering the contribution in 2006 and 2007 by 56 and 45 percent, respectively. The Pension Holidays had the dual effect of increasing the UAAL and further delaying payment of the deferred portion of the contribution to a future fiscal year.

17. Contrary to the State's CAFRs, which stated that the Pension Holidays would be offset by increased contributions from 2008 to 2010, the 2005 amendment to the Statutory Funding Plan did not require increased contributions in 2008 through 2010 to offset the reduced contributions in 2006 and 2007. Instead, the statute required contributions from 2008 to 2010 to be "increased in equal annual increments from the required State contribution for State fiscal year 2007." In other words, the Illinois legislature mandated a resumption of the ramp period from the reduced 2006 and 2007 levels, not an increase in the 2008, 2009, and 2010 contribution levels to offset those reduced contributions.

18. Although the State disclosed the basic fact of these reduced contributions, the State did not disclose that each of these deviations exacerbated the Structural Underfunding, deferred contributions further into the future, impaired the ability of the State to meet its pension obligations, and negatively impacted the State's creditworthiness.

19. Due to the State's failure to adhere to the original Statutory Funding Plan prior to the conclusion of the ramp period, the State should have known that it likely would have significant difficulty making the required contributions in the future. In addition, the State should have known that its disclosures regarding the Structural Underfunding and the related risks were inadequate.

Significance to Potential Investors

20. The funding of pension obligations is a significant aspect of the State's budget and financial status. Reasonable investors would have considered information regarding the State's Structural Underfunding of its pensions, the risks created by that underfunding, and the financial condition of the pension plans to be important factors in the investment decision-making process. Reasonable investors would have viewed such information as significantly altering the total mix of information available regarding the State's financial condition and the State's future financial prospects. Such information allows investors to weigh and price the risk associated with the State's debt obligations.

21. Concern about the State's pension financing was a significant factor prompting downgrades of the State's credit rating from 2010 to 2012. For example, on June 4, 2010, Moody's lowered the State's general obligation bond rating based on the State's increased reliance on non-recurring measures. A significant factor cited by Moody's was the fiscal pressure caused by the State's pension funding burden, and, for the first time, Moody's provided additional detail regarding the State's funding challenges and difficulty complying with its pension law in recent years.

22. Certain events ultimately revealed the State's Structural Underfunding of pensions and the risks associated with the underfunding. For example, on January 21, 2011, the State included enhanced pension disclosures released in a preliminary official statement for a general obligation offering on February 11, 2011. Following this event and others, the risk premium associated with Illinois bonds rose, causing the spread between the yield on Illinois bonds relative to other AAA-rated municipal bonds to widen.

Institutional Failures

23. The State's misleading disclosures resulted from, among other things, various institutional failures. The State failed to adopt or implement sufficient controls, policies, or procedures designed to ensure that material information was assembled and communicated to individuals responsible for disclosure determinations, to train personnel involved in the disclosure process adequately, or to retain disclosure counsel. As a result, the State lacked proper mechanisms to identify and incorporate into its official statements relevant information held by the pension systems and other bodies within the State.

24. GOMB, which managed the issuance of debt for the State, coordinated the drafting, review, and revision of the bond disclosure documents, including the section regarding pension funding. GOMB's procedures were inadequate for ensuring that material information concerning State Pension Funds or the State's financing of State Pension Funds was disclosed and accurate in bond offering documents. The State failed to implement sufficient policies and procedures, to conduct adequate training, or to consult securities disclosure counsel to ensure adequate disclosure. Relying on prior "carryover" disclosures and "page-turn" reviews during group conference calls, the State and its advisors did not scrutinize the institutionalized description of the Plan adequately and made little affirmative effort to collect potentially pertinent information from knowledgeable sources—in particular, actuaries for the pension systems and the State's Commission on Government Forecasting and Accountability ("COGFA").

25. Within GOMB, the team responsible for managing the disclosure process purported to rely on its consultants, underwriters, underwriter's counsel, and bond counsel to identify and evaluate the need for additional disclosures. Those parties, however, relied on the State to do the same. The result was a process in which no one person fully accepted responsibility for identifying and analyzing potential pension disclosures.

Remedial Measures

26. The State has taken significant steps to correct these process deficiencies and enhance its pension disclosures. Among other things, the State issued enhanced disclosures; retained disclosure counsel; instituted written policies and procedures, disclosure controls, and training programs; and designated a disclosure committee.

a. In the State's April 2009 bond offering documents, the State provided a hyperlink to a February 2009 COGFA monthly briefing in which COGFA provided certain negative information regarding, among other things, the decline in the State's pension system assets.

b. In June 2009, the State commissioned a Pension Modernization Task Force to evaluate the benefit structure, costs, and funding of the State's pension systems. The task force

met from June to November 2009 and issued a report in November 2009. The report contained detailed information about the history of pension investments, benefits, and funding and reflected the views of various experts. In its official statement for the January 2010 offering, the State included a hyperlink to the task force report in the pension section.

c. In late 2009, the State made a series of personnel changes in the GOMB, including in its most senior positions. These new officers worked to formalize the disclosure and underwriting process.

d. In March 2010, COGFA produced a report on the funded status of the pension systems as of June 30, 2009. The report contained certain historical and projected information regarding the State's funding of its pensions.

e. Promptly following the Commission's settled action against the State of New Jersey in August 2010,⁴ the State began to implement a series of remedial measures. The State retained disclosure counsel, significantly enhanced disclosures in the pension section of its bond offering documents, developed training materials, and added formal disclosure controls regarding pension disclosures. The State also designated a disclosure committee responsible for collecting information from relevant sources, evaluating the State's disclosure obligations, and approving bond offering disclosures. Prior to dissemination of official statements, the committee ensures that the disclosures are reviewed by the pension systems, COGFA, the Office of the Comptroller, the Office of the Treasurer, and the Office of the Illinois Attorney General.

f. These steps culminated with significant corrective disclosures in connection with an offering in February 2011, the State's first offering since the Commission's settled action against the State of New Jersey. In particular, the State disclosed contrasts between contributions determined under the Illinois Statutory Funding Plan and the costs implied by standard actuarial methods and assumptions and Government Accounting Standards Board ("GASB") Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*, and GASB Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers*. The State also discussed the effect of such deviations on the State's ability to meet its pension obligations and included the projected funded status of the pension systems. Finally, the State disclosed the effect of amendments to its Statutory Funding Plan on its ability to fund its pension obligations and the State's financial condition. The State's disclosures also included an extensive discussion of the background of the pension systems, history of contributions to the pension systems, the financial condition of the plans, projections of funded status, substantive references to additional sources of information, and a discussion of disclosure policies and procedures.

Legal Discussion

27. Issuers of municipal securities are responsible for the accuracy of their disclosure documents. Proper disclosure allows investors to understand and evaluate the financial health of the municipality in which they invest. The Commission has repeatedly emphasized that disclosure

⁴ *In re* State of New Jersey, Securities Act Release No. 33-9135 (Aug. 18, 2010).

in municipal debt offerings may be rendered materially misleading due to the omission of other material facts.

28. The antifraud provisions of Section 17(a) of the Securities Act prohibit fraudulent or deceptive practices in the offer or sale of securities by the issuers of municipal securities. Section 17(a) of the Securities Act prohibits obtaining money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading. A fact is material if there is a substantial likelihood that a reasonable investor would have viewed the information as “having significantly altered the ‘total mix’ of information available.” *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976). To the extent the omitted information relates to contingent future events, materiality depends upon “a balancing of both the indicated probability that the event will occur and the anticipated magnitude of the event in light of the totality of circumstances.” *Basic, Inc. v. Levinson*, 485 U.S. 224, 238 (1988). Negligence is sufficient to prove violations of Section 17(a)(2) or (3) of the Securities Act. *Aaron v. SEC*, 446 U.S. 680, 696-97 (1980).

Violations

29. As a result of the negligent conduct described above, the State violated Sections 17(a)(2) and 17(a)(3) of the Securities Act. Specifically, in numerous bond offerings from approximately 2005 through March 2009, the State misled bond investors by omitting to disclose information about the adequacy of its statutory plan to fund its pension obligations and the risks created by the State’s Structural Underfunding of its pension obligations. During this same time period, the State also misled bond investors about the effect of changes to that plan, including the Pension Holidays in 2006 and 2007.

30. The State was aware of the Structural Underfunding and the potential effects of the underfunding. However, due largely to institutional failures, the State misled investors by omitting to disclose material information, rendering certain statements misleading, in bond offering documents regarding the State’s ability to fund its pension obligations or the impact of the State’s pension obligations on the State’s financial condition.

Remedial Acts

31. In determining to accept the Offer, the Commission considered remedial acts promptly undertaken by the State, as described in Paragraph 26, and cooperation afforded the Commission staff during the investigation.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in the State's Offer.

Accordingly, it is hereby ORDERED that, pursuant to Section 8A of the Securities Act, the State of Illinois shall cease and desist from committing or causing any violations and any future violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act.

By the Commission.

Elizabeth M. Murphy
Secretary

END NOTES

¹ Nat'l Fed'n of Indep. Bus. v. Sebelius, 132 S. Ct. 2566, 2576 (2012)(Roberts, C.J.).

² Id. At 2666 (Scalia, Kennedy, Thomas and Alito, JJ., dissenting).

³ Executive Office of the President, Statement of Federal Financial Accounting Concepts No. 2: Entity and Display, at 75 (2010).

⁴ Federal Accounting Standards Advisory Board, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board Statement of Federal Financial Accounting Standards 34* (July 2009).

⁵ GAO, 2012 Financial Report of the United States Government, 217 (2012). The following entities are not part of the Governmentwide reporting entity based on an assessment of these entities in accordance with the indicative criteria stated in SFFAC No. 2, Entity and Display. However, this list is not inclusive of all entities excluded from these statements. American International Group (AIG), Board of Governors of the Federal reserve System (Including the Federal Reserve Banks), Citigroup, Federal Home Loan Banks, Freddie Mac, Fannie Mae, Thrift Savings Fund, The Financing Corporation, GMAC Financial (Ally Financial), Amtrak, Public-Private Investment Funds, Resolution Funding Corporation and Student Loan Marketing Association.

⁶ Exposure Draft excerpts.

⁷ Walter Stahr, *John Jay* 105-108 (Hambledon 2005).

⁸ Paul F. Figley & Jay Tidmarsh, *The Appropriations Power and Sovereign Immunity*, 107 Mich. L. Rev. 1207, 1253 (2009)

⁹ Id.

¹⁰ Id. at 1252-53.

¹¹ Id. at 1253.

¹² Id.

¹³ Ronald J. Krotoszynski, Jr., *Reconsidering the Nondelegation Doctrine: Universal Service, the Power to Tax, and the Ratification Doctrine*, 80 Ind. L.J. 239, 250 (2005)

¹⁴ Id.

¹⁵ Id. at 251.

¹⁶ Id.

¹⁷ Id.

¹⁸ Id.

¹⁹ Id. at 252.

²⁰ Id.

²¹ Id.

²² Id.

²³ Id. at 253.

²⁴ Id.

²⁵ Id.

²⁶ Id.

²⁷ Id.

²⁸ Id.

²⁹ Id. at 254.

³⁰ Id.

³¹ Id.

³² Id.

³³ Id.

³⁴ Id. at 255.

³⁵ Id.

³⁶ Id.

³⁷ Id.

³⁸ Id.

³⁹ *Id.* at 256.

⁴⁰ *Id.*

⁴¹ *Id.*

⁴² *Id.*

⁴³ *Halperin v. Cent. Intelligence Agency*, 629 F.2d 144, 156 (D.C. Cir. 1980).

⁴⁴ *Id.*

⁴⁵ *Id.*

⁴⁶ *Id.*

⁴⁷ *Id.*

⁴⁸ *Id.*

⁴⁹ *Id.*

⁵⁰ *Id.* at 156.

⁵¹ *Id.*

⁵² *Id.*

⁵³ *Id.*

⁵⁴ *Id.*

⁵⁵ *Id.* at 159.

⁵⁶ The Federalist No. 48, at 278 (James Madison) (Clinton Rossiter ed., 1961).

⁵⁷ *Id.* No. 58, at 327 (James Madison).

⁵⁸ The Federalist No. 66, at 404 (Alexander Hamilton) (Clinton Rossiter ed., 1961).

⁵⁹ *Id.* No. 72, at 403 (Alexander Hamilton).

⁶⁰ *Id.* No. 78, at 433 (Alexander Hamilton).

⁶¹ Ronald J. Krotoszynski, Jr., *Reconsidering the Nondelegation Doctrine: Universal Service, the Power to Tax, and the Ratification Doctrine*, 80 Ind. L.J. 239, 258 (2005)

⁶² *Id.*

⁶³ *U. S. v. Richardson*, 418 U.S. 166, 199-200, 94 S. Ct. 2940, 2958, 41 L. Ed. 2d 678 (1974)

⁶⁴ 1 Annal of Congress 1031, 1061, 1141.

⁶⁵ 2 Annals of Congress 302.

⁶⁶ *Halperin v. Cent. Intelligence Agency*, 629 F.2d 144, 162 (D.C. Cir. 1980)

⁶⁷ See, e.g., Fourth Annual Message of Thomas Jefferson (Nov. 8, 1804), reprinted in 1 THE STATE OF THE UNION MESSAGES, *supra* note 62, at 77 (“Accounts of the receipts and expenditures of the last year, with estimates for the ensuing one, will as usual be laid before you”).

⁶⁸ First Annual Message of George Washington (Jan. 8, 1790), reprinted in 1 THE STATE OF THE UNION MESSAGES, *supra* note 62, at 4.

⁶⁹ *Id.* at 168.

⁷⁰ *Richardson v. United States*, 465 F.2d 844 (3d Cir. 1972) rev'd, 418 U.S. 166, 94 S. Ct. 2940, 41 L. Ed. 2d 678 (1974).

⁷¹ *United States v. Richardson*, 418 U.S. 166 (1974). (Douglas, J., dissenting).

⁷² *Id.* At 166, 198.

⁷³ *Id.* at 200.

⁷⁴ *Id.* at 201.

⁷⁵ *Id.* At 202.

⁷⁶ *Richardson v. United States*, 465 F.2d 844 (3d Cir. 1972) rev'd, 418 U.S. 166, 94 S.Ct. 2940, 41 L. Ed. 2d 678 (1974).

⁷⁷ 31 U.S.C. 3513(a)

⁷⁸ *Id.*

⁷⁹ Compare U.S. Const, Art I, Sec. 9, cl. 7 with Articles of Confederation, Art. IX, p 5 (requiring Congress to account to the states for “sums of money***borrowed or emitted”).

⁸⁰ 3 ST. GEORGE TUCKER, BLACKSTONE’S COMMENTARIES: WITH NOTES OF REFERENCE TO CONSTITUTION AND LAWS OF THE FEDERAL GOVERNMENT OF THE UNITED STATES AND OF THE COMMONWEALTH OF VIRGINIA (The University of Chicago Press 2000), available at http://press-pubs.uchicago.edu/founders/print_documents/a1_9_7s3.html.

⁸¹ Id.

⁸² 3 JOSEPH STORY, COMMENTARIES ON THE CONSTITUTION OF THE UNITED STATES § 1342 (The University of Chicago Press 2000), available at http://press-pubs.uchicago.edu/founders/documents/a1_9_7s4.html.

⁸³ See Stith, Kate, “Congress’ Power of the Purse” (1988). Faculty Scholarship Series. Paper 1267. http://digitalcommons.law.yale.edu/fss_papers/1267; See also Office of the General Counsel – Principles of Federal Appropriations Law Second Edition Volume I July 1991 and Louis Fisher, The Authorization-Appropriation Process Congress: Formal Rules and Informal Practices, 29 Cath U.L. Rev. 51, 53-59 (1979).

⁸⁴ See *Reeside v. Walker*, 52 U.S. (11 How.) 272, 290-91 (1850); *Hart’s Case*, 16 Ct. Cl. 459, 484 (1881) (“[A]bsolute control of money of the United States is in Congress, and Congress is responsible for its exercise of this great power only to the people.”), *aff’d*, 118 U.S. 62 (1886); cf. *Baker v. Carr*, 369 U.S. 186, 217 (1962) (texturally demonstrable constitutional commitment of the issue to a coordinate political department...)”).

⁸⁵ Stith, Kate, “Congress’ Power of the Purse” (1988). Faculty Scholarship Series. Paper 1267. http://digitalcommons.law.yale.edu/fss_papers/1267.

⁸⁶ Id.

⁸⁷ 31 U.S.C.A. § 3302 (b).

⁸⁸ 31 U.S.C. § 1341-51.

⁸⁹ Stith, Kate, “Congress’ Power of the Purse” (1988). Faculty Scholarship Series. Paper 1267. http://digitalcommons.law.yale.edu/fss_papers/1267.

⁹⁰ Stith, Kate, “Congress’ Power of the Purse” (1988). Faculty Scholarship Series. Paper 1267. http://digitalcommons.law.yale.edu/fss_papers/1267.

⁹¹ Stith, Kate, “Congress’ Power of the Purse” (1988). Faculty Scholarship Series. Paper 1267. http://digitalcommons.law.yale.edu/fss_papers/1267.

⁹² Kate Stith, *Rewriting the Fiscal Constitution: The Case of Gramm-Rudman-Hollings*, 76 Cal. L. Rev. 593, 607 n. 91-92 (1988); Permanent appropriations operate automatically to provide funding each year, without action by Congress. The major entitlement programs have permanent appropriations. Examples include social security, 42 U.S.C. §§ 401-433 (1982 & Supp. IV 1986), and federal retirement payments, 10 U.S.C. §§ 1201, 1202, 1204, 1205, 1275, 1315, 1331 (1982 & Supp. IV 1986); Some entitlement programs must be annually funded, including Medicaid, 42 U.S.C. § 1396 (1982 & Supp. IV 1986), Aid to Families with Dependent Children, 42 U.S.C. § 601 (1982), and various veterans benefits, 38 U.S.C. §§ 314, 503, 521 (1982 & Supp. III 1985), but these appropriations are treated as mandatory by Congress, like liquidating appropriations for contract authority.

⁹³ Id.

⁹⁴ See 19 ANNALS PF CONG. 1330-31 (1809) ([U]nless the House examine if the amount of appropriation is exceeded by the expenditure; or if it be misapplied, that is, if money appropriated for one object be expended for another; unless we do this sir, our control over the public purse is a mere name-an empty shadow.”) (statement of Rep. J. Randolph); see also L. Wilmerding, *supra* note 4, at 199 *passim* (“the Effort to Control After Expenditure”).

⁹⁵ Id.

⁹⁶ See *United States v. Lovett*, 328 U.S. 303, 313-14 (1946) (Congress cannot enact bills of attainder through appropriation legislation); see also 41 Op. Att’y Gen. 507 (1960); 41 Op. Att’y Gen. 230 (1955); 4 Op. Off. Legal Counsel 731 (1980) (all stating that Constitution prohibits Congress from exercising appropriations power in a manner that violates other constitutional requirements); cf. *Buckley v. Valeo*, 424 U.S. 1, 132 (1976) (*per curiam*) (even where Congress has plenary legislative authority, it cannot exercise that authority so as to offend some other constitutional restriction).

⁹⁷ *S. Dakota v. Dole*, 483 U.S. 203, 207-09 (1987); *Nevada v. Skinner*, 884 F.2d 445, 447 (9th Cir. 1989) *cert. denied*, 110 S. Ct. 1112.

⁹⁸ Woodrow Wilson, *Congressional Government: A Study in American Politics* (Baltimore: John Hopkins University Press, 1981; orig. ed., 1885), pp. 27, 215.

⁹⁹ The Federalist No. 51, at xxx James Madison)(Clinton Rossiter ed., 1961).

¹⁰⁰ 31 U.S.C.A. 41

¹⁰¹ 31 U.S.C. §702(a)

¹⁰² 31 U.S.C.A. § 3511

¹⁰³ *Id.*

¹⁰⁴ 31 U.S.C. 714(b)

¹⁰⁵ Cornelius E. Tierney, Edward F. Kearney, & Roldan Fernandez, *Audit Federal Financial Controls: Sooner Rather Than Later?*, AGA CPAG Research Series: Report No. 1, Mar. 2005, at 5.

¹⁰⁶ 31 U.S.C. 65

¹⁰⁷ 31 U.S.C.A. 65; 31 U.S.C. §§3511-3515, 3521

¹⁰⁸ 31 U.S.C. 8351

¹⁰⁹ United States. Cong. *Budget and Accounting-Amendment*. 84th Cong., 2nd sess.

<http://www.usaid.gov/policy/ads/600/pl84-863.pdf>.

¹¹⁰ 31 U.S.C.A. §1301

¹¹¹ See Arthur Anderson & Co., *Sound Financial Reporting in the Public Sector: a Prerequisite to Fiscal Responsibility* (Sept. 1975); See also Arthur Andersen & Co., *Sound Fiscal Management in the Public Sector* (Oct. 1976).

¹¹² At the time of AA's recommendation the Government computed two estimates of future liabilities for Social Security. These estimates were based on a present-value approach, taking into consideration future contributions and benefits which have been established by present laws. Beginning in 1972, benefits are automatically adjusted for changes in the consumer price index. The first estimate, usually referred to as the Official Actuarial Concept, indicates that the excess of benefits to be paid to present and future participants (defined years thereafter as the Open Group) over anticipated receipts for the next seventy-five years on a present value basis is \$1.312 trillion as of June 30, 1974. The second estimate, usually referred to as the Full-reserve Actuarial Concept, estimates that the excess of benefits to be paid to present participants over contributions by present participants (defined years thereafter as the Closed Group) on a present value basis is \$2.460 trillion as of June 30, 1974.

¹¹³ Congressional Budget Office, *Federal Financial Reporting: Accrual Accounting and the Budget* (1977).

¹¹⁴ U.S. Gov't Accountability Office, GAO/AFMD-85-35-A, *Managing the Cost of Government: Building an Effective Financial Management Structure* (1985).

¹¹⁵ § 307. Adoption of Capital Accounting Standards. PL 101-576, 1990 HR 5687

¹¹⁶ § 3515. Financial statements of agencies, PL 103-356, 1994 S 2170

¹¹⁷ Federal Accounting Standards Advisory Board, *FASAB Facts* (2009).

¹¹⁸ Memorandum of Understanding Among the Gov't Accountability Office, the Dep't. of the Treasury, and the OMB on the Federal Gov't Accounting Standards and a Federal Accounting Standards Advisory Board (Revised October 2009).

¹¹⁹ James Patton & David Mosso, *Is the Federal Accounting Standards Advisory Board Independent? Can the Federal Accounting Standards Advisory Board Be More Independent?*, Journal of Government Financial Management, Fall 2009, at 61.

¹²⁰ *Id.*

¹²¹ *Id.*

¹²² *Id.*

¹²³ *Financial Reporting - AICPA Recognizes FASAB as GAAP Standard Setter*, Journal of Accountancy, Mar. 2000, at 1.

¹²⁴ James Patton & David Mosso, *Is the Federal Accounting Standards Advisory Board Independent? Can the Federal Accounting Standards Advisory Board Be More Independent?*, Journal of Government Financial Management, Fall 2009.

¹²⁵ Federal Accounting Standards Advisory Board, *FASAB News Federal Accounting Standards Advisory Board* (June/July 2010).

¹²⁶ James Patton & David Mosso, *Is the Federal Accounting Standards Advisory Board Independent? Can the Federal Accounting Standards Advisory Board Be More Independent?*, Journal of Government Financial Management, Fall 2009.

¹²⁷ Federal Accounting Standards Advisory Board, *Accounting for Social Insurance (Revised) Statement of Federal Financial Accounting Standards Preliminary Views* (Oct. 2006).

¹²⁸ *Id.* at 8.

¹²⁹ *Id.*

¹³⁰ Federal Accounting Standards Advisory Board, *FASAB News Issue 105*, at 5 (September/October 2007).

¹³¹ "Social Security Online History Pages." The United States Social Security Administration. Web. 02 Sept. 2011. <<http://www.ssa.gov/history/nestor.html>>.

¹³² "Accounting: Historical Perspectives: Encyclopedia of Business and Finance." *ENotes - Literature Study Guides, Lesson Plans, and More*. Web. 04 Sept. 2011. <<http://www.enotes.com/business-finance-encyclopedia/accounting-historical-perspectives>>.

¹³³ See 17 C.F.R. 210.4-01(a)(91)(2002) and Objectives of Financial Reporting by Business Enterprises, Financial Accounting Standards Board, Statement of Financial Accounting Concepts No. 1, paragraph 44.

¹³⁴ U.S. Government Accountability Office, 2012 Financial Report of the United States Government, x (2012).

¹³⁵ FINANCIAL MANAGEMENT SERVICE: A BUREAU OF THE U.S. DEPARTMENT OF THE TREASURY, Overview: Combined Statement of Receipts, Outlays, and Balances of the United States Government (Combined Statement): Publications & Guidance: Financial Management Service, <http://www.fms.treas.gov/annualreport/overview.html>.

¹³⁶ U.S. Office of Management and Budget, President's 2014 Fiscal Year Budget, (2013).

¹³⁷ U.S. Gov't Accountability Office, 2012 Financial Report of the United States Government, (2012).

¹³⁸ *United States v. Richardson*, 418 U.S. 166 (1974).

¹³⁹ U.S. Gov't Accountability Office, 2012 Financial Report of the United States Government, 6 (2012).

¹⁴⁰ Under U.S. GAAP, most U.S. Government revenues are recognized on a 'modified cash' basis, or when they become measurable.

¹⁴¹ Kate Stith, *Rewriting the Fiscal Constitution: The Case of Gramm-Rudman-Hollings*, 76 Cal. L. Rev. 593, 607 n. 91-92 (1988).

¹⁴² "Social Security Online History Pages." The United States Social Security Administration. Web. 02 Sept. 2011. <<http://www.ssa.gov/history/nestor.html>> (citing *Flemming v. Nestor*, 363 U.S. 603, 80 S. Ct. 1367, 4 L. Ed. 2d 1435 (1960)).

¹⁴³ Federal Accounting Standards Advisory Board, *Accounting for Social Insurance Statement of Recommended Accounting Standards Number 17* (August 1999).

¹⁴⁴ FINANCIAL MANAGEMENT SERVICE: A BUREAU OF THE U.S. DEPARTMENT OF THE TREASURY, Overview: Combined Statement of Receipts, Outlays, and Balances of the United States Government (Combined Statement): Publications & Guidance: Financial Management Service, <http://www.fms.treas.gov/annualreport/overview.html>.

¹⁴⁵ ¹⁴⁵ U.S. Gov't Accountability Office, 2012 Financial Report of the United States Government, (2012).

¹⁴⁶ <http://fordhamcorporatecenter.org/2012/01/24/representation-without-accountability-2/>

¹⁴⁷ U.S. Gov't Accountability Office, 2012 Financial Report of the United States Government, (2012).

¹⁴⁸ U.S. Gov't Accountability Office, 2012 Financial Report of the United States Government, (2012).

¹⁴⁹ Peter G. Peterson, *Running on Empty* 111 (Farrar, Straus and Giroux 2004).

¹⁵⁰ <http://fordhamcorporatecenter.org/2012/01/24/representation-without-accountability-2/>

¹⁵¹ Federal Accounting Standards Advisory Board, *Accounting for Social Insurance Statement of Recommended Accounting Standards Number 17*, 8, 22 (August 1999).

¹⁵² There are several key definitions and concepts one needs to be familiar with when reviewing the SOSI. The **Closed Group** includes a) participants who have attained eligibility and b) participants who have not attained eligibility. The **Open Group** adds future participants to the Closed Group.

¹⁵³ U.S. GOV'T ACCOUNTABILITY OFFICE, 2010 FINANCIAL REPORT OF THE UNITED STATES GOVERNMENT 140 tbl.1 (2010); However, please note that this projection is based on a fiscal year starting on October 1, 2010.

¹⁵⁴ *Id.* at 141-142. Assumptions Used and Relationship to Other Financial Statements – A fundamental assumption underlying the projections in Table 1 is that current Federal policy – as defined below – does not change...The following summarizes the assumptions used for key categories of receipts and spending presented in Table 1 and in the related analysis....**Medicare:** Current law Medicare spending is based on incurred expenditures from the 2010 Medicare trustees' report, which reflect the changes in Medicare that resulted from passage of the Affordable Care Act (ACA), and, therefore, projects lower costs than in previous reports. However, some adjustments are required to convert these amounts to Medicare spending as measured by the budget. Medicare Part B and D premiums, as well as State contributions to Part D, are subtracted from gross spending in measuring Part B and Part D outlays in the budget.⁶ (Footnote 6 – Medicare Part B and D premiums and State contributions to Part D are subtracted from the Part B and D spending displayed in Table 1. The total 75-year present value of these subtractions is \$7.7 trillion, or 0.9 percent of GDP.) The budget treats these premiums as “negative spending” rather than receipts, since they represent payment for a service and in that sense “business like.” Government receipts are defined as payments obtained through the Government's sovereign power to tax. With these adjustments, Medicare spending net of administrative costs corresponds to Medicare spending in the budget. The long-term fiscal projection uses historical budget data from FY2010 for Medicare spending and Part A payroll tax revenues, with both growing at growth rates presented in the trustees' report. Also, as discussed in Note 26, there is uncertainty about whether the projected reductions in health care cost growth will be fully achieved. Note 26 includes an alternate projection to illustrate the uncertainty of projected Medicare costs. **Medicaid:** The Medicaid program was also affected by the changes legislated in the ACA. Medicaid enrollment will be larger because of health reform, and many newly insured Americans will be covered through Medicaid. To reflect these changes, certain adjustments were made in the model that has been used to project Medicaid in past years for the Financial Report. The model starts with the projections from the 2008 Actuarial Report prepared by the Office of the Actuary, Centers for Medicare and Medicaid Services (CMS).⁷ (Note 7 Christopher J. Truffer, John D. Klemm, E. Dirk Hoffman, and Christian J. Wolfe, 2008 Actuarial Report of the Financial Condition for Medicaid, Office of the Actuary, Centers for Medicare and Medicaid Services, United States Department of Health and Human Services.) As projections in this report only extend until 2018, the model assumes that Medicaid benefits in 2019 and later years grow at the same rate per beneficiary as Medicare benefits grow. Effects of the ACA, as calculated by CMS, were added to the base projections, as were other adjustments, to align base projections with the latest budget data. The Medicaid projections reflect the temporary increase in Medicaid spending due to the American Recovery and Reinvestment Act of 2009 (ARRA) as well as the phase-out of the Medicaid spending authorized by ARRA.

¹⁵⁵ *Id.* at 130-31, 222, 224, 226-28. *See also* U.S. GOV'T ACCOUNTABILITY OFFICE, 2011 FINANCIAL REPORT OF THE UNITED STATES GOVERNMENT 134 (2011) AND 2012 FINANCIAL REPORT OF THE UNITED STATES GOVERNMENT, 131-138, 155-156 (2012).

¹⁵⁶ U.S. Gov't Accountability Office, 2012 Financial Report of the United States Government, 188 (2012). ...a 75-year projection can be a misleading indicator of all future financial flows. For example, when calculating unfunded obligations, a 75-year horizon includes revenue from some future workers but only a fraction of their future benefits. In order to provide a more complete estimate of the long-run unfunded obligations of the programs, estimates can be extended to the infinite horizon. The open-group infinite horizon net obligation is the present value of all expected future program outlays less the present value of all expected future program tax and premium revenues.

¹⁵⁷ U.S. GOV'T ACCOUNTABILITY OFFICE, 2012 FINANCIAL REPORT OF THE UNITED STATES GOVERNMENT 21 tbl.8 (2012).

¹⁵⁸ "Trustees Report Summary." *Social Security Online Actuarial Publications*. USA Social Security Administration. Web. 04 Sept. 2011. <<http://www.ssa.gov/oact/trsum/index.html>>.

¹⁵⁹ *Id.* at 2.

¹⁶⁰ Federal Accounting Standards Advisory Board, *Accounting for Social Insurance Statement of Recommended Accounting Standards Number 17* (August 1999).

¹⁶¹ See U.S. Gov't Accountability Office, 2001-2012 Financial Reports of the United States Government (2001-2012) for Statements of Social Insurance included therein.

¹⁶² Nat'l Fed'n of Indep. Bus. v. Sebelius, 132 S. Ct. 2566, 2663 (2012). Ginsberg, J., concurring in part and concurring in the judgment in part and dissenting in part).

¹⁶³ *Id.* at 2632.

¹⁶⁴ See Appendices A and B.

¹⁶⁵ See Schedule 4.

¹⁶⁶ U.S. Gov't Accountability Office, 2012 Financial Report of the United States Government, at 11 tbl.5 (2012).

¹⁶⁷ *Id.* at 42.

¹⁶⁸ Joseph Marren, *The Statement and Account Clause and Caperton: Part II*, JURIST - Sidebar, Apr. 18, 2013, <http://jurist.org/sidebar/2013/04/joseph-marren-caperton-partII.php>.

¹⁶⁹ Withrow, 421 U.S., at 47.

¹⁷⁰ Charles T. Munger, *Poor Charlie's Almanack: The Wit and Wisdom of Charles T. Munger*, 390-446 (Peter D. Kaufman 2005).

¹⁷¹ *Id.* at 401.

¹⁷² THE FEDERALIST No. 72 at 257 (Alexander Hamilton (1788)).

¹⁷³ See "Setting Recusal Standards after Caperton v. A.T. Massey Coal Company

¹⁷⁴ *Id.* at 407.

¹⁷⁵ *Id.* at 409.

¹⁷⁶ *Id.* at 431-32.

¹⁷⁷ *Id.* at 435.

¹⁷⁸ Federal Accounting Standard Advisory Board, *Accounting for Social Insurance, Revised*, at 8 (2006).

¹⁷⁹ *Id.* at 434.

¹⁸⁰ *Id.* at 438.

¹⁸¹ Munger, *Poor Charlie's Almanack: The Wit and Wisdom of Charles T. Munger*, 425 (Peter D. Kaufman 2005).

¹⁸² Fed. Election Commission v. Akins, 524 U.S. 11 (1998).

¹⁸³ United States v. Hayes, 515 U.S. 737 (1995).

¹⁸⁴ Nat'l Fed'n of Indep. Bus. v. Sebelius, 132 S. Ct. 2566, 2576 (2012)(Roberts, C.J.).

¹⁸⁵ 531 U.S. 533 (2001).

¹⁸⁶ 319 F.Supp.2d 69 (D.D.C. 2004).

¹⁸⁷ Fed. Election Comm'n v. Akins, 524 U.S. 11.

¹⁸⁸ James E. Pfander, *Triangulating Standing*, 53 St. Louis U. L.J. 829, 835 (2009)

¹⁸⁹ *Id.*

¹⁹⁰ *Fed. Election Comm'n v. Akins*, 524 U.S. 11, 21, 118 S. Ct. 1777, 1784, 141 L. Ed. 2d 10 (1998)

¹⁹¹ Joseph Marren, *The Statement and Account Clause and Citizens United*, JURIST - Sidebar, Jan. 9, 2013, <http://jurist.org/sidebar/2013/01/joseph-marren-citizens-part1.php>

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¹⁹³ Joseph Marren, *The Statement and Account Clause and Caperton: Part I*, JURIST - Sidebar, Apr. 8, 2013, <http://jurist.org/sidebar/2013/04/joseph-marren-sa-caperton-part1.php>

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¹⁹⁵ 273 U.S. 510.

¹⁹⁶ THE FEDERALIST No. 10, p. 59 (J. Cooke ed. 1961)(J. Madison).

¹⁹⁷ 273 U.S. at 520.

¹⁹⁸ *Id.* at 522.

¹⁹⁹ *Id.* at 535.

²⁰⁰ *Ibid.*

²⁰¹ *Withrow*, 421 U.S., at 47.

²⁰² 409 U.S. 57 (1972).

²⁰³ 409 U.S., at 60.

²⁰⁴ *Ibid.*

²⁰⁵ *Gibson v. Berryhill*, 411 U.S. 564, 579 (1973).

²⁰⁶ *Withrow*, 421 U.S., at 47.

²⁰⁷ Joseph Marren & Elizabeth Marren, *ACA Medicaid Decision is Judicial Malpractice*, JURIST - Sidebar, Sept. 5, 2012, <http://jurist.org/sidebar/2012/09/marren-marren-medicaid-malpractice.php>

²⁰⁸ *S. Dakota v. Dole*, 483 U.S. 203, 107 S. Ct. 2793, 97 L. Ed. 2d 171 (1987).

²⁰⁹ *S. Dakota v. Dole*, 107 S. Ct. at 2794.

²¹⁰ *Id.*

²¹¹ U.S. GOV'T ACCOUNTABILITY OFFICE, 2011 FINANCIAL REPORT OF THE UNITED STATES GOVERNMENT 32 (2011).

²¹² *Id.* at xiii.

²¹³ 9 The Writings of James Madison 103 (Gaillard Hunt, ed. 1910)

²¹⁴ 14 Writings of Thomas Jefferson 384 (Mem ed. 1903)

²¹⁵ “John Adams, Dissertation on Canon and Feudal Law, 1765, From: Our Sacred Honor, Bennett, 253.

²¹⁶ *Fed'n of Indep. Bus. v. Sebelius*, 132 S. Ct. 2566, 2576 (2012)(Roberts, C.J.).

²¹⁷ F. Andrew Hessick, *Standing, Injury in Fact, and Private Rights*, 93 Cornell L. Rev. 275, 287 (2008). See Richard H. Fallon, Jr., *Individual Rights and the Powers of Government*, 27 Ga. L. Rev. 343, 351 (1993) (discussing private rights endowed by the Constitution and the interests those rights protect). Professor Bandes and then-Professor Nichol argue that all constitutional provisions should be cognizable. See Bandes, *supra* note 3, at 284-85; Gene R. Nichol, Jr., *Rethinking Standing*, 72 Cal. L. Rev. 68, 86 (1984).

²¹⁸ *Blue Chip Stamps*, 421 U.S. at 737.

²¹⁹ Cf. *Bateman Eichler, Hill Richards, Inc. v. Berner*, 472 U.S. 299, 310 (1985) (noting that the Supreme Court has repeatedly emphasized that “private actions provide ‘a most effective weapon in the enforcement’ of the securities laws and are ‘a necessary supplement to [SEC] action’” (quoting *J.I. Case Co. v. Borak*, 377 U.S. 426, 432 (1964))).

²²⁰ *N.Y. v. U.S.*, 505 U.S. 144, 112 S. Ct. 2408, 120 L. Ed. 2d 120 (1992).

²²¹ Erwin Chemerinsky, *Protecting the Spending Power*, 4 Chap. L. Rev. 89, 100 (2001).

²²² 9 THE WRITINGS OF JAMES MADISON 103 (Gaillard Hunt, ed. 1910).

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²²⁴ Budget and Accounting-Amendment, Pub. L. No. 863 (1921), available at <http://www.usaid.gov/policy/ads/600/pl84-863.pdf>.

²²⁵ CBO’s Budgetary Treatment of Fannie Mae and Freddie Mac.

²²⁶ Kate Stith, *Rewriting the Fiscal Constitution: The Case of Gramm-Rudman-Hollings*, 76 Cal. L. Rev. 593, 607 n. 91-92 (1988); Permanent appropriations operate automatically to provide funding each year, without action by Congress. The major entitlement programs have permanent appropriations. Examples include social security, 42 U.S.C. §§ 401-433 (1982 & Supp. IV 1986), and federal retirement payments, 10 U.S.C. §§ 1201, 1202, 1204, 1205, 1275, 1315, 1331 (1982 & Supp. IV 1986); Some entitlement programs must be annually funded, including Medicaid, 42 U.S.C. § 1396 (1982 & Supp. IV 1986), Aid to Families with Dependent Children, 42 U.S.C. § 601 (1982), and various veterans benefits, 38 U.S.C. §§ 314, 503, 521 (1982 & Supp. III 1985), but these appropriations are treated as mandatory by Congress, like liquidating appropriations for contract authority.

²²⁷ Stith, Kate, “Congress’ Power of the Purse” (1988). Faculty Scholarship Series. Paper 1267. http://digitalcommons.law.yale.edu/fss_papers/1267.

²²⁸ The six acts are: the Securities Act of 1933, 15 U.S.C. sec 77a-77aa (1994); the Securities Exchange Act of 1934, 15 U.S.C. sec 78a-78ll (1994); the Public Utility Holding Company Act of 1935, 15 U.S.C. sec 79-79z(6) (1994); the Trust Indenture Act of 1939, 15 U.S.C. sec 77aaa-77bbb (1994); the Investment Company Act of 1940, 15 U.S.C. sec 80a(1)-80(a)(64) (1994); and the Investment Advisers Act of 1940, 15 U.S.C. sec 80b(1)-80b(21) (1994).

²²⁹ Louis D. Brandeis, *Other People’s Money and How the Bankers Use It* 92 (1914).

²³⁰ *Matrixx Initiatives et al., v. Siracusano et al.*, 563 U.S. (2011).

²³¹ 485 U.S. 224, 231-232 (1988)

²³² 426 U.S. 438, 449 (1976)

²³³ 15 U.S.C. sec 78j(b).

²³⁴ 17 CFR sec 240.10b-5(b).

²³⁵ *Basic*, 485 U.S., at 238. Under the private Securities Litigation reform Act of 1995 (PSLRA), when a plaintiff’s claim is based on an alleged misrepresentation or omissions of a material fact, “the complaint shall specify each statement alleged to have been misleading, [and] the reason or reasons why the statement is misleading,” 15 U.S.C. sec 78u-4(b)(1)

²³⁶ *Id.*, at 231-232 (quoting *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976))

²³⁷ 485 U.S., at 231 (quoting *TSC Industries*, 426 U.S., at 448-449).

²³⁸ 17 CFR sec 240.10b-5(b); see also *Basic*, 485 U.S., at 239, n. 17 (“Silence, absent a duty to disclose, is not misleading under Rule 10b-5”)

²³⁹ *Matrixx Initiatives, Inc., ET AL., Petitioners v. James Siracusano ET AL.* 563 U.S. (2011)

²⁴⁰ 426 U.S. at 449.

²⁴¹ *Cione v. Gorr*, 843 F. Supp. 1199, 1202 (N.D. Ohio 1994). See also *Robinson v. Penn Cent. Co.*, 336 F. Supp. 655, 657 (E.D. Pa. 1971) (“It may be that a sophisticated analyst, with knowledge of the corporate world, would ultimately deduce from the proxy material [the material information]. However, our concern is not the sophisticated analyst, but the reasonable stockholder...”).

²⁴² See *Weiner v. Quaker Oats Co.*, 129 F.3d 310, 317 (3d Cir. 1997).

²⁴³ See *United Paperworkers*, 985 F.2d at 1199 (“[E]ven information actually sent to shareholders need not be considered part of the total mix reasonably available to them if ‘the true’ is ‘buried’ in unrelated discussions.”)

²⁴⁴ *Werner v. Werner*, 267 F.3d 288, 297 (3d Cir. 2001) (quoting *Kas v. Fin. Gen. Bankshares, Inc.*, 796 F.2d 508, 516 (D.C. Cir. 1986)).

²⁴⁵ *TSC Industries*, 426 U.S. at 450 (quoting *Johns Hopkins U. v. Hutton*, 422 F.2d 1124, 1129 (4th Cir. 1970)).

²⁴⁶ Pub. L. No. 107-204, 116 Stat. 745 (codified in scattered sections of 11, 14, 18, 28, and 29 U.S.C.).

²⁴⁷ 15 U.S.C. sec 78m(j) (2006)

²⁴⁸ 418 U.S. 166 (1974).

²⁴⁹ *United States v. Richardson*, 418 U.S. 166, 178 n.11 (1974) (Burger, C.J.).

²⁵⁰ *Id.*

²⁵¹ Joseph Marren & Elizabeth Marren, *ACA Medicaid Decision is Judicial Malpractice*, JURIST - Sidebar, Sept. 5, 2012, <http://jurist.org/sidebar/2012/09/marren-marren-medicaid-malpractice.php>

²⁵² *Nat’l Fed’n of Indep. Bus. v. Sebelius*, 132 S. Ct. 2566, 2576 (2012) (Roberts, C.J.).

²⁵³ *Id.* at 2571.

²⁵⁴ *Id.*

²⁵⁵ *Id.*

²⁵⁶ *Id.* at 2572-73.

²⁵⁷ *Id.* at 2666 (Scalia, Kennedy, Thomas, and Alito, JJ., dissenting).

²⁵⁸ *Id.* at 2663.

²⁵⁹ *Id.* at 2632 (Ginsberg, J., concurring in part and concurring in the judgment in part and dissenting in part).

²⁶⁰ *Id.* at 2604 (Roberts, C.J.).

²⁶¹ *Id.* at 2572.

²⁶² *Id.* at 2602 (Roberts, C.J.)(quoting *Barnes v. Gorman*, 536 U.S. 181, 186 (2002)).

²⁶³ *Id.*

²⁶⁴ *Id.* at 2604.

²⁶⁵ *Id.* at 2605.

²⁶⁶ *Id.* at 2602 (Roberts, C.J.).

²⁶⁷ *Id.* at 2660 (Scalia, Kennedy, Thomas, and Alito, JJ., dissenting).

²⁶⁸ *Id.* at 2633 n.17 (Ginsberg, J., concurring in part and concurring in the judgment in part and dissenting in part).

²⁶⁹ *Id.* at 2575 (2012).

²⁷⁰ Nat'l Fed'n of Indep. Bus. v. Sebelius, 132 S. Ct. 2566, 2576 (2012)(Roberts, C.J.).

²⁷¹ U.S. GOV'T ACCOUNTABILITY OFFICE, 2010 FINANCIAL REPORT OF THE UNITED STATES GOVERNMENT 140 tbl.1 (2010).

²⁷² *Id.* at 130-31, 222, 224, 226-28. *See also* U.S. GOV'T ACCOUNTABILITY OFFICE, 2011 FINANCIAL REPORT OF THE UNITED STATES GOVERNMENT 134 (2011).

²⁷³ U.S. GOV'T ACCOUNTABILITY OFFICE, 2011 FINANCIAL REPORT OF THE UNITED STATES GOVERNMENT 32 (2011).

²⁷⁴ *Id.* at xiii.

²⁷⁵ Nat'l Fed'n of Indep. Bus. v. Sebelius, 132 S. Ct. 2566, 2632 n.15 (2012)(Ginsberg, J., concurring in part and concurring in the judgment in part and dissenting in part).

²⁷⁶ Fed. Election Commission v. Akins, 524 U.S. 11 (1998).

²⁷⁷ United States v. Hayes, 515 U.S. 737 (1995).

²⁷⁸ 531 U.S. 533 (2001).

²⁷⁹ 319 F.Supp.2d 69 (D.D.C. 2004).

²⁸⁰ Nat'l Fed'n of Indep. Bus. v. Sebelius, 132 S. Ct. 2566, 2576 (2012)(Roberts, C.J.).

July 3, 2013

Memorandum

TO: Wendy M. Payne
Executive Director, Federal Accounting Standards Advisory Board

FROM: Randy W. McGinnis
Assistant Inspector General for Audit, GA

SUBJECT: Reporting Entity Exposure Draft Comments

The HUD's Office of Inspector General (HUD-OIG) appreciates the opportunity to comment on FASAB's Reporting Entity Exposure Draft (ED). The ED asked the respondents to comment on 11 specific questions. While we support the Board's position on questions 1 – 4 and 6-11, we have concerns related to question number 5 and how this would impact our agency if the Board's proposed accounting standard is ratified. Our comments discussed in detail below reflect our views on the issue as it relates to question number 5.

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. 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.

Response: We do not agree that the consolidation FASAB and FASB based information without conversion is appropriate. HUD insures mortgages for single family and multifamily dwellings through its mortgage insurance programs administered by Federal Housing Administration (FHA). HUD also guarantees, through Government National Mortgage Association (Ginnie Mae), the timely payment of principal and interest on Mortgage-Backed Securities issued by approved private mortgage institutions and backed by pools of mortgages insured by the FHA, U.S. Department of Agriculture, U.S. Veterans Affairs, and HUD's Office of Public and Indian Housing. As component entities, Ginnie Mae (prepared using FASB standard) and FHA's financial information (prepared using FASAB standard) are reported to HUD for consolidation.

In HUD-OIG's view, consolidating financial information using different basis of accounting can provide misleading information to the users of HUD's financial statements. This is true, even with additional disclosures, especially in instances where material differences between FASB and FASAB accounting standards could result in very different accounting outcomes. This scenario applies to HUD because Ginnie Mae's FASB based information is reported to HUD for consolidation and the FASB and FASAB conversion information is material

to HUD's group financial statements. Further, transactions between Ginnie Mae and FHA (as component reporting entities of HUD) with regard to defaulted insured mortgages had generated material intragovernmental balances and activities in their respective books in recent years, but each prepare stand-alone financial statements using FASB and FASAB accounting standards respectively.

The Board also indicates that, as a consideration for its proposal to allow consolidation of different basis of accounting without conversion, the conversion imposes a cost and it is not clear that the cost is justifiable based on the benefits to the user. However, the additional disclosure provision in the ED would most certainly require entities to incur additional disclosure costs already and therefore the cost conversion concern should not have significant incremental effect.

Accordingly, we recommend the Board to reconsider its position to not allow consolidation without conversion in cases where material differences exist between FASB and FASAB accounting standards. Additionally, with respect to the additional disclosure requirement on intragovernmental amounts proposed in the ED, the Board needs to clarify whether the requirement is only required in the component entity's stand-alone financial statements or both the component and parent/group management entity's financial statements.

Thank you for the opportunity to provide our views. We would be happy to meet with the FASAB staff to more fully explain the reporting differences and the effect on the consolidated financial statements. If you have any questions or comments regarding this letter, please do not hesitate to contact me at 202-402-8107.

bcc:

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| G | Montoya | 8256 |
| G | Albert | 8256 |
| G | Chron | 8256 |
| GA | McGinnis | 8286 |
| GA | Rokosz | 8286 |
| GA | Chron | 8286 |
| GAP | Begola | 8178 |
| GAP | Chron | 8178 |
| GAF | McEnanly | 8282 |
| GAF | Sequeira | 3162 |
| GAF | Medina | 3162 |
| GAF | Chron | 3162 |

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Concurrence:

| Hoopes | Medina | McEnanly | Rokosz | McGinnis |
|---------------|---------------|-----------------|---------------|-----------------|
| | | | | |

Reporting Entity

Please submit to fasab@fasab.gov

Date: July 3, 2013

Name of Respondent: Joseph D. Cummings, CPA, Director, Financial Statement Audits

Organization: Department of Health and Human Services Office of Inspector General
Office of Audit Services (Federal Auditor)

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.**

The inclusion principles as presented provide a good basis for an organization to be included in the government-wide General Purpose Federal Financial Report (GPFFR). While the Budget of the United States is a good starting point, financial statement preparers and auditors can use the other inclusion principles to determine if an organization controlled or managed by the Federal government, but not necessarily noted in the budget, should be included in 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.**

The definitions and indicators for the inclusion principles seem to be very clear and helpful. They provide very good explanations and give the appropriate guidance for preparers and the auditors to determine if organizations should be included in government-wide GPFFR.

- 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.

All organizations should be included in the government-wide GPFFR if it would be misleading not to include them even though they do not meet one of the three inclusion principles. Some organizations that do not necessarily fall under the inclusion principles could put the overall Federal government at risk. The decision to include or not include an organization should be decided in consultation between the preparer of the government-wide GPFFR (Treasury's Fiscal Service) and the auditor (Government Accountability Office (GAO)).

- 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.

The inclusion principles should be applied to all organizations to determine if they should be included in GPFFR. As indicated in the response to number Q1.c, organizations that can put the Federal government at risk should be disclosed and included in the GPFFR.

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.

There should be some differentiation between consolidation entities and disclosure organizations. For the most part, HHS is a consolidation entity and this portion would not affect its financial reporting. HHS really does not have any disclosure organizations. The determination between consolidation entities and disclosure organizations should be made in consultation between the preparers for agency GPFFR and their auditors.

- 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.

The attributes properly distinguish between consolidation and disclosure organizations. They are logical and appear to follow what one would expect to find in proper Federal financial reporting. No additional attributes appear to be needed in the proposed standard.

- 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.

As indicated above, the attributes are adequate to make a determination whether the organizations included in number Q2 c. are consolidation entities or disclosure entities. These attributes, if properly applied by preparers and auditors of GPFFRs, define both consolidation entities and disclosure organizations.

- 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),
- ii. the objectives for disclosures (see par. 72), and
- iii. the examples provided (see par. 73)?

Please provide the rationale for your answers.

The factors to be considered, the objectives and the examples provided show very clear concepts on how disclosure organizations should be reported in the GPFFRs. These items follow what one would expect to see in normal Federal financial reporting. Again, if applied properly, the use of the areas described in paragraphs 69, 72 and 73 will help preparers and auditors of GPFFRS provide adequate disclosures for organizations where the Federal government has a financial, material and/or managerial interest.

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.**

The component entity should report in its GPFFR all organizations for which it is accountable. This would include consolidation entities and disclosure organizations for which it has administrative responsibilities. Including all consolidation entities and disclosure organizations ensures completeness of the entity's GPFFR.

- 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.**

Paragraphs 54-63 adequately identify administrative assignments. No additional administrative assignments need to be identified in the proposed standard at this time.

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.

The component and government-wide reporting entity should consolidate in their entirety organizations for which it is accountable without regard to funding source. This should be for organizations that receive appropriations, donations and/or funding from non-Federal sources. Both component and the government-wide reporting entities need to take into account any funding sources from which there is increased risk to the component entity or to the Federal government, taken as a whole.

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.

HHS prepares its financial statements in accordance with standards established by FASAB. This question is directed to those entities that prepare their GPFFR in accordance with standards established by FASB. A more appropriate response could be provided to Treasury, GAO and the agencies that prepare their standards in accordance with standards established by FASB.

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.**

Since HHS prepares its financial statements in accordance with standards established by FASAB and prepares its required disclosures, it is not appropriate to comment on this area. These questions are directed more to the Federal

Reserve, Treasury, OMB and GAO. A more appropriate response would be obtained by these entities.

- 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.

Not aware of any other significant organizations for which minimum disclosures 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.

The definitions and requirements in paragraphs 78-87 adequately describe related parties. They are logical and define how related parties should be disclosed. The definitions and requirements follow what one would expect to find in normal Federal financial reporting.

- 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.

The list in paragraph 93 appropriately defines the types of organizations that would generally be considered related parties. The list follows what one would expect to find in normal Federal financial reporting.

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

Not aware of additional organizations that should be considered related parties.

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

The list of exclusion in Paragraph 84 appears complete and normal for what one might expect in Federal financial reporting.

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

Not aware of additional exclusions that should be reported.

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.

The conforming changes should be made to SFFAC 2 since what is required for inclusion in an entities' GPFFR will now be in a Statement of Federal Financial Accounting Standards (SFFAS). The SFFAS' have a higher priority than the concept statements in the Federal accounting hierarchy.

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.

The effective date for the new Statement and Amendments to SFFAS 2 appears reasonable. This implementation date should give preparers and auditors of component and government-wide GPFFRs enough time to account or make any changes needed for reporting under the new statement.

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?

The appendices were extremely helpful in defining how to apply the proposed standards. The flowchart in Appendix B is also extremely helpful in showing support for the illustrations described in Appendix C.

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

The appendices should remain in the Statement when issued by FASAB. They are especially helpful to those who have limited experience in Federal financial reporting.

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

Not aware of any additional examples that would be useful in understanding the application of the standards

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.

Not aware of other unique standards that should addressed within this Statement.

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 alternative view should not be considered based on the fact these are still disclosures organizations. All Federal reporting entities should disclose areas where the component reporting entities or the Federal government taken as whole would be at risk. Receiverships, conservatorships and interventions

provide a great deal of risk for Federal agencies. Disclosure of these items helps report on actual financial condition of the Federal government.

- 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.

All requirements for reporting entities should be included in one single Statement of Federal Accounting Standards. Two different Statements of Federal Financial Accounting Standards that define potential reporting entities or disclosure organizations could create different interpretations and lead to inconsistent financial reporting.

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.

SEC Recommendation 1(a): 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.¹⁴ 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) 5³ because they are not

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.”

SEC Recommendation 1(b):

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) 5⁵ 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 or information, such as a website link, to the disclosure organization's most recent audited financial statements.

- Add the following additional language to paragraph 76:

If the component entity is aware of significant changes in information occurring from the end of the disclosure organization's reporting period, such changes 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.

SEC Recommendations 1(c): 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 FASB-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) 5⁷ 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 5⁸ 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:

Disclosure organization views/perspective – 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.

SEC Recommendation: Consider adding the following additional language to paragraph 69c:

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.

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.

SEC Recommendation:

- 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:
If the component entity is aware of significant changes in information occurring from the end of the disclosure organization's reporting period, such changes 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.

SEC Recommendation: 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.

SEC Recommendation: 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 5⁹ 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.

U.S. Department of Labor

Office of Inspector General
Washington, D.C. 20210



JUL -3 2013

Wendy M. Payne
Executive Director
Federal Accounting Standards Advisory Board
441 G Street, NW, Suite 6814 (Mailstop 6k17V)
Washington, DC 20548

Dear Ms. Payne:

On behalf of the Office of Audit, Office of Inspector General, Department of Labor, enclosed are our responses to questions posed in the exposure draft titled "Reporting Entity."

If you have any questions or need additional information, please contact Joseph L. Donovan, Jr., Audit Director, Financial Statement Audits, at 202-693-5248.

Sincerely,

A handwritten signature in black ink that reads "Elliot P. Lewis". The signature is written in a cursive, flowing style.

Elliot P. Lewis
Assistant Inspector General for Audit

Enclosure

**Department of Labor
Office of Inspector General
Office of Audit**

Exposure Draft: Reporting Entity

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:

We agree with each of the inclusion principles.

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

We agree that the inclusion principles and related definitions and indicators are helpful and clear.

- 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.

We agree that an organization not meeting one of the inclusion indicators should none the less be included if it would be misleading to exclude it. This is necessary to ensure the full viability of this standard, as every situation cannot be anticipated.

- 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.

We agree that the inclusion principles can be applied to all organizations.

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.

We agree with the concept of distinguishing between consolidation entities and disclosure organizations. Not all entities should be considered part of the federal government entity itself, but there is a significant enough relationship to the federal government that at least there should be disclosure of information of such entity.

- 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.

We generally agree with the attributes in determining the difference between consolidating entities and disclosure organizations. However, we do not believe that whether or not an entity provides goods or services on a non-market basis should be a deciding factor—individually or aggregated with other factors.

- 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.

We do not have any additional attributes to add to those already enumerated in the draft standard.

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),
- ii. the objectives for disclosures (see par. 72), and
- iii. the examples provided (see par. 73)?

Please provide the rationale for your answers.

We agree with i. through iii., above.

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.

We agree that each component reporting entity should report on all organizations for which it is responsible in order for the component reporting entity's financial reporting to be complete.

In reference to paragraph 59, if an entity is disclosed in more than one component entity's GPFFR or a consolidation entity has a relationship with other reporting entities, such other entities and their relationship should be disclosed in each applicable component entity's GPFFR.

- 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.

We agree that administrative assignments can be identified as proposed in the exposure draft detail.

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.

We agree that each entity determined to be a component entity should be included in its entirety. An entity should not be split in terms of reporting, it is either a component entity or it is not.

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.

We agree that any the consolidation entities should be consolidated without conversion of FASB-based information to a FASAB basis. We agree with the Board's discussion that to do so could cause confusion due to differing amounts presented, but also could raise questions about the appropriateness of the entity's method of accounting.

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.

We agree with the minimum disclosures for the central banking system.

- 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.

See answer to Q12.a.

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.

We agree with the related parties definition and requirements.

- 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.

We agree with the list of the types of organizations.

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

We identified no additional related organizations.

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

We agree with the list of exclusions.

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

We identified no additional exclusions.

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.

We agree with the conforming changes.

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.

We agree with the proposed effective date.

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?

The appendices would be very helpful in the application of the proposed standard.

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

Yes, the appendices should remain as a part of the issued Statement.

- 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.

We identified not additional changes or additions to the examples.

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.

None.

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.

We believe the alternative view includes a number of valid points; however, we believe these can be addressed by the standard establishing a minimum level of disaggregation and disclosure of information for such entities. We do concur with the majority view that such entities should be included in the GPFFR. The proposed standard allows latitude as to presentation for disclosure entities and whether and how disclosure entities should be aggregated or reported separately (paragraphs 70 through 73 of the proposed standard, and A45 of Appendix A). Perhaps two broad classes of disclosure entities could be defined with the requirement for separate reporting and minimum level of disclosure in the GPFFR. This may help address the concerns raised in the alternative view, which we share.

- 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.

A separate standard on interventions may be appropriate for other purposes; however, the standard on the reporting entity should provide complete guidance on determining what constitutes the reporting entity and stand on its own.



HONORABLE JOHN D. BATES
Director

ADMINISTRATIVE OFFICE OF THE
UNITED STATES COURTS

CHARLES S. GLENN
Controller
Accounting and Financial
Systems Division

JILL C. SAYENGA
Deputy Director

WASHINGTON, D.C. 20544

Office of Finance and Budget

July 3, 2013

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

Dear Ms. Payne:

The Administrative Office of the U.S. Courts has reviewed the exposure draft of the proposed revision to the Statement of Federal Financial Accounting Standards (SFFAS), entitled Reporting Entity, dated April 3, 2013. In several places the Federal Accounting Standards Advisory Board (FASAB) exposure draft proposes that the Judicial Branch should be included in the government-wide General Purpose Federal Financial Report (GPFFR) and required to submit financial statements prepared using FASAB standards. We strongly disagree.

The exposure draft represents a laudatory effort by the FASAB to further full reporting on the federal government's budget. However, there are valid, substantial, and vitally important reasons why the Judiciary has not been included in the GPFFR. Like the Legislative Branch, the Judiciary's financial operations and structure are based on different statutory authorities than the Executive Branch, and consistent with these authorities, the Judiciary has developed its own policies and processes for financial management and accountability. The Judiciary has established accounting and financial reporting systems based on these policies and processes, and the Judiciary prepares financial reports in accordance with an Other Comprehensive Basis of Accounting.

Furthermore, the GPFFR was created specifically for the particular business operations of the Executive Branch. Attempting to apply the GPFFR to the Judiciary would be a nearly impossible undertaking due to the significant differences between the

Ms. Wendy Panye

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branches. The proposed standard identifies the Judiciary for inclusion in the government-wide GPFFR under the (in the Budget) inclusion principle. When considering the concept of "misleading to exclude," the Judiciary continues to represent an immaterial line in the Budget. Therefore, excluding the Judiciary from the GPFFR would not result in a material misstatement of the GPFFR.

In conclusion, the required additional budgetary resources needed to convert the Judiciary's existing accounting and financial reporting structure to comply with FASAB standards would result in substantial costs with no material benefit to the primary intended users of the GPFFR. We therefore ask that the Judiciary be excluded from the proposal.

Sincerely,

A handwritten signature in black ink, appearing to read "C. S. Glenn", with a stylized flourish at the end.

Charles S. Glenn
Controller

GSA comments on SFFAS Exposure Draft - Reporting Entity 07-03-2013

Name of Respondent: Erik Dorman

Organization: General Services Administration

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.

Response: *GSA agrees that Federal agencies should include information in their financial statements so that readers of the financial statements are not misled. However, it seems this ED is addressing symptoms of much larger government wide epidemic. The government continues to expand its financial reach and control outside of federal entities. We need to focus on a cure for the "disease" instead of adding band aids to the symptoms.*

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

Response: *GSA does not think the inclusion principles, definitions and indicators are completely clear. Please clarify how Public Private Partnerships fit.*

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.

Response: *This concept is too vague. Please provide examples of something that might be misleading to exclude even though it does not meet one of the three inclusion principles.*

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.**

Response: No, see comments above.

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.

Response: GSA agrees with the concept of distinguishing between consolidation entities and disclosure organizations. However, in practice, GSA is not sure how well this will work.

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.

Response: The attributes seem appropriate.

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.

Response: No comments

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),
- ii. the objectives for disclosures (see par. 72), and
- iii. the examples provided (see par. 73)?

Please provide the rationale for your answers.

Response: *The guidelines regarding factors in determining disclosures seem rather subjective. GSA does agree with the objectives of disclosure and thinks the examples provided are useful in this instance. However, Part 73.b.i, the amount that best represents the federal government's maximum exposure to gain or loss with the disclosure organization remains a significant concern, in keeping with the other comments provided in response to Question 1 above. It is just unknown how maximum exposure could be quantified without some rules defining what the true limits to liability are.*

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.**

Response: *GSA agree that each component reporting entity should report in its GPFFR organizations for which it is accountable, so as to not mislead readers of financial statements.*

- 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.**

Response: *GSA agrees. The guidelines seem appropriate.*

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.

Response: *GSA understands the rationale for consolidating financial information for all entities/organizations, even when sources such as donations are involved. However, this will probably be very burdensome because:*

- 1. This financial information will need to be obtained, and some organizations may not agree with the Federal agency on inclusion;*
- 2. Reporting periods may not be the same; and*
- 3. Reporting criteria and breakouts may not be similar.*

These relationships should be reviewed and it may be determined to bring many of these organizations into the Federal agency.

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.

Response: *No, it will be very difficult to combine financial statements unless reporting is based on same guidelines.*

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.**

Response: *Per the notes already provided above, GSA see no justification for applying the rules differently just because the Federal Reserve System is the only entity of its kind, especially given the magnitude of its banking operations and the need for transparency. GSA agrees if the minimum disclosures for the central banking system are in addition to the disclosures required of other reporting entities.*

- 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.**

Response: *No comments.*

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.**

Response: *GSA agrees that the definition as stated is sufficiently comprehensive and justifiable.*

- 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.**

Response: *GSA agree that the list is sufficient, so long as it is a representative sample list and not all inclusive.*

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

Response: *No comments.*

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

Response: GSA does not agree that it is necessary to provide exclusions for Part 84, Sections' (d), (e), and (f) especially for special interest groups. The guidance indicates that significant influence is the power to participate in the policy decisions of an entity, but not control those policies. The guidance goes on to state that regulation or economic dependency, together with other factors, may give rise to significant influence and therefore a related party relationship. Most importantly, the guidance states that judgment is required in assessing the impact of regulation and economic dependence on a relationship. It is believed that there may indeed be instances where foreign governments and special interest groups meet the definitions as provided herein in certain relationships. The power to disclose such related party information should not be taken from the disclosing entity under any general exclusion principle.

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

Response: See comment above.

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.

Response: It is agreed that conforming changes to the 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 are necessary for the reasons stated.

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.

Response: GSA agree that the effective date, which is well over two years from now, should give reporting entities sufficient time to prepare for these new guidelines and requirements.

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?

Response: *The appendices provide some useful insight into application of the guidelines, but there are some inconsistencies in the examples, in the Commentator's opinion (see comments in Question 11 below). The guidelines serve to demonstrate how truly subjective this reporting requirement is, and how it can be anticipated that inconsistencies in application will be the norm for reporting disclosure organizations.*

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

Response: *GSA agrees that the appendices should remain as useful insight into application of the guidelines, but only after the examples goes through another review by independent parties to insure their consistency.*

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.

Response: *See comments on 10a. above.*

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.

Response: *No comments*

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.**

Response: *GSA disagrees with the alternate view. It is pointed out that Mr. Steinburg's position is that the organizations in question were established in the private sector and they carry out activities not intended to be performed by the federal government, and that equating them with other disclosure organizations could be viewed as a broadening of the reach of the federal government into the private sector. GSA not only believes that equating these bailout entities with other disclosure organizations could be viewed as a broadening of the reach of the federal government, but that is in fact exactly what happened. It is not a view - it is a fact. The real question is how such dramatic interference into operations of the private sector could ever possibly be legal. When the government owns something, it is part of the federal government by definition. There is no avoidance of that fact.*

- 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.**

Response: *GSA sees no problem with disclosing the information as a separate standard as long as it is fully disclosed and is fully accounted for as part of the assets and liabilities of the Federal government. More important to the subject at hand would be how to fully disclose the government's current and future potential liabilities in these areas.*



Greater Washington Society of CPAs and GWSCPA Educational Foundation

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July 3, 2013

Wendy Payne, Executive Director
Federal Accounting Standards Advisory Board
Mail Stop 6K17V
441 G Street, NW – Suite 6814
Washington, DC 20548

Dear Ms. Payne:

The Greater Washington Society of Certified Public Accountants (GWSCPA) Federal Issues and Standards Committee (FISC) appreciates the opportunity to provide comments on the Federal Accounting Standards Advisory Board's (FASAB) Exposure Draft (ED) on the proposed Statement of Federal Financial Accounting Standards (SFFAS), *Reporting Entity*.

The GWSCPA consists of approximately 3,300 members, and the FISC includes 27 GWSCPA members who are active in accounting and auditing in the Federal sector. This comment letter represents the consensus comments of our members. Our response to the ED questions follow.

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.

- b. Do you believe the inclusion principles, and the related definitions and indicators, are helpful and clear? Please provide the rationale for your answer.
 - 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.
 - 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.
- A1. The FISC agrees with the three inclusion principles listed in the ED, but suggests that the second and third inclusion principles be expanded to indicate that relationship must be other than temporary in nature between the federal government and the organization when the ownership interest or risk of loss or expectation of benefit principles are met. Therefore, we suggest that the second and third inclusion principles be modified to state:
- An organization in which the federal government holds a majority ownership interest, *and the federal government's majority ownership interest is other than temporary in nature.*
 - An organization that is controlled by the federal government with risk of loss or expectation of benefit, *and the federal government's control of the organization is other than temporary in nature.*

In instances in which the relationship is temporary in nature, we suggest that the federal government's relationship with the federal government's ownership interest and/or estimated risk of loss or expectation of benefit as of the balance sheet date be disclosed in the notes to the financial statements in the GPFFR.

The FISC agrees that the inclusion principles should be applied to the entities identified in the Board's question for comment.

- 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.
- 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.
- 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.
- 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),
 - ii. the objectives for disclosures (see par. 72), and
 - iii. the examples provided (see par. 73)?

Please provide the rationale for your answers.

- A2. The FISC agrees with the concepts of consolidation and disclosure entities, and the attributes used to make the distinction between these types of entities. However, we suggest that the Board include a criterion in the determination of the consolidation entities that the organization's relationship with the federal government is other than temporary in nature. Therefore, we suggest that a 5th criterion be added for consolidation entities that states, "(5) connected to the federal government in an other than temporary nature."

In addition, we suggest that the Board consider allowing the preparer community with additional time or an alternative forum to consider the effects on component agencies' GPFFRs and the government-wide GPFFR. The ED could be interpreted to require entities not currently envisioned within today's view of the Federal Government's reporting entity to be required as a consolidation or disclosure entity, such as the Government of the District of Columbia. (The Government of the District of Columbia is included in the Budget and receives funding through Congressional appropriations other than federal financial assistance (criterion 1), and the U.S. Congress exercises control through legislative review of key laws

passed by the City Council (criterion 3)). There are additional entities that are named in the U.S. Budget that we do not believe are currently considered part of the Federal reporting entity, such as the U.S. Virgin Islands, Puerto Rico, Guam, American Samoa, several major universities that hold Federal charters and are included in the U.S. Budget (such as Gallaudet University and Howard University), along with numerous “friends of” entities of U.S. National Service Parks and other units. In addition, would the scenario of a state bankruptcy – an unlikely event but not unheard of in discussions of the past five years – cause the entire state government to be included if the government-wide and/or a component agency GPFFR (e.g., the Department of Treasury’s GPFFR) since the Federal Government would potentially have administrative control with risk of loss (criterion 3)? The FISC suggests that additional time to consider the potential implications of this ED, in its final form, would be worthwhile to prevent unintended reporting impacts when implementation is required.

Finally, we suggest that the Board remove the requirement in paragraph 66 that requires FASB-based organizations to disclose intragovernmental amounts measured in accordance with federal financial accounting standards. Such a requirement for disclosure in the FASB-based organization’s GPFFR does not appear to meet the requirement for general-purpose reporting since the disclosure is needed solely to facilitate elimination entries in the preparation of the government-wide financial statements. In addition, reporting in accordance with two bases of GAAP (i.e., FASB and FASAB) may lead to unnecessary confusion among the users of the FASB-based organization’s financial statements. Such intragovernmental information could continue to be reported to the U.S. Department of Treasury through the Closing Package process.

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.

- 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.
- A3. The FISC generally agrees with the proposed standards and paragraphs related to the identification and inclusion of administrative entities in the GPFFR. However, we suggest that:
1. The evaluation of administrative assignments include a criterion that the administrative assignment has been made on an other than temporary basis.
 2. The ED further defines the circumstances or framework in which the “misleading to include” or “misleading to exclude” situations would occur, as has been suggested by certain Board members in paragraph A28. More information from the Board would be important to allow preparers to form an objective basis of opinion to support the position that an entity would be “misleading to include” or “misleading to exclude.”
- 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.

- A4. The FISC agrees with the inclusion of all funding sources for all consolidation entities, but we suggest that the definition of consolidation entities include a requirement that the relationship between the organization and the federal government be other than temporary in nature.
- 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.

- A5. The FISC generally agrees that the consolidation of FASAB and FASB-based information without conversion for consolidation entities is appropriate. We suggest that the Board:

1. Include guidance on the conversion or consolidation of GASB-based information. There could be circumstances in which a consolidation entity could be a state-controlled organization, and the ED does not address the circumstances of what a GASB-based organization should do to comply with this Standard.
 2. Add additional information in the ED on the Board's views on methods for consolidation of FASB entities into FASAB-based general purpose financial reports, such as whether the equity, cost, or acquisition consolidation method is preferred, and how an agency should handle consolidation of entities with year-ends other than September 30.
- 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.
 - 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.
- A6. The FISC agrees with the proposed standards included in paragraph 77.
- 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.

- 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.
 - c. Are there additional organizations that generally should be considered related parties? Please provide the rationale for your answer.
 - d. Do you agree or disagree with the list of exclusions? Please provide the rationale for your answer.
 - e. Are there additional exclusions that should be considered? Please provide the rationale for your answer.
- A7. The FISC generally agrees with the definition of related parties found in paragraphs 78-87. However, we suggest that additional guidance be provided to address whether a related party exists when a federal board or commission (such as many of the entities named under the Accountability of Tax Dollars Act of 2002) has members of its board of directors or commissioners who maintain employment outside of the Federal government, and then the federal board or commission issues a contract or grant with the company, state, university, or charitable organization that is represented by the board member or commissioner. Given the guidance in the ED, the member of the board or commissioner has significant influence since the individual has the “power to participate in policy decisions of an entity” (paragraph 80). However, the board member or commissioner likely doesn’t have the ability to direct a specific grant or contract to create a less-than-arms-length transaction between the federal board or commission and the individual’s company, state, university, or charitable organization.
- Further, the definition of a related party appears to differ from the FASB’s definition of related parties. For example, the ED differs from FASB literature in the discussions of arms-length transactions, and how arms-length transactions with related parties impact the reporting of those relationships in the entity’s GPFFR. If differences exist in the two definitions, then the consolidation of reporting entities with FASB-based information may be complicated if two definitions of related parties are applied.
- 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.
- A8. The FISC agrees with the conforming changes to SFFAC 2.
- 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.

A9. The FISC suggests that the Board take an iterative step before full implementation of this ED. This Standard has the potential for some far-reaching consequences that may not be envisioned in deliberations during this limited comment period. We suggest that the Board consider an expanded comment period for implementation challenges, and/or allow the preparer community additional time to consider whether the consequences of this ED may result in unintended legal or political challenges.

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

A10. The FISC agrees with the appendices included the ED.

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.

A11. Please see our responses to questions 2 & 7.

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.
 - 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.
- A12. The FISC agrees with the Board Member’s alternative view. Receiverships, conservatorships, and interventions are less than temporary in nature, and information related to the federal government’s role in these organizations should be disclosed separately from the financial information included for disclosure organizations in the notes to the financial statements of the GPFFRs. We suggest that the disclosures for receiverships, conservatorships, and interventions be limited to the risk of loss or expectation of benefit associated with the federal government’s temporary role in those organizations. We agree with the Board Member that presenting all of the financial information for receiverships, conservatorships, and interventions would give a false impression to the readers of the GPFFRs of the federal government’s size and financial position.

This comment letter was reviewed by the members of FISC, and represents the consensus views of our members.

Very truly yours,



Andrew C. Lewis
FISC Chair

Comments to FASAB Reporting Entity due 7.3.2013

According to the *Financial Audit: U.S. Government's Fiscal Years 2012 and 2011 Consolidated Financial Statements*:

The Government's fundamental mission is derived from the Constitution: "...to form a more perfect union, establish justice, insure domestic tranquility, provide for the common defense, promote the general welfare and secure the blessings of liberty to ourselves and our posterity." The Congress authorizes and agencies implement programs as missions and initiatives evolve over time in pursuit of key public services and objectives, such as providing for national defense, promoting affordable health care, fostering income security, boosting agricultural productivity, providing veteran benefits and services, facilitating commerce, supporting housing and the transportation systems, protecting the environment, contributing to the security of energy resources, and helping States provide education.

There are 24 Chief Financial Officer Act agencies:

1. *Department of Agriculture*
2. *Department of Commerce*
3. *Department of Defense*
4. *Department of Education*
5. *Department of Energy*
6. *Department of Health and Human Services*
7. *Department of Homeland Security*
8. *Department of Housing and Urban Development*
9. *Department of the Interior*
10. *Department of Justice*
11. *Department of Labor*
12. *Department of State*
13. *Department of Transportation*
14. *Department of the Treasury*
15. *Department of Veterans Affairs*
16. *Environmental Protection Agency*
17. *General Services Administration*
18. *National Aeronautics and Space Administration*
19. *National Science Foundation*
20. *Office of Personnel Management*
21. *Small Business Administration*
22. *Social Security Administration*
23. *U.S. Agency for International Development*
24. *U.S. Nuclear Regulatory Commission*

There are 11 *Additional Significant Entities*:

1. *Export-Import Bank of the United States*
2. *Farm Credit System Insurance Corporation*
3. *Federal Communications Commission*
4. *Federal Deposit Insurance Corporation*
5. *National Credit Union Administration*
6. *Pension Benefit Guaranty Corporation*
7. *Railroad Retirement Board*
8. *Securities and Exchange Commission*
9. *Smithsonian Institution*
10. *Tennessee Valley Authority*
11. *U.S. Postal Service*

There are 115 Additional Entities/Funds:

1. *Abraham Lincoln Bicentennial Commission (no longer active)*
2. *Administrative Conference of the United States*
3. *Advisory Council on Historic Preservation*
4. *African Development Foundation*
5. *American Battle Monuments Commission*
6. *Antitrust Modernization Commission (no longer active)*
7. *Appalachian Regional Commission*
8. *Architect of the Capitol*
9. *Architectural and Transportation Barriers Compliance Board*
10. *Armed Forces Retirement Home*
11. *Barry Goldwater Scholarship and Excellence in Education Foundation*
12. *Broadcasting Board of Governors*
13. *Bureau of Consumer Financial Protection*
14. *Central Intelligence Agency*
15. *Chemical Safety Hazard Investigation Board*
16. *Christopher Columbus Fellowship Foundation*
17. *Commission for the Preservation of America's Heritage Abroad*
18. *Commission of Fine Arts*
19. *Commission on Civil Rights*
20. *Commission on International Religious Freedom*
21. *Commission on Security and Cooperation in Europe*
22. *Commission on Weapons of Mass Destruction (no longer active)*
23. *Committee for Purchase from People Who Are Blind or Severely Disabled*
24. *Commodity Futures Trading Commission*
25. *Congressional Budget Office*
26. *Congressional-Executive Commission on the People's Republic of China*
27. *Consumer Product Safety Commission*
28. *Corporation for National and Community Service*
29. *Council of the Inspectors General on Integrity and Efficiency*
30. *Court of Appeals for Veterans Claims*
31. *Court Services and Offender Supervision Agency for DC*

32. *DC Courts*
33. *DC Courts–Defender Services*
34. *Defense Nuclear Facilities Safety Board*
35. *Delta Regional Authority*
36. *Denali Commission*
37. *Dwight D. Eisenhower Memorial Commission*
38. *Eisenhower Exchange Fellowship Program*
39. *Election Assistance Commission*
40. *Environmental Dispute Resolution Fund*
41. *Equal Employment Opportunity Commission*
42. *Executive Office of the President*
43. *Farm Credit Administration*
44. *Federal Election Commission*
45. *Federal Financial Institutions Examination Council Appraisal Subcommittee*
46. *Federal Housing Finance Agency*
47. *Federal Labor Relations Authority*
48. *Federal Maritime Commission*
49. *Federal Mediation and Conciliation Service*
50. *Federal Mine Safety and Health Review Commission*
51. *Federal Trade Commission*
52. *Financial Crisis Inquiry Commission (no longer active)*
53. *Foreign Military Sales Program*
54. *Government Accountability Office*
55. *Government Printing Office*
56. *Harry S. Truman Scholarship Trust Fund*
57. *Indian Law and Order Commission*
58. *Institute of American Indian and Alaska Native Culture and Arts Development*
59. *Institute of Museum and Library Services*
60. *Interagency Council on the Homeless*
61. *Inter-American Foundation*
62. *International Trade Commission*
63. *James Madison Memorial Fellowship Foundation*
64. *Japan-United States Friendship Commission*
65. *John C. Stennis Center*
66. *John F. Kennedy Center for the Performing Arts*
67. *Library of Congress*
68. *Marine Mammal Commission*
69. *Medicaid and Children’s Health Insurance Program Payment and Access Commission*
70. *Medicare Payment Advisory Commission*
71. *Merit Systems Protection Board*
72. *Millennium Challenge Corporation*
73. *Morris K. Udall Scholarship Foundation*
74. *National Archives and Records Administration*

- 75. *National Capital Planning Commission*
- 76. *National Commission on Libraries and Information Science (no longer active)*
- 77. *National Council on Disability*
- 78. *National Endowment for the Arts*
- 79. *National Endowment for the Humanities*
- 80. *National Gallery of Art*
- 81. *National Labor Relations Board*
- 82. *National Mediation Board*
- 83. *National Railroad Retirement Investment Trust*
- 84. *National Transportation Safety Board*
- 85. *Neighborhood Reinvestment Corporation*
- 86. *Northern Border Regional Commission*
- 87. *Nuclear Waste Technical Review Board*
- 88. *Occupational Safety and Health Review Commission*
- 89. *Office of Compliance*
- 90. *Office of Government Ethics*
- 91. *Office of Navajo and Hopi Indian Relocation*
- 92. *Office of Special Counsel*
- 93. *Office of the Director of National Intelligence*
- 94. *Office of the Federal Coordination for Alaska Natural Gas Transportation Projects*
- 95. *Office of the Nuclear Waste Negotiator (no longer active)*
- 96. *Open World Leadership Center*
- 97. *Overseas Private Investment Corporation*
- 98. *Patient Centered Outcomes Research Trust Fund*
- 99. *Peace Corps*
- 100. *Presidio Trust*
- 101. *Public Defender Service*
- 102. *Ronald Reagan Centennial Commission*
- 103. *Recovery Act Accountability and Transparency Board*
- 104. *Selective Service System*
- 105. *Senate Preservation Fund*
- 106. *St. Lawrence Seaway Development Corporation*
- 107. *State Justice Institute*
- 108. *U.S. Capital Preservation Commission*
- 109. *U.S. China Security Review Commission*
- 110. *U.S. Holocaust Memorial Museum*
- 111. *U.S. Institute of Peace*
- 112. *U.S. Trade and Development Agency*
- 113. *Vietnam Education Foundation*
- 114. *White House Commission on the National Moment of Remembrance (no longer active)*
- 115. *Woodrow Wilson International Center for Scholars*

The report states:

Legislative and Judicial Branches

There are no legal or other requirements for the legislative or judicial branches to prepare consolidated audited financial statements or to provide accrual-based accounting data for inclusion in the Government-wide financial statements. Therefore, these consolidated statements do not include accrual-based accounting data for such entities as the U.S. Courts or the Congress. Some legislative branch entities voluntarily prepare and submit such information (e.g., Government Accountability Office, Government Printing Office, and Library of Congress). The President's Budget includes cash-based outlay data for the legislative and judicial branches and, to a limited extent, this outlay data is also a part of the information contained in this report.

The report states:

Entities Excluded from These Statements

The following entities are not part of the Government-wide reporting entity based on an assessment of these entities in accordance with the indicative criteria stated in SFFAC No. 2, Entity and Display. However, this list is not all inclusive of all entities excluded from these statements.

Those 13 entities are:

1. American International Group (AIG)
2. Board of Governors of the Federal Reserve System (Including the Federal Reserve Banks)
3. Citigroup
4. Federal Home Loan Banks
5. Federal Home Loan Mortgage Corporation (Freddie Mac)
6. Federal National Mortgage Association (Fannie Mae)
7. Thrift Savings Fund
8. The Financing Corporation
9. GMAC Financial (Ally Financial)
10. National Railroad Passenger Corporation (does business as Amtrak)
11. Public-Private Investment Funds
12. Resolution Funding Corporation
13. Student Loan Marketing Association

We believe the Citizens have the Constitutional right for full disclosure, even incorporated companies and non-profit corporations and other consultants who act as government agencies with oaths required. They are de-facto agencies.

The National Security Agency has blossomed into a worldwide contracting agency, yet the Public did not have a clue as to their use of funding on behalf of the Federal Government.

We now have privatized space exploration in a similar path.

The Executive Branch operates without consent, and those entities who execute those orders, also need to be disclosed.

Without full financial disclosure, we cannot achieve our general welfare, blessings of liberty now and for future generations and are overall freedom.

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| QUESTION 1 |
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Q1. The Board is proposing three inclusion principles for an organization to be included in the government-wide GPFFR:

- 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

a. Do you agree or disagree with each of the inclusion principles?

Please provide the rationale for your answer.

b. Do you believe the inclusion principles, and the related definitions and indicators, are helpful and clear?

Please provide the rationale for your answer.

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.

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.

Comment:

We agree with each of the inclusion principles.

The principle:

- *An organization in which the federal government holds a majority ownership interest*

may need further explanation. Public Private Partnerships may be formed. How is that defined under this principle? Are Memorandums of Understanding MOUs included as ownership interest as participation is a controlling interest factor.

The principle:

- *An organization that is controlled by the federal government with risk of loss or expectation of benefit*

Are Memorandums of Understanding MOUs included in this category?

Do you consider non-profit organizations requiring Federal approval for that tax-exempt status as being controlled by the federal government and approve the Mission Statement?

We are trying to ascertain the use of the non-profit corporation as a substitute for a government agency. Would the non-profit substitute be misleading because of the dependence of tax funding to operate that government-substituted function?

We believe the Inclusion Principles should apply all organizations. The People deserve to know who their representatives are, and through these organizations, that representation is masked.

The People must be able to petition their government, and these financial mazes make it extremely difficult.

QUESTION 2

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.

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.

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.

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),**
- ii. the objectives for disclosures (see par. 72), and**
- iii. the examples provided (see par. 73)?**

Please provide the rationale for your answers.

[Comment:](#)

[As you have stated:](#)

Materiality is an overarching consideration in financial reporting

How are you approaching a Non-Profit Corporation acting as a Program Manager on a project partially funded by Federal funds?

Who determines the definition limited funding from general tax revenues?

If Disclosure Entities are privately owned, what are the liability tests?

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| QUESTION 3 |
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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.

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.

[Comment:](#)

Under

*56. Administrative assignments to component reporting entities are typically made in laws and policy documents such as statutes, budget documents, regulations, or strategic plans. Administrative assignments can be identified by evaluating:*24

24 Component reporting entities should develop processes to ensure they identify and assess any organizations
(1) within the scope of their budget process,
(2) for which accountability is established within their component reporting entity,
or
(3) which are misleading to exclude. It is anticipated that central agencies will determine if there is a need for coordinated guidance to ensure government-wide consistency.

a. Scope of the Budget Process

b. Accountability Established Within a Component Reporting Entity

c. Misleading to Exclude and/or Misleading to Include.

Regulations are a major part of the Government as our Strategic Plans. The entities governed by regulations are controlled by Federal government agencies. Under what category do you distinguish this relationship?

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| QUESTION 4 |
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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.

Comment:

Consolidation is preferable. From a Public perspective, private fundraising on a government entity, whether component or disclosed.

We are seeing a trend to produce non-tax-exempt income on entities where decision making is controlled by the government.

Protection of assets is an issue not addressed. Collections and other valuable assets need to be disclosed to the Public.

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| QUESTION 5 |
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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

[Comment:](#)

It should be noted that no conversion took place. At a point in time, you may wish to analyze if this decision is the proper one.

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| QUESTION 6 |
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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.

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.

Comment:

Central Banking system aka Federal Reserve System FRS is too critical a factor in government, not to include it in consolidation.

Since the system is regional, all regions of the FRS should be disclosed. The aspect of Cash holdings need to be addressed, as this entity prints its own money. Uncirculated cash needs to be included as should any physical assets such as gold.

The offsetting entity needs full disclosure under Comments or Footnotes.

The Public needs to grasp the liability aspect of the Federal Reserve System and its investments in foreign and/or offshore banking and the terms of any relationship.

All risk should be disclosed.

Accountability has been lacking and that aspect of Representation needs to be addressed.

Space is being privatized. With that, the industry should be analyzed for inclusion. Future assets in the area of mining inventories need inclusion in this process as well as the risks and liabilities.

The Judicial Branch should never be excluded, yet it does not operate in disclosure.

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| QUESTION 7 |
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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.

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.

c. Are there additional organizations that generally should be considered related parties?

Please provide the rationale for your answer.

d. Do you agree or disagree with the list of exclusions?

Please provide the rationale for your answer.

e. Are there additional exclusions that should be considered?

Please provide the rationale for your answer.

[Comment:](#)

[You state:](#)

A83. Because of the extent of the federal government's relationships – whether already established or implied – “related parties” concepts may result in numerous relationships requiring disclosure.

Therefore, the Board proposes disclosure of related party relationships of such significance to the reporting entity that it would be misleading to exclude information about them.

For clarity of intent, the standards rely heavily on listing parties to be included and excluded. In addition, the proposal provides room for judgment because one cannot anticipate all types of relationships the federal government may have or might have in the future that should be reported.

The related parties category is needed to provide for disclosure of those organizations that are not included under the inclusion principles but where there is an existing relationship of such significance that it would be misleading to exclude.

As related parties become complex, so does disclosure. We, the public, need to understand these relationships, financially and operatively.

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| QUESTION 8 |
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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.

[Comment:](#)

[You state:](#)

89. Paragraph 2 is replaced with the following paragraph which describes the amended purpose and contents of the Statement.

The purpose of this statement is to establish concepts regarding what would be encompassed by a Federal Government entity's financial report. The statement specifies the types of entities for which there should be financial reports (hereinafter called "reporting entities"), establishes an organizational perspective for considering the makeup of each type of reporting entity, identifies types of financial reports for communicating the information for each type of reporting entity, suggests the types of information each type of report would convey, and identifies the process and factors the Board may consider in determining whether information should be basic information, required supplementary information (RSI), or other accompanying information (OAI).

We are not clear if all entities involved would be Reporting Entities. They should be. The Federal Register is a notification to the public on Notices, Proposed Rules and Final Rules. One assumes that this is notification of how the government works with an opportunity for the public to comment. Without the full encompassing of the process, government becomes hidden or a "Black Government." "Black Government" definitely fits into the misleading category.

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| QUESTION 9 |
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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.

[Comment:](#)

No, it should be sooner. Political campaigns years should not be influential in these decisions. The year 2016 is a Presidential Election Year.

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| QUESTION 10 |
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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?

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

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.

[Comment:](#)

Yes, keep them in. The Board members are industry related, but the accountability is to the Public.

Visual tools help as does color.

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| QUESTION 10 |
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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.

[Comment:](#)

The Judicial Branch is to hidden from the Public and it is part of the three-armed governance. They must be included.

Memorandums of Understanding should be addressed. It becomes a form of government outside representation and that signature may only need the approval of an agency head, not a legislative approval.

Yes, they may involve Local and State Government Agencies and Non-Profit Corporation hybrids.

Public-Private Partnerships are formed to avoid public disclosure and oversight when it is time to rein the secrecy.

Joyce Dillard
P.O. Box 31377
Los Angeles, CA 90031

From: Karczewski, Stanley - OCFO
Sent: Thursday, July 04, 2013 9:34 AM
To: FASAB
Cc: Simpson, Cynthia - OCFO
Subject: Comments on Exposure Draft, Statement of Federal Financial Accounting Standards, "Reporting Entity"

Attached please find comments from the U.S. Department of Labor (DOL), Office of the Chief Financial Officer (OCFO), on the exposure draft of proposed Statement of Federal Financial Accounting Standards, "Reporting Entity." DOL/OCFO has no comments on questions 1, 2, 4—8, 10, and 12; however, we have comments on questions 3, 9, and 11.

Thank you for the opportunity to provide comments. If there are any questions, please contact Cynthia Simpson at simpson.cynthia@dol.gov or 202-693-6807.

Regards,

Stan Karczewski
Office of the Chief Financial Officer
U.S. Department of Labor

**U.S. Department of Labor
Office of the Chief Financial Officer
Comments on Exposure Draft,
Statement of Federal Financial Accounting Standards,
“Reporting Entity”**

Below please find comments from the U.S. Department of Labor (DOL), Office of the Chief Financial Officer (OCFO), on the exposure draft of proposed Statement of Federal Financial Accounting Standards, “Reporting Entity.” DOL/OCFO had no comments on questions 1, 2, 4—8, 10, and 12; however, we had comments on questions 3, 9, and 11.

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.**
- 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.**

DOL/OCFO comments on question 3: With regard to paragraph 62, we disagree that an organization may be excluded from the component entity’s consolidation as long as it is consolidated in another component entity or directly in the government-wide reporting entity. We believe that the decision on whether or not to consolidate an organization in the component entity should depend on the interpretation of the accounting standard and should not depend on the financial reporting of another component entity or on the financial reporting of the government-wide reporting entity. Therefore, we believe that the following phrase in the last sentence of paragraph 62 should be deleted: “. . . so long as it is consolidated in another component reporting entity or directly in the government-wide reporting entity.”

In the exposure draft, we are not aware of any disclosure requirements for “misleading to include” in the consolidation; we believe that a brief disclosure may improve the reader’s understanding of the financial statements.

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.

DOL/OCFO comments on question 9: With regard to paragraph 102, we have no comments on the effective date. However, because coordination may be required between component entities and between the government-wide entity and component entities to implement this accounting standard, we believe that encouraging earlier implementation may make coordination more difficult and that reporting entities may be better served by a date certain for implementation.

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.

DOL/OCFO comments on question 11: We believe that if FASAB proposes no conversion from FASB to FASAB information for those amounts to be consolidated, then there should also be no conversion from FASB to FASAB information for those amounts to be disclosed.

DOL/OCFO believes that there are entities currently consolidated in the Financial Report of the U.S. Government for which the U.S. Government is not responsible for obligations of this entity under current law. For example, the FY 2012 Financial Report of the U.S. Government states, “PBGC insures pension benefits for participants in covered defined benefit pension plans. As a wholly-owned corporation of the U.S. Government, PBGC’s financial activity and balances are included in the consolidated financial statements of the U.S. Government. However, under current law, PBGC’s liabilities may be paid only from PBGC’s assets and not from the General Fund of the Treasury or assets of the Government in general.” (FY 2012 Financial Report of the U.S. Government, Note 18, page 105) We do not believe that the exposure draft addresses this unique situation with regard to consolidation entities. In paragraph A71, the second sentence states, “. . . liabilities not fully guaranteed by the federal government might be added to federal liabilities. Instead, financial balances and amounts for organizations having the characteristics of disclosure organizations should be kept separate from balances and amounts for those organizations having the characteristics of consolidation entities to prevent distortions to the consolidated financial statements.” The wording in paragraph A71 for disclosure organizations may imply that consolidation entities would have liabilities that would be fully guaranteed by the Federal government.

DOL/OCFO believes that the relationship between this exposure draft and SFFAS 31, “Accounting for Fiduciary Activities,” is unclear. Please describe the relationships between the fiduciary activities and the reporting entity from the government-wide entity and component entity perspective.

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.

We agree the inclusion principles adequately encompass the characteristics of most organizations that should be included in the government-wide GPFFR based upon their financial, organizational, and operational impact on the federal government. We agree with each of the inclusion principles. Two of the three principles relate to majority ownership and control, which are concepts commonly applied in the public sector to define the reporting entity. The third concept, budget inclusion, is a reasonable test since the US Budget approval passes through Congress and the President, which implies some level of government involvement with the entity and should be considered.

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

We believe the inclusion principles, and the related definitions and indicators, are helpful and clear. The definitions promote a thorough understanding of each concept, while the indicators serve as examples to further assist the practitioner in the determination process.

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.

We agree 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. Generically

speaking, the objective of financial reporting is to provide stakeholders with information that is useful in the decision-making process. Therefore, it is reasonable to conclude that misleading financial reports would hamper that objective.

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 governmentwide GPFFR? Please provide the rationale for your answer.

We agree the inclusion principles can be applied to all entities and should be.

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 nonexchange 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.

We agree distinguishing between consolidation entities and disclosure organizations enhances the usefulness of the financial reports as stated in Paragraph 67, and enables the GPFFR of the reporting entity to more accurately reflect relevant information that faithfully represents the financial position and organizational structure of the entity. There should be a distinction between the reporting of consolidation entities and disclosure organizations. The underlying tests to define organizations in this manner are designed to assess the level of financial and operational autonomy an organization

holds. The reporting entity is held to a higher standard of reporting on organizations with greater operational and financial dependency upon it (consolidation) than those with less dependency (disclosure).

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.

We agree with the attributes used to make the distinction between consolidation entities and disclosure organizations because the principles applied are consistent with those used in the public sector for determining such treatment, and can, and should also, be applied to entities that have a relationship with 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.

We agree there is adequate guidance in order to determine disclosure versus consolidation entities.

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),

We agree both qualitative and quantitative factors should be considered in determining whether information regarding a disclosure should be presented separately due to its significance, or aggregated with the information regarding other disclosure organizations. This concept is widely applied in the commercial sector and is a logical way to present information with varying levels of significance to the organization

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

We agree the disclosure objectives in paragraph 72 provide the reader the appropriate type of information to assess the potential current/future impact the disclosure organization has/could have on the reporting entity.

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

We agree the examples included in paragraph 73 adequately assist the reader in understanding the specific types of information necessary to meet the disclosure objectives in paragraph 72.

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.

We agree 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. The underlying principles provided for this are consistent with those outlined for the principles for inclusion in the government-wide GPFFR (e.g., budget inclusion, majority ownership, control, and misleading to exclude). This will ensure the financial statements present a complete picture of the entity.

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.

We agree administrative assignments can be adequately determined by evaluating (1) the scope of the budget process, (2) accountability established within a component reporting entity, and (3) whether it is misleading to exclude/ include in the GPFFR. Paragraphs 54-63 define these in detail and, as noted in the previous response, the concepts are consistent with the principles of inclusion. However, it will be beneficial if FASAB considers providing a concise definition of an administrative assignment.

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.

We agree all reporting entities should consolidate all organizations for which they are accountable; no matter what the funding source is (this should all be disclosed too).

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.

We disagree; it is not appropriate to consolidate FASAB- and FASB-based information without conversion for consolidation entities. Consolidating amounts without regard for differences that may result from the differing accounting standards being used by the reporting entity and the consolidation entity may result in inconsistency in financial reporting. The proposed standards should include guidance related to material differences between FASB and FASAB accounting standards.

- Situations may occur in which different accounting standards are applied to different entities, which could lead to possible presentation and disclosure conflicts when they are consolidated.
- The use of different accounting standards reduces the confidence users and prepares have in the qualitative characteristics of the financial reports specifically consistency, comparability, reliability, and understandability.
- Situations may arise in which there is a high opportunity cost to convert all financial statements and reports from FASB to FASAB and the cost outweighs the potential benefit. In these situations, the entity should evaluate the material impact of various accounting differences between the two standards and convert only those that would significantly change or could significantly change the presentation of the financial reports and the decision making of stakeholders and users.

The board should consider the inclusion of principles discussing the requirements and guidance related to consolidation concerns when evaluating differences between FASB and FASAB. This could significantly mitigate costs of interpretation, provide clarity on the subject matter for preparers of a GPFFR, and enhance the usefulness of financial reports for users and stakeholders.

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.

We disagree; the central banking system should be required to report disclosures that provide for complete disclosure of their activities. Due to the unique nature of the central banking system, maybe additional guidance should be issued by the board to address specifically all of the central banking system's unique accounting and operations. The statement does not provide sufficient minimum disclosure requirements for the central banking system and the board should consider providing the additional disclosure requirements referenced below.

- Paragraph 77, item b should include an assessment of meeting the objectives of federal and monetary policy. Item b requires the Federal Reserve System to disclose significant roles and responsibilities and how they relate to federal objectives, which is important, but incomplete. Financial reports are useful when they possess comparability and relevance to the user. As a result, it is important that not only the objectives are linked to the roles and responsibilities, but that an assessment is provided of those objectives (similar to a balanced scorecard).
- Paragraph 77, item c should include actions such as open market operations, reserve requirements, adjustments to the fed funds rate, specific financial services provided to the federal government, and investments in specific financial instruments used by the Federal Reserve System (e.g. swaps, asset backed

securities, collateralized debt and mortgage obligations, interest rate derivatives, commodities, real assets, etc.) in which significant positions are taken.

- Paragraph 77, item d should also include significant transactions and balances within the fiscal period that would impact the decision making of stakeholders and GPFFR users.
- The Federal Reserve System should disclose transactions and relationships with foreign governments and financial institutions as well as significant holdings (currencies, debt, treasury securities, ownership interests, etc.) that could be materially useful to a user of the GPFFR.

The current minimum disclosures do not encompass these disclosures requirements, which should be articulated to a greater degree in order to ensure that the government-wide GPFFR is reliable and the information presented is verifiable, and completely and faithfully represents what it purports to represent. The Federal Reserve System is a unique organization; therefore, the board should emphasize transparency in Federal Reserve System disclosures. The board should also consider developing a single statement devoted to the central banking system.

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.

We believe the board should consider providing minimum disclosures for the following organizations:

- Federally Funded Research and Development Centers;
- Venture capital projects; and
- Government sponsored enterprises such as the Federal Agricultural Mortgage Corporation, Federal National Mortgage Corporation, and Federal Home Loan Mortgage Corporation due to their impact on political, monetary, and fiscal policy objectives, and the federal government.

The statement should require similar disclosures to the Federal Reserve System such as the roles and responsibilities of the organization, how it is accomplishing specified objectives and an assessment of meeting those objectives, nature of the research, development, or venture, sources and uses of funds, significant transactions, and governance structure. The government-wide GPFFR should provide transparency and accountability for the activities financed by taxpayers and non-exchange revenue as well as organizations that have a significant impact on policy making. In turn, this will provide users and stakeholders with sufficient information for decision making purposes.

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.

We believe the definition and requirements set forth in sections 79 and 87, respectively, provide an adequate understanding of what constitutes a related party and the appropriate information for the reader to understand the nature and extent of the relationship.

The definitions and requirements provided for related parties provide sufficient guidance that enable preparers and auditors of financial reports to assess an organization's relationship to the federal government and whether it should be included and disclosed in the GPFFR.

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.

We agree that the list of the types of organizations that generally would be considered related parties, while limited, is adequate. Determining whether a related party exists requires professional judgment and the application of a number of tests/principles to reach the appropriate conclusions, which cannot necessarily be anticipated and/or defined by a particular type of organization.

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

We believe the board should also consider the influence of those listed below when considering related parties:

- Free trade agreements
- Customs unions
- Common markets
- United Nations
- Foreign financial institutions

Each of these organizations could possess significant influence due to their relationships with the federal government, its organizations, and non-profit or private sector organizations that impact the federal government.

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

We agree with the list of exclusions because it is either explicit or implicit that the transactions do not meet the principles of inclusion or do not meet the related party definition.

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

We do not believe there are additional exclusions needed.

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.

We agree the conforming changes to SFFAC 2 relating to rescissions and additions based on the explanations provided in paragraphs 88-101. Rescissions appear to be justified based on the explanations provided in the Exposure Draft. There are two newly added paragraphs, the first of which relates the financial reporting objective of accountability to that of the reporting entity, and the second of which (containing subparagraphs 53A-53E) provides a more detailed distinction between consolidation entities and disclosure organizations.

The remaining changes described are either amendments or replacements. The document does not specify what was replaced and/or why it was replaced. We would recommend that the document specify this information to provide the reader with FASAB's rationale for the proposed change.

FASAB should consider providing more specific guidance related to the material differences before rescinding paragraph 78.

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.

We agree the effective date gives entities adequate time to implement the new standard.

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?

We agree Appendix B (Flowchart) is helpful in the application of the proposed standards as it provides a simplified depiction of the process, including decision trees, to enable the user to easily understand the thought process that applies to determining the appropriate composition of the reporting entity.

We agree Appendix C (Illustration) is helpful in the application of the proposed standards because it provides detailed scenarios for control, ownership, budget inclusion and related parties, which serve to deepen the reader's understanding of the concepts presented in the standard.

Although Appendix A was not referenced in this question, we believe this appendix is helpful in the application of the proposed standards as it provides the reader with FASAB's rationale for each proposed action in the standard.

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

We believe the appendices should remain after the Statement is issued for the reasons stated in Q10a.

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.

We do not believe there are any additional changes or examples needed.

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.

We believe an exception statement should also be added for the applicability to certain entities if application of this standard will be detrimental to national security.

- The proposed guidance does not include information pertaining to the disclosure of the consolidation policy in the GPFFR. It would be helpful to the user to understand the policy implemented to by each consolidating entity. The consolidation process will differ from organization to organization; therefore, providing stakeholders with information pertaining to the policies and methodologies employed could significantly enhance the users understanding of the financial reports.
- The proposed guidance does not discuss differences in fiscal periods between the consolidating entity and the component entity. There are instances in which the fiscal periods may differ for some entities; therefore, the board should

consider including guidance related to consolidating an entity with a fiscal period different than that of the consolidation entity. For example, a component entity may be required to prepare a set of financial statements for a period that corresponds with or closely approaches the fiscal period of the consolidation entity.

- Presentation guidance for consolidating and/or combining financial statements is not provided in the statement. The board should consider the possible conflicts and interpretation differences among preparers and auditors of GPFFRs that could arise due to limited guidance between combining and consolidating and the process of presenting information in a uniform manner for users.
- The statement does not discuss principles and guidance related to combinations. Instances could arise in which a combination of ownerships or non-controlling interests is employed by the preparer. The board should address differences in consolidation and combinations of organizations in the financial statements and the disclosures, and the appropriate presentation that may not be provided in SFFAC No. 2 or SFFAS No. 34.
- Deconsolidation principles and guidance are not provided in the statement (the reporting entity deconsolidating a consolidation entity as of the date the reporting entity no longer has majority ownership, exposure to significant benefits or losses, contractual agreement expires, etc.) Presentation requirements for deconsolidations are also not provided in the statement. The board should provide principles and guidance related to these matters since they are possible situations that may occur.
- Majority ownership does not necessarily ascertain that an organization should be included as a consolidation entity or disclosure organization. The board should consider adding a paragraph to the statement providing guidance on a majority-owned entity that does not rest with the majority owner. For example, FAS 160/ABS 51, regarding subsidiaries and parent reporting entities, states that “a majority-owned entity shall not be consolidated if control does not rest with the majority owner if the entity is in legal reorganization or in bankruptcy or operates under foreign exchange restrictions, controls, or other governmentally imposed uncertainties so severe that they cast doubt on the parent’s ability to control the entity.” Similar scenarios and situations should be considered when evaluating the majority ownership of an organization from the perspective of the federal government because there are possible situations which may arise that prohibit the Federal Government from having control of the consolidated or disclosed entity.
- A consolidating entity’s interest as the majority owner may change as a result of legal, regulatory, or financial difficulties, the consolidation entity may issue additional stock, which could alter the majority ownership position, purchase

and/or sell ownership interests, and change a contractual agreement, which provides control over an entity.

- The combination of several non-controlling interests could result in a potential risk, loss, or expected benefit to the federal government and could be more impactful than a majority ownership. The board should consider the impact of combining non-controlling interests and the way this information should be presented and disclosed.

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.

We agree 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. If these types of entities have a material relationship with the federal government, they should be disclosed, but there needs to be criteria developed to distinguish the reporting requirements for these types of entities versus true disclosure entities per this standard. The proposed standards should establish specific terminology in order to refer to disclosure entities that are part of the federal government and disclosure entities that are not part of the federal government. The current definition and proposed language for disclosure entities could create unnecessary confusion regarding the type of relationship between a disclosed entity and the federal government, and between a receivership, intervention, or conservatorship (RIC) and the federal government. Disclosure organizations are categorized in the statement as (1) receiving limited or no funding from general tax revenues, (2) having less direct involvement, and influence, by the Congress and/or the President, (3) imposing limited risks and rewards on the federal government, and/or (4) are more likely to provide goods and services on a market basis. These requirements as well as those mentioned throughout the statement do not align with RICs due to

- the unique nature of their relationships with the federal government;
- the government's exposure to significant loss or benefit;
- the characteristics of RICs in relation to those of a typical disclosure organization; and
- the high degree of influence by Congress and/or the President.

The board should consider differentiating between organizations required to be disclosed and a disclosure entity. RICs should be disclosed in the financial reports; however, based upon the statement they do not meet the qualification of disclosures organizations (i.e. an organization being disclosed does not necessary mean it's a disclosure organization). As a result, the board should consider developing separate distinctions and principles for RICs in order to segregate the characteristics and nature of disclose organizations from RICs.

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.

We agree a separate standard should be developed to capture and address all of the unique aspects of these types of entities. Guidance for all interventions should be presented in a single Statement of Federal Financial Accounting Standard in order to adequately discuss all situations and concerns that may arise related to interventions. The brief guidance provided in this proposed Statement of Federal Financial Accounting

Standard does not capture all aspect of interventions; therefore, in order to effectively guide preparers on this subject matter a single standard should be established.

Section: PRINCIPLES FOR INCLUSION IN THE GOVERNMENT-WIDE GPFFR**1. Page 14, Line 21**

Suggestion: Recommend removing footnote 10 and including this verbiage directly in line 21.

Rational: Provide more clarity without requiring the reader to refer to footnotes, similar to verbiage in line 24 on page 15.

Section: SITUATION WHERE CONTROL DOES NOT EXIST**2. Page 17, Line 32**

Suggestion: (U) A blanket statement that control does not exist when the organization is economically dependent upon the federal government is unrealistic to a reasonable person; (i.e., the "power of the purse") the presumption should be that there is an ability to influence/control the behaviors of the recipients even when not specifically called out in an agreement -- though it might not be true in all cases and reasonable judgment would be required.

Section: RECEIVERSHIPS AND CONSERATORSHIPS**3. Page 21, Line 49**

Suggestion: The Basis for Conclusions related to receiverships and conservatorships appears to provide a judgmental conclusion on how to report these organizations, which is not consistent with terminology reflected in the body of the exposure draft.

Rational: Line 49 indicates that "Organizations controlled or owned through receiverships or conservatorships are likely to be disclosure organizations." However, in Appendix A, line A48, the basis for conclusion indicates "... such controlled or owned organizations would be disclosure organizations...."

Sections: RECEIVERSHIPS AND CONSERVATORSHIPS & FEDERAL GOVERNMENT INTERVENTION ACTIONS RESULTING IN CONTROL OR OWNERSHIP**4. Page 21, Lines 49-53**

Suggestion: Segregating receiverships and conservatorships separately from other Federal Government Intervention Actions Resulting in Control or Ownership may not be necessary. Information included in lines 50-53 could be applied to receiverships and conservatorships to conclude on disclosure requirements.

Rational: Note 20 indicates the difference between the two is that receivership and conservatorship activities are considered part of the mission of the federal reporting entity. However, agencies such as TARP were established with the mission to temporarily oversee/assist financial institutions back to safe and sound conditions as part of an economic intervention activity, similar to FHFA's mission to temporarily assist Fannie Mae/Freddie Mac (referred to as receiverships and conservatorships).

Section: SCOPE OF BUDGET PROCESS**5. Page 23, Line 58.b**

Suggestion: Recommend editing - b. inclusion in an organization's published organization chart -- may be an indicator but not necessarily evidence of a particular type of relationship; there is no substance to that particular criteria upon which to base a decision.

Section: ACCOUNTABILITY ESTABLISHED WITHIN A COMPONENT REPORTING ENTITY**6. Page 24, Line 60**

Suggestion: Line 60 appears to have an error. Instead of: "If a disclosure organization has not been administratively assigned to a consolidation entity...." should it state: "If a disclosure organization has not been administratively assigned to a component reporting entity...."

Rationale: Section 58-60 refers to accountability for component reporting entities.

Section: GPFFR CONSOLIDATION AND DISCLOSURE**7. Page 26, Page 66**

Suggestion: Disagree that consolidation of FASAB and FASB based information without conversion for consolidation entities is appropriate. Recommend that the reporting entity convert any consolidation entity balances to either the FASB or FASAB standards used by the reporting entity.

Rationale: While this provision in line 66 may have been included to address cost/benefit concerns, two of the six qualitative characteristics for developing accounting standards discussed in SFFAC No. 1 and SFFAC No. 4 are consistency and comparability. Consolidating balances from two or more organizations without regard to FASAB and FASB differences does not represent consistent application of accounting principles in a GPFFR.

8. Page 26, Line 66

Suggestion: Disagree that any component reporting entity that publishes financial reports pursuant to FASB standards should be required to disclose intragovernmental amounts measured in accordance with FASAB standards to facilitate elimination entries for the government-wide financial statements

Rationale: Federal reporting components that use FASB standards are already required by Treasury to prepare GFRS (closing package) financial statements which presents the necessary converted intragovernmental elimination information required for the government-wide financial statements. This additional disclosure may be confusing and/or not useful to the reporting entity's wider GPFFR audience.

Section: DISCLOSURE REQUIREMENTS**9. Page 28, Lines 72.c, 73.e, 73.i, 73.j**

Suggestion: Disagree that disclosures should include the objective of providing a description of future exposures. Recommend considering future exposure information as part of the risk assumed project (Required Supplementary Information).

Rationale: The disclosures (footnotes) are part of the audited financial statements. It may be difficult for reporting entities to make such determinations and defend them during the audit process as this information may be judgmental and/or speculative in nature.

Section: MINIMUM DISCLOSURES REGARDING THE CENTRAL BANKING SYSTEM**10. Page 30, Line 77**

Suggestion: Minimum Disclosures regarding the Central Banking System -- should include significant types of transactions and balances related to exchanges between the central banking system and foreign entities.



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July 8, 2013

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

Dear Ms. Payne:

On behalf of the Association of Government Accountants (AGA), the Financial Management Standards Board (FMSB) appreciates the opportunity to provide comments to the Federal Accounting Standards Advisory Board (FASAB) on its April 3, 2013 exposure draft entitled Reporting Entity. This exposure draft proposes principles to guide preparers of financial statements in determining what organizations should be included in the reporting entity's general purpose federal financial reports (GPFFR).

The FMSB is comprised of 25 members (list attached) with accounting and auditing backgrounds in federal, state and local government, as well as academia and public accounting. The FMSB reviews and responds to proposed standards and regulations of interest to AGA members. Local AGA chapters and individual members are also encouraged to comment separately.

The FMSB agrees with the position of the FASAB as expressed in the exposure draft and supports the principle based approach proposed by the FASAB to determine what entities properly belong in a GPFFR and what entities do not. We find that the approach proposed by the FASAB aligns with the approach adopted by GASB and view this as a positive development. The exposure draft provides important clarification on the issues that must be considered when making professional judgments of what does and does not belong within the federal entity. When finalized it should provide preparers and auditor's with the guidance necessary to make the necessary decisions regarding what belongs in the federal entity.

We do have some questions regarding the exposure draft and also some items that we believe could be clarified. In addition we have a suggestion regarding how information for disclosure organizations should be handled. Our comments follow on from this section. We then provide answers to the questions posed in the exposure draft.

Comments Regarding the Executive Summary Section

We believe the language in the second paragraph of the Executive Summary should be clarified to make it clear to the reader that when the FASAB is discussing

the matter of including organizations in the GPFFR, such inclusion could be as either a consolidating entity or a disclosure organization, dependent upon other considerations. This would help to join the first part of the determination with the second part of the determination. We also believe that the Executive Summary would be strengthened if it emphasized the intended temporary nature of a financial relationship as a key factor for determining if an entity is to be considered for consolidation or simply disclosure.

Comments Regarding the Body of the Exposure Draft

We believe that the body of the exposure draft is well organized and sufficiently detailed to provide guidance regarding the federal entity. Following are some concerns we had as a result of our committee's review.

Paragraph 25 – Part of the definition of the phrase “control with risk of loss or expectation of benefit” uses the phrase “... with the potential to be obligated to provide financial support or assume financial obligations or obtain financial resources or non-financial benefits.” We believe that FASAB needs to provide better guidance in this part to assist the preparer and the auditor. The word “potential” has a fairly broad meaning and guidance should be provided on this matter. Would the preparer and auditor be expected to apply the same standards it might apply when measuring a contingency or do they expect a lesser standard of measurement to be used. We believe that this should be clarified.

Paragraphs 27 and 28 – These paragraphs discuss issues of control and that control can be indicated by the federal government's authority to determine or influence the policies governing activities. A concern discussed by members of the FMSB is that these paragraphs might justify the inclusion of information from certain states and/or localities in the GPFFR. Although, we believe that it is not the FASAB's intent to include either a state or locality's financial information in the GPFFR, clarity would be improved if this matter were addressed either directly or through a footnote.

Paragraph 31- The paragraph provides additional indicators of control that may exist and must be considered in the aggregate when reaching a decision as to whether an entity is or is not to be included in the GPFFR. Although we find parts of this paragraph useful we are also concerned that it may serve to confuse matters. When reviewing the list, we were able to identify many key indicators that might be associated with various federal programs that exist today, such as for Small Business Loan guarantees. While we do not believe it is the intent of the FASAB to include entities that received such guarantees as a result of a routine federal program within the federal entity, this paragraph may lead to this debate. We recommend the FASAB add additional language to this paragraph to clarify matters on this issue.

Paragraph 32 – This paragraph appears designed to reinforce the concept that regulatory control and economic dependency alone should not be the sole or dual factors that influence a decision to include an entity within the GPFFR. If this is its intent, we would suggest a more direct statement on this matter as the term inferred is often confused with the term implied.

Paragraphs 35 and 36 – We believe these paragraphs should be expanded to provide additional guidance for the preparer and the auditor on the meaning of the terms “Misleading to Exclude”. While we recognize that this matter will certainly require the exercise of professional judgment, it should be expanded to note that the preparer and auditor shall have to consider both quantitative factors and/or qualitative factors in reaching this decision.

Paragraph 40 – This paragraph discusses the governance structure and that for consolidation entities the chain of command leads directly to elected officials. We suggest that the FASAB include a statement that

the judicial and legislative branches are included in the federal entity as stated in paragraph A13 of the Basis for Conclusions. This might avoid confusion regarding the chain of command issue to the user.

Paragraph 87 – Paragraph 87 provides guidance regarding what should be disclosed once the determination is made that an entity is considered a related party. We believe Part 87.b. should be expanded to include information that discusses the fiscal interdependency of the related party to the federal funds in addition to information on the risks to the federal government. What represents a small risk or exposure to the federal government will generally present a significant risk to the related party. Such potential impacts should be disclosed relevant to related parties.

Selected Terminology

In reviewing the exposure draft we believe that the FASAB needs to reconsider the terminology selected to describe disclosure organizations. In the exposure draft, the FASAB has chosen the terms “consolidation entities” and “disclosure organizations” to distinguish between those that will have their financial information integrated into the GPFFR and those that will instead be included in the notes to the GPFFR. We understand the need for such distinction but we are concerned the term “disclosure organization” will cause confusion on two fronts. The general term disclosure is associated with a wide variety of issues, yet as used in this exposure draft it is now associated with the accounting for a very specific purpose. Likewise, we see the term “organization” used in place of the word entity, when speaking about organizations whose financial information will not be shown on the face of the GPFFR. Is an organization the same as an entity, but just handled differently? This can cause confusion.

Reporting of Disclosure Organizations Financial Information

The FASAB has provided that the financial information for disclosure organizations should be disclosed on an individual basis to the reader. The exposure draft’s discussion, however, does not recognize the essential nature of the information available on such organizations. For example, information that can be presented in the form of a financial statement and is “essential to understanding the financial position and results of operations” of the organization should be presented in that form, while information that helps in understanding such information should be presented in note form. Therefore, would it not be preferable to include the financial statement information about such organizations in one or more combining statements, with notes structured, as appropriate, for each separately presented organizations? Structurally, this would be similar to how “discretely presented component units” are reported for state and local governments even to the point of presenting the consolidation of all “disclosure organizations” in a single column beside the sum of all of the “consolidation entities.” We think that such a presentation would be more readily understood by stakeholders than what might otherwise be a string of separate notes for each disclosure organizations. This would enhance the reader’s ability to understand the full financial impacts.

Comments on Alternative Views in the Basis for Conclusion Section

We have read the alternative views contained in paragraph A89 through A93 and we find the views presented by Mr. Steinberg regarding the case of receivership, conservatorships and interventions compelling. Although we are disappointed that the FASAB chose to omit these from the current project, we agree with Mr. Steinberg that these issues must be considered in the risk assumed project. In our letter of comments regarding the FMSB’s latest three year plan, we suggested these projects be combined or operated on parallel tracks as there are interrelated issues that must be considered.

Following are our answers to the questions posed by the FASAB.

Question 1

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

The FMSB agrees with the inclusion principles proposed by the FASAB. We agree that a principles based approach is superior to a rules based approach. This provides a longer lasting solution to the issues under consideration and aligns with the use of professional judgment. Regarding the three inclusion principles, we find that the three principles align well with the GASB principles.

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

We believe that the inclusion principles and the related definitions are helpful and clear. In our response we have offered some areas where we believe improvements can be made. However the definitions and indicators are clear and understandable.

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.

Yes, we agree that an organization should be included in the GPFFR if it would be misleading to exclude it. This provides a safe haven for significant exceptions to the principles should they arise. However, as stated in our comments, we believe additional guidance should be included in the final document.

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 governmentwide GPFFR? Please provide the rationale for your answer.

The FMSB agrees that the inclusion principles can be applied for such determinations.

Question 2

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

The FMSB agrees with this approach. The FMSB agrees that beyond the factors of being in the budget and majority owned by the federal government, control is the principal factor that must be considered in determining if an entity is classified as a consolidating entity or a disclosing organization. The principle behind the consolidated presentation is one of control.

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.

The FMSB agrees with the attributes used to make the distinction between consolidating entities and disclosing organizations. However we have concerns about some of the "Indicators" in the exposure draft that will be used for deciding if an organization is to be consolidated or disclosed. As stated in our comments above, we believe that some of the indicators in paragraph 31 are too wide ranging and can be

applied to organizations not within the federal entity. We suggest these be clearly labeled as some form of lesser indicator for the preparer and auditor to consider in reaching their conclusion.

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.

The FMSB agrees with the FASAB on this matter. The attributes are generally sound and can be applied to reach a reasonable conclusion.

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),
- ii. the objectives for disclosures (see par. 72), and
- iii. the examples provided (see par. 73)?

The FMSB agrees with the factors to be considered in making judgments about the extent of appropriate disclosures, the objectives for the disclosure and the examples provided. In particular, we believe the issue of future loss exposures is especially significant and we applaud the FASAB for requiring this information in 73.i.

Question 3

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.

The FMSB agrees with the position of the FASAB. The FMSB believes providing a comprehensive GPFFR at every level is important and is consistent with the overall goal of the federal entity exposure draft.

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

The FMSB agrees that administrative assignments can be identified as provided for in paragraphs 54 – 63. The important factor in this process is the decision to consolidate or disclose. The rationale provided in paragraph 59 a. and 59.b. provide a sound basis for making a decision.

Question 4

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.

The FMSB agrees that if the decision to consolidate is made, it is in an all-inclusive manner. The basis for consolidation versus disclosure will hinge for the most part upon the issue of control. As such if control is considered sufficient, all the financial results for the entity should be included. Providing only a partial view of the financial results benefits no one.

Question 5

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.

The FMSB agrees the consolidation of FASAB and FASB based information without conversion is appropriate. Restatement of FASB information to a FASAB basis will provide opportunities for errors to occur and may effectively require two sets of records. Furthermore the information based on FASB principles are used by management and should stay as originally prepared.

Question 6

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 FMSB agrees with the minimum disclosures for the central banking system. The importance of the central banking system warrants minimum disclosures. However we are puzzled by the FASAB's decision to not provide a definitive determination as to whether the FRS should or should not be considered within the federal entity and at what level.

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.

No.

Question 7

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

The FMSB has some concerns about the use of the term related parties in the exposure draft. Under GASB, state and local governments are required to disclose certain related party transactions and to recognize the transaction for its economic form rather than its legal form. Thus related party issues are linked to transactions. The FASAB approach is to call the entity a related party if one party has the ability to influence financial and operating decisions. It is not linked to any particular transaction. Thus the use of the term by FASAB seems inconsistent with the use of the term in other professional pronouncements and we urge the FASAB to utilize another term.

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.

The FMSB agrees with the list.

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

The FMSB has no additions to suggest at this time.

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

The FMSB has no comment.

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

The FMSB has no comment.

Question 8

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

The FMSB agrees with the conforming changes to SFFAC 2.

Question 9

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

The FMSB agrees with the effective date.

Question 10

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

The FMSB agrees that the appendices are useful in applying the proposed standards.

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

The FMSB believes the appendices should remain after the Statement is issued.

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.

The FMSB has no suggested changes.

We appreciate the opportunity to comment on this document and would be pleased to discuss this letter with you at your convenience. A majority of the FMSB members approved of the issuance of this letter of comments. If there are any questions regarding the comments in this letter, please contact Steven E. Sossei, CPA, and AGA's staff liaison for the FMSB, at ssossei@agacgfm.org or at (518) 522- 9968

Sincerely,

A handwritten signature in black ink, appearing to read 'E. Berman', with a long horizontal flourish extending to the right.

Eric S. Berman, CPA, Chair
AGA Financial Management Standards Board

cc: Evelyn A. Brown, CGFM-Retired
AGA National President

**Association of Government Accountants
Financial Management Standards Board**

July 2012 – June 2013

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Steven E. Sossei, Staff Liaison, AGA

Reporting Entity

Organization: National Science Board

Name of Respondent: Ann Bushmiller
Senior Counsel, National Science Board

Q.7. 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.

The National Science Board (NSB) fully supports the comments made by the National Science Foundation (NSF) on the subject of related parties. The NSB submits comments to highlight some specific points.

The federal government has numerous relationships with private sector and non-profit entities. NSB agrees with FASAB that it is appropriate to focus disclosure requirements only on those relationships of “such significance to the reporting entity that it would be misleading to exclude information about them.” Paragraph A83, Appendix A, and paragraph 78.

In paragraph 80, FASAB indicates that ‘significant influence’ may be exercised by representation on the board of directors or equivalent governing body of an entity. The NSB recommends that FASAB clarify the definition of ‘significant influence’ used in paragraphs 78 – 82 to make clear that Presidentially appointed or Congressionally confirmed individuals in collegial bodies that head agencies, and the institutions with which those individuals are affiliated, do not automatically have a related party relationship with that agency. The operation of the National Science Board is illustrative.

The National Science Foundation by law consists of the National Science Board and a Director. 42 U.S.C. § 1861. There are 24 members of the NSB; they are appointed by the President. Board members are eminent in the fields of basic science, medical science, social science, engineering, agriculture, education, research management and public affairs. The NSB establishes the policies of NSF within the framework of applicable national policies set forth by the President and Congress. In this capacity, the NSB acts both strategically, in that it identifies issues that are critical to NSF’s future and approves NSF’s strategic budget directions, and in certain instances it acts operationally, by approving major new programs plus specified kinds of large grants and awards. There are typically fewer than 15 NSB-approved awards per year.

NSB members may be affiliated with institutions such as universities where researchers are eligible to receive grants and awards from NSF. Individual NSF grant awards are made

pursuant to a peer-review based process within NSF and the vast majority are not reviewed by the NSB. The NSB only reviews proposed awards that are larger than a designated threshold or meet other specific criteria. Federal conflict of interest rules prohibit NSB members from participating in matters where they have a conflict of interest or there is an impartiality concern without prior authorization from the designated agency Ethics Official. Individual NSB members are not involved in the review or approval of any proposed grant awards to their affiliated institutions.

NSB is concerned that the reference in paragraph 80 that significant interest lies in the power to participate in policy decisions may be interpreted too broadly in circumstances where agencies are headed by collegial bodies. This definition should be narrowed to distinguish between 'strategic' (high-level strategy and future direction) policy decisions, and 'operational' policy decisions, that is, day-to-day or transactional level policies. Strategic policy decisions do not have a direct influence on financial transactions and operating decisions and should not be determinative of the existence of a related party relationship. The NSB's strategic policy decisions do not have a direct influence on the day-to-day or financial transactions of NSF. With regard to operational policy decisions, NSB members are regulated by government-wide conflict of interest rules designed to prevent federal employees from participating in matters where they have a conflict of interest or there is an impartiality concern.

The NSB fully supports FASAB's underlying goal of transparency in an agency's financial statements. As a matter of course, NSF and NSB include information in the NSF Financial Statements about the NSB's role in the Foundation and the total amount of grant awards that NSF made to NSB member-affiliated institutions in the reporting year. The yearly award totals from NSF to each member-affiliated institution are provided. In years when the NSB has approved a grant to a Board member-affiliated institution, that amount is provided as well. However, to assume a related party relationship between an NSB member and NSF, or between the NSB member's affiliated institution and NSF, would itself be misleading to the public. It could imply the existence of the factors in paragraph 86, such as the ability to cause the agency to enter in transactions on different terms or conditions than those available to unrelated parties (paragraph 86.c). As explained above, this is not the case with the NSB.

Thus, the NSB recommends clarification of the definition of 'significant influence' paragraphs 78 – 82 to make clear that Presidentially appointed or Congressionally confirmed individuals in collegial bodies that head agencies, and institutions with which those individuals are affiliated, do not automatically have a related party relationship with that agency. This appears to be the intent of paragraph 84.c, but for avoidance of doubt NSB and NSF recommend the changes below.

Paragraph 80 – The current reference to policy decisions should be narrowed to distinguish between "operational" (day-to-day, transactional level) and "strategic" (high level strategy and direction) policy decisions. As noted above, strategic policy decisions do not have a direct influence on financial transactions and operating decisions and should not be determinative of the existence of related party relationships. NSF suggests adding the language from paragraph 79 to the first sentence of paragraph 80 to clarify the intent: **"Significant influence (for the**

purpose of this Statement) is the power to participate in the financial and operating policy decisions of an entity, but not control those policies.”

Paragraph 84 – Paragraph 84.c indicates that “key executives of the federal government and organizations owned or managed by key executives, other employees of the federal government, or members of their families” should be excluded from the related party definition. NSF suggests that FASAB explicitly add **“Including Presidentially appointed agency board members”** to the list of exclusions. Alternatively, paragraph 84.b could be expanded to state **“This exclusion also applies to management and board members of institutions that jointly serve on the board of a federal agency. This occurrence does not automatically result in a related party relationship between the federal government and the individual or the federal government and the affiliated institution.”**

Furthermore, NSF requests that FASAB add the term “that may or may not” to paragraph 84.b as indicated below:

“Organizations with which the federal government transacts a significant volume of business that may or may not result in economic dependence such as....”

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.

NO NSB COMMENT

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

NO NSB COMMENT

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

As noted above, NSF suggests that FASAB explicitly add in 84.c **“Presidentially appointed agency board members”** to the list of exclusions. Alternatively, paragraph 84.b could be expanded to state **“This exclusion also applies to management and board members of institutions that jointly serve on the board of a federal agency. This occurrence does not result in a related party relationship between the federal government and the individual or the federal government and the affiliated institution.”**

NSB requests that FASAB add the term **“that may or may not”** to paragraph 84b as indicated below:

“Organizations with which the federal government transacts a significant volume of business that may or may not result in economic dependence such as....”

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

As noted in response Q.7.d above, NSB suggests that FASAB explicitly add “**presidentially appointed agency board members**” to the list of exclusions.

* * *

Q.10. 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?

NO NSB COMMENT

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

Yes – the illustrative scenarios in particular help the reader to understand FASAB's intended application of each definition.

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.

NSF, and presumably other agencies with Boards such as the Nuclear Regulatory Commission, Federal Communications Commission, Federal Retirement Thrift Investment Board, and the Corporation for National and Community Service, would benefit from a related party scenario involving agency Board members. The scenario should involve a federal agency with a board of directors that approves strategic and high level budget decisions. A board member with an administrative or professorial role at a collegial institution, or that serves in a management capacity at a not-for-profit organization should be included. The illustration should indicate that the agency does not have a related party relationship with the board member or the institution/organization with which the board member is affiliated.

From: christina.ho@fms.treas.gov [mailto:christina.ho@fms.treas.gov]

Sent: Friday, July 05, 2013 10:12 AM

To: Payne, Wendolyn M

Subject: Fw: Reporting Entity - FASAB Pronouncement Exposure Draft.docx

Hi Wendy,

See below for comments on the Reporting Entity exposure draft from the Bureau of the Fiscal Service.

Thank you for the opportunity to comment, and please let me know if you have any questions.

Christina

FASAB Pronouncement Exposure Draft
“Reporting Entity”

Purpose: To address what appears to be a gap in “reporting entity”, whereby certain entities that are managed by elected officials are not being captured in General Purpose Federal Financial Reports (GPFFR); the exposure draft guides agencies in determining what organizations should be included at the government-wide and reporting component unit levels

Factors to Consider: Agencies are guided by specific factors to determine the appropriateness of financial statement presentation and/or footnote disclosure, based notably on management and financial control and financing sources

Effective Date: Applies to periods beginning after September 30, 2016

Comment Due Date: July 3, 2013

Internal Review/Comment Due Date: June 14, 2013

Other specifically referenced accounting standards:

SFFAS 34 (The Hierarchy of GAAP)

SFFAC 2 (Entity and Display)

Questions for Respondents:

1. Three inclusion principles (President’s Budget; federal government – majority owner; controlled; government risk of loss or expected benefit): paragraphs 20-36
 - a. **Do you agree or disagree**
Agree – with each of the 3 inclusion principles
 - b. **Yes** – definitions/indicators are helpful and clear
 - c. **Agree** – include if it would be misleading to exclude, even if qualifying criteria to include are not met (*providing examples of instances where it would be “misleading to exclude” would be helpful in guiding applicable primary reporting entities*)
 - d. **Agree** – apply on the basis of the 3 inclusion criteria and misleading to exclude principle
2. Establishes criteria for inclusion in agency financial statements (consolidating) vs. footnote disclosure: paragraphs 37-53 and 64-77; A30-54; A71-81
 - a. **Agree** – different levels of Federal government responsibility/control should determine whether or not the entity would be consolidated with the primary agency or if a lesser role exists, it would be more appropriate to disclose the relationship and disclose the financial impact
 - b. **Agree** – The Federal government’s responsibility to fund and ability to exercise control over an agency with a risk of loss/opportunity to benefit are substantive criteria for consolidating, while a reduced role in determining the overall health of an organization would substantiate a disclosure of the relationship and the resulting financial impact

- c. Paragraph 45-48 attempt to address the specific nuances that call out these organizations
- d. Reasonableness of disclosures
 - i. **Disagree** – I don't understand why 'how the agency views its relationship with the government' should have a bearing on what gets disclosed
 - ii. **Agree** – includes the relevant factors that should be addressed for any related party disclosure
 - iii. **Agree** – represents all the relevant disclosure characteristics
- 3. Component reporting entity GPFFR consolidation entities and disclosure organizations: paragraphs 54-63; A55-61
 - a. **Agree** – if the criteria exists establishing a consolidation entity or disclosure organization, it should be included in the component reporting entity's financial statements
 - b. **Agree** – The referenced paragraphs focus heavily on what constitutes a consolidation entity and a disclosure organization
- 4. Consolidating entities: paragraphs 54-64: A19; **Agree** – Once an entity falls into the "consolidation entity" classification, all of its financial data should be reported accordingly
- 5. FASAB vs. FASB: paragraphs 65-66; A66-70; **Disagree** – although FASB is in compliance with GAAP, FASAB follows budgetary accounting reporting principles which do not apply to FASB; Without the reporting entity and organizational unit following the same accounting standards, USSGL propriety/budgetary tie points will not reconcile if the USSGL data for the tie points is derived from the consolidated trial balance which would be uploaded to FACTS I and II and/or GTAS for government-wide reporting; if the organization unit is not included in the FACTS I and II/GTAS trial balance, then how will the entity's data be reported government-wide?
In addition, the government-wide financial statements are reported on a FASAB basis; therefore, agencies need to convert to FASAB before reporting to the government-wide level.
- 6. Federal Reserve System – minimum disclosure requirements: paragraph 77; A30-37
 - a. **Agree** – The minimum disclosure requirements appropriately identify what, why, and the financial implications of the work performed within the federal banking system on behalf of the Federal government
 - b. **No** – I am not aware of other non-Federal entities that should receive unique consideration related to this exposure draft
- 7. Related Party considerations: paragraphs 78-87; A82-84
 - a. **Agree** – significant control should be the overriding factor for identifying a related party
 - b. **Agree** – the ability to manage or control activities is the driving factor for these two conditions
 - c. **No**
 - d. **Yes** – the exclusions do not represent factors related to control; (b) relates to concentrations of risk, (c) relates to family members but neither of these exemplifies control

- e. **No**
8. SFFAC #2 - Entity and Display: paragraphs 88-101; A85-88; **Agree** – the changes give proper consideration to the effects of implementing this exposure draft
 9. Effective date for implementation; paragraph 102; **Agree** – the proposed date gives agencies an opportunity for the Board to consider reviewer responses, to effect any changes, roll out the new standard and for agencies to assess the impact as a Reporting Entity. It also provides the opportunity for early implementation.
 10. Applying the proposed standards; Appendices B and C
 - a. **Agree** - Appendix B is a useful resource for organization considerations; Appendix C is useful in providing various examples.
 - b. **Yes**
 - c. **Yes** - The exposure draft does not provide clear guidance for the reporting entity's financial statement presentation when it involves a consolidating entity (i.e. Is columnar presentation recommended or required that specifically identifies consolidation entities?) Are any updates necessary for OMB Circular A-136 or was consideration given to directing the reader to A-136 for sample presentation formats?
 11. Other unique situations that should be addressed:
 - Should a reporting entity or the consolidating disclosure entity know or make known that another entity is consolidating or disclosing information about the agency to avoid more than one agency reporting/disclosing the same entity? (The standard does not appear to assist agencies in determining substantial control if control resides with more than one federal agency.)
 - How does Treasury intend to capture the information necessary to consolidate/disclose data without possibly duplicating consolidating reporting entity data that may be submitted by multiple federal agencies?
 12. Receiverships, conservatorships, and interventions; paragraphs 7, 13-14, 41, 49-53, 65, A1-2; A9-11, A20-23, A30-31, A44-54, A89-93; Appendix A
 - a. **Disagree** – One purpose of financial statement disclosure is to provide relevant information to assist the reader in interpreting unique relationships between federal entities and/or federal/non-federal entities and why/how those relationships were formed and the extent to which they exist; resulting receivables/payables and operating activities that exist between the entities should be appropriately disclosed
 - b. **Disagree** – I believe one standard focusing on the “Reporting Entity” is capable of addressing consolidating entities as well as disclosure organizations. Due to the short term nature of interventions, a separate standard could easily be disregarded by a reporting entity as it considers the impact of consolidation only, giving little or no consideration to interventions due to their infrequency of occurrence

NRC's comments are included in the attachment. Please contact me or Carl Fredericks if you have any questions.

Thanks.
Sincerely,

May Ma, Chief
Financial Reporting and Analysis Branch
Division of the Controller, OCFO
U. S. Nuclear Regulatory Commission (NRC)

Reporting Entity

Please submit to fasab@fasab.gov

Name of Respondent:

Organization: U.S. Nuclear Regulatory 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. **Agree with reporting/consolidation entities and ownership interest or control should be disclosure only.**
- b. Do you believe the inclusion principles, and the related definitions and indicators, are helpful and clear? Please provide the rationale for your answer. **Yes.**
- 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. **Yes, but only as a disclosure and not as a consolidation entity.**
- 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, as the Federal Reserve System is independent from control by the President and Congress.**

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.

1. Do you agree or disagree with the concept of distinguishing between consolidation entities and disclosure organizations? Please provide the rationale for your answer.
Agree
2. 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.
Agree.
1. 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, also need to include all 3 branches of the Federal government. The Judicial and Legislative branches should be included in the consolidated report. It should be stated that this standards applies to all 3 branches of the Federal government.
- d. Do you agree or disagree with: **Agree**
 - i. the factors to be considered in making judgments about the extent of appropriate disclosures (see par. 69),
 - ii. the objectives for disclosures (see par. 72), and
 - iii. the examples provided (see par. 73)?

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. **Agree, but also need to include the Judicial and Legislative branches of government in paragraph 57.**
- 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. **Agree.**

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. **Agree.**

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, there should be one consistent accounting basis for Federal accounting and reporting, which is FASAB.**

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. **Disagree as the Federal Reserve is independent. Disclosure if required should only include items a, e, and f. Disclosure information contained in items b, c, and d would be included in the Federal Reserve's reports.**
- 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. **Yes, if the Judicial and Legislative branches are not considered consolidating entities, then there should be disclosures pertaining to these entities and the fact that they receive appropriations funded from Federal tax revenue.**

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.**
- 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.**

- c. Are there additional organizations that generally should be considered related parties? Please provide the rationale for your answer. **Disclosures should also include business entities and key individuals residing outside the United States for the purposes of conducting international business.**
- d. Do you agree or disagree with the list of exclusions? Please provide the rationale for your answer. **Agree; educational institutions, state and local governments, and foreign governments should be excluded.**
- e. Are there additional exclusions that should be considered? Please provide the rationale for your answer. **No.**

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. **Agree.**

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.**

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**
- b. Do you believe the appendices should remain after the Statement is issued? **Disclosures should also include business entities and key individuals residing outside the United States for the purposes of conducting international business or for taxation.**
- 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. **Yes, include the Judicial and Legislative branches of government in paragraphs A38 – A41..**

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. **No.**

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. **Agree.**
- 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. **No, a separate standard does not seem necessary and exceptions should be included within the single standard.**



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July 15, 2013

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

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

Dear Ms. Payne,

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

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

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



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

Background

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

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

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

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

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



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

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

The Exposure Draft

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

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

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

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

⁴ Although pursuant to Section 109 of SOX, the SEC is required to determine annually that the FASB accounting support fee is within the parameters prescribed by Congress, the SEC does not have authority, and is not required, to approve the FASB budget.

⁵ The *Budget of the U.S. Government: Analytical Perspectives-Supplemental Materials* schedule entitled "Federal Programs by Agency and Account" (Schedule 32-1); referring to the FASB as the "Standard Setting Body" (Account 527-00-5377)).

⁶ It should be noted that notwithstanding the explicit statutory language providing that the accounting support fees do not constitute public monies or public funds, the OMB has determined that the FASB is subject to sequestration.

⁷ The Exposure Draft also provides guidance regarding the circumstances when consolidated financial statements would be appropriate for an organization in the GPFFRs ("consolidation entities"), or when disclosure would be appropriate ("disclosure organizations").



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

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

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

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

⁸ Although the Exposure Draft refers to inclusion in the Budget as a “principle,” it appears to us to be more in the nature of a rule, requiring an entity to be included in the GPFFR if it is in the Budget.

⁹ It seems anomalous to us that the FASB may not be entitled to rely on this exception (and therefore may be required to be included in the GPFFRs) precisely because it does not receive any form of federal financial assistance.

¹⁰ We assume that, even were the FASB to be included in the GPFFRs, it would not be deemed to be a consolidation entity. As the Exposure Draft states, “Consolidation is not appropriate for organizations operating with a high degree of autonomy. Some organizations that meet the principles for inclusion are insulated from political influence and intended to be non-taxpayer funded. Presenting information about these discrete organizations in consolidated financial statements would obscure the operating results and financial position of the reporting entity.” We also believe, though, that the FASB should not be considered to be a “disclosure organization,” on the basis that the absence of any governmental ownership, or any operational governmental



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

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

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

Very truly yours,

/s/ Jeffrey W. Rubin

Jeffrey W. Rubin

Vice President and General Counsel

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

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

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



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

July 15, 2013

BY ELECTRONIC MAIL

(fasab@fasab.gov)

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

RE: Statement of Federal Financial Accounting Standards Exposure Draft

Dear Ms. Payne:

Thank you for the opportunity to share with the Federal Accounting Standards Advisory Board the views of the Department of the Treasury with regard to the Statement of Federal Financial Accounting Standards Exposure Draft, *Reporting Entity*, dated April 3, 2013 (hereinafter referred to as the "ED"). We respectfully provide responses below to your questions regarding the ED, with additional commentary on the ED provided at the end of this document.

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.

AGENCY RESPONSE: Agree. While we generally agree with the concept of these inclusion principles, we believe the ownership and control principles described in paragraphs 23-28 should be expanded to indicate that the relationship must be other than temporary in nature between the federal government and the organization in order for an organization to be included in the GPFFR. Therefore, we suggest that the second and third inclusion principles be modified to state:

- An organization in which the federal government holds a majority ownership interest and the federal government's majority ownership interest is *other than temporary in nature*.
- An organization that is controlled by the federal government with risk of loss or expectation of benefit, and the federal government's control of the organization is *other than temporary in nature*.

Additionally, we do not believe that the "majority ownership interest" should be a separate principle, given that federal government entities generally do not hold majority ownership interests in other organizations. Though Treasury currently possesses a majority ownership interest with certain organizations as a result of federal interventions, such relationships are considered temporary in nature and therefore are not consolidated in Treasury's consolidated financial statements. Accordingly, we believe consideration should be given to deleting "majority ownership interest" as a separate principle and, instead, incorporating it as part of the "control with risk of loss or expectation of benefit" principle.

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

AGENCY RESPONSE: Yes. We believe the inclusion principles, and related definitions and indicators, are helpful and clear.

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.

AGENCY RESPONSE: Agree. We believe that an organization not meeting the criteria for inclusion based upon the three inclusion principles specified in paragraph 21 should still be considered for inclusion in the GPFFR if it would be misleading to exclude. Such inclusion, however, should be based on the premise that the organization is a related party (rather than a consolidation or disclosure entity) and therefore should be included as a footnote disclosure based on the disclosure requirements of a related party as discussed in paragraphs 78-87. As such, we recommend that paragraphs 35 and 36 be deleted. In the Appendix B: Flowchart, we further recommend deleting the "Misleading to Exclude" decision box located after the "Control" decision box and prior to the "Related Parties" decision box. (See Addendum A at the end of this document).

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.**

AGENCY RESPONSE: Agree. The examples in Appendix C demonstrate how the principles can be theoretically applied to various types of organizations such as the Federally Funded Research and Development Centers, Government Sponsored Enterprises, museums, and others.

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.

AGENCY RESPONSE: Agree. How an organization is included in an agency financial report (either as a "consolidation entity" or "disclosure entity") should be distinguished based upon the nature of the relationship and the characteristics as listed beginning with paragraph 37.

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.

AGENCY RESPONSE: Agree. We identified no additional attributes. However, we believe clarification is needed regarding paragraph 39 which states that "Organizations listed in the budget, except for non-federal organizations receiving federal assistance, are presumed to qualify as consolidation entities..." The phrase "presumed to qualify as consolidation entities" is very misleading, especially since there are a number of organizations, beyond those that are non-Federal entities receiving federal assistance, which are currently not consolidated within the government-wide financial report (FR). Specifically, organizations that are listed in the budget under the judicial or legislative branch are not consolidated nor are they required to be consolidated since they are

not subject to the periodic financial reporting requirements of Office of Management and Budget's Circular No. A-136, *Financial Reporting Requirements*. Currently, cash-related activity and balances of legislative and judicial branch organizations that are not consolidated within the FR are nevertheless included in the FR using receipt and outlay data from the central accounting system. This is necessary to account for the changes in government-wide cash balances that result from their operating activities. This accounting policy is disclosed in Note 1A of the FR. However, this current accounting and reporting practice differs significantly from the concept of consolidation of accounts which is "presumed" for all entities included in the budget, as proposed by this ED. If the ED is finalized as written without modifying current financial accounting and reporting practices for legislative and judicial branch organizations, the FR could receive an audit finding for not complying with the finalized accounting standard. It would seem that the only possible means for the FR to overcome such an audit finding without undergoing significant modifications to its current financial account and reporting practices would be to provide evidence that all account balances and related activity other than cash, both by individual entity and collectively for all legislative and judicial branch organizations, would not be material to the FR's consolidated financial statements. Such evidence may need to be provided on an annual basis. The Board should therefore consider whether the potentially significant burden of complying with this new requirement outweighs the intended benefits to be derived.

- 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.**

AGENCY RESPONSE: Agree. The attributes seem adequate to make a determination regarding the listed organizations and others that are similarly situated.

- 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),**
- ii. the objectives for disclosures (see par. 72), and**
- iii. the examples provided (see par. 73)?**

Please provide the rationale for your answers.

AGENCY RESPONSE: We generally agree with the following exceptions. With regards to factors for determining disclosures, how a disclosure organization views its relationship with the federal government should not have a significant bearing on a federal agency's determination of what should be disclosed in its agency financial report regarding this disclosure organization. Accordingly, we recommend that paragraph 69(c) be removed.

Disclosure of the amount of the federal government's exposure to gains and losses from future operations of the disclosure organization appears to be "forward looking" and should be avoided in

audited notes to the financial statements. We therefore recommend removing the phrase “or future operations” from paragraph 72(c).

We do not believe disclosure should be made of a disclosure organization’s key financial indicators and changes in key financial indicators as proposed in paragraph 73(e). Audit assurance of key financial indicators of a disclosure organization, even if they could be readily identified, could be difficult and costly to obtain especially given its relative informational value. It would be better to point the reader to the disclosure organization’s annual financial report, as required by paragraph 73(f), rather than disclosing such information in the audited notes to the financial statements of a federal agency financial report. Accordingly, we suggest removing paragraph 73(e).

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.**

AGENCY RESPONSE: Agree. As noted in footnote 24 to paragraph 56, coordinated guidance between central agencies may be required to ensure government-wide consistency on processes for identifying and assessing organizations for which federal agencies are accountable.

- 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.**

AGENCY RESPONSE: Agree. We agree that administrative assignments can be identified in accordance with the provisions of paragraphs 54-63.

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.

AGENCY RESPONSE: Agree. Federal reporting entities should consolidate in their entirety organizations for which they are accountable without regard to funding source.

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.

AGENCY RESPONSE: Agree. Consolidation of FASB-based accounts of component entities without conversion may be appropriate for agencies that publish financial reports pursuant to FASAB standards, particularly if differences between the two bases of accounting for these entities are not significant. Certain of Treasury's component entities, including Bureau of Engraving and Printing and the Exchange Stabilization Fund, maintains their financial accounts and prepare stand-alone audited financial reports on a FASB basis. Currently, we convert their accounts to FASAB accounts prior to consolidating them. While the provisions of the ED may eliminate the burden of conversion in the future, we do express concern as to potential new issues that may arise with regards to budgetary accounting and financial reporting requirements associated with these FASB accounts which are currently addressed when these FASB accounts are converted to FASAB accounts.

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.**

AGENCY RESPONSE: Agree. We generally agree with the ED's minimum disclosures for the central banking system, with the exception of paragraph 77(c). Based on the inclusion principles outlined in paragraph 21, we do not believe the FRB would meet the criteria for being included as a consolidation or disclosure entity. Therefore, we agree that separate guidelines, such as those presented in paragraph 77, are needed to ensure that appropriate disclosure is given to this related party entity which is too misleading to exclude.

We recommend removing the phrase "and changes in those actions" in paragraph 77(c). Treasury's agency financial report disclosures currently provide a general description of the FRB's monetary policy and how this policy is executed. We disagree with disclosing specific details about how monetary policy is executed or even changes in these actions or tools used to effect monetary policy. Not only is would this discussion be complex but is subject to significant change each year. Furthermore, audit assurance of this information could be difficult and costly to obtain. Reference to the availability of the FRB's annual report, as required by paragraph 77(f), would provide a reader with more in-depth information on this subject rather than in Treasury's agency financial report.

- 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.**

AGENCY RESPONSE: Yes. Some organizations falling outside of the inclusion principles may be viewed by the public as being part of the federal government such as Medicaid and state unemployment programs. Perhaps some level of disclosure explaining the federal government's limited role with regards to organizations such as these would be useful to readers of GPFFRs.

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.

AGENCY RESPONSE: Agree. While we generally agree with the related party definition (paragraph 12) and requirements (paragraphs 78-87), the standard does not appear to provide a clear distinction between the characteristics of a related party and those of a disclosure organization meeting the "misleading to exclude" inclusion principle. More specifically, it could be interpreted that a disclosure entity meeting the "misleading to exclude" inclusion principle is a related party and therefore could be disclosed under the requirements of either a disclosure entity or related party. Thus, the section "misleading to exclude" should not be placed as a "catch-all" for the inclusion principle (paragraphs 35 and 36), and then again in paragraphs 78-79 in referring to related parties. Instead, entities not meeting the "Budget", "Ownership", and "Control" inclusion criteria should then be considered for disclosure as a "related party" if too misleading to exclude. Also see related comments and recommendations in our response to Q1(c) and Addendum A.

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.

AGENCY RESPONSE: Agree with one minor exception. The federal government is party to certain multi-lateral development banks where it does not have significant influence. Paragraph 83(b) should therefore be amended to read "(for example, *certain* multi-lateral development banks)."

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

AGENCY RESPONSE: No. We did not identify any missing types of organizations.

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

AGENCY RESPONSE: Agree. We agree with the list of exclusions.

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

AGENCY RESPONSE: No. We did not identify any additional exclusion that should be considered.

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.

AGENCY RESPONSE: Agree. We generally agree that conforming changes to SFFAC 2 are appropriate and necessary since, without these changes, there is a risk that federal agencies will erroneously follow the original guidance in the SFFAC and miss the guidance in the new standard. However, due to the significant number of changes that are proposed to SFFAC 2, the Board should give consideration to superseding the provisions of SFFAC 2 in their entirety with this ED, or alternatively completely revising SFFAC 2.

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.

AGENCY RESPONSE: Agree. The proposed effective date seems reasonable as long as changes in reporting entity, if applicable, follow the past practice that these types of changes are not retroactively restated in comparative statements.

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?

AGENCY RESPONSE: Agree. The appendices provide quick reference to pertinent sections.

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

AGENCY RESPONSE: Yes. The appendices should remain after the Statement is issued as they provide quick reference to pertinent sections.

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.

AGENCY RESPONSE: Yes. See Addendum A, and responses to Q1(c) and Q7(a) above regarding proposed changes to the Flowchart in Appendix B. Additionally, an illustration that provides clarity in the application of the "administratively assigned" principles would also be a positive addition to the standard.

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.

AGENCY RESPONSE: No. We did not identify any other unique situation that should be addressed.

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.**

AGENCY RESPONSE: Disagree. The criteria proposed in the ED seem clear enough that a reader would not infer that receiverships, conservatorships, and interventions are part of the federal government.

- 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.

AGENCY RESPONSE: Disagree. One standard focusing on the “reporting entity” is capable of addressing consolidation and disclosure entities. Due to the short-term nature of interventions, a separate standard would only require the same disclosures as are being proposed in this standard for disclosure entities, thereby creating unnecessary duplication.

Additional Comment

In addition to the responses above, Treasury has one additional comment to the ED for consideration. In general, we found the ED difficult to read which we believe is primarily due to how the provisions of the standard are organized. Discussion of the three inclusion principles seems to apply only for purposes of the government-wide GPFFR, while the characteristics for distinguishing between a consolidation and disclosure entity seem to apply to both the government-wide and component reporting entities’ GPFFR. We recommend that the Board reorganize this ED by focusing its discussion on the three inclusion principles and then the characteristics for distinguishing between a consolidation and disclosure entity, and that these guidelines be applicable to both the government-wide and component reporting entities’ GPFFR.

In conclusion, we thank the Board 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 Shawn Mickey (202-622-0916), Gary Ward (202-622-0274), Kawan Taylor (202-622-7899), or Carole Banks (202-622-0818).

Shawn Mickey
Senior Accountant
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Gary Ward
Senior Accountant
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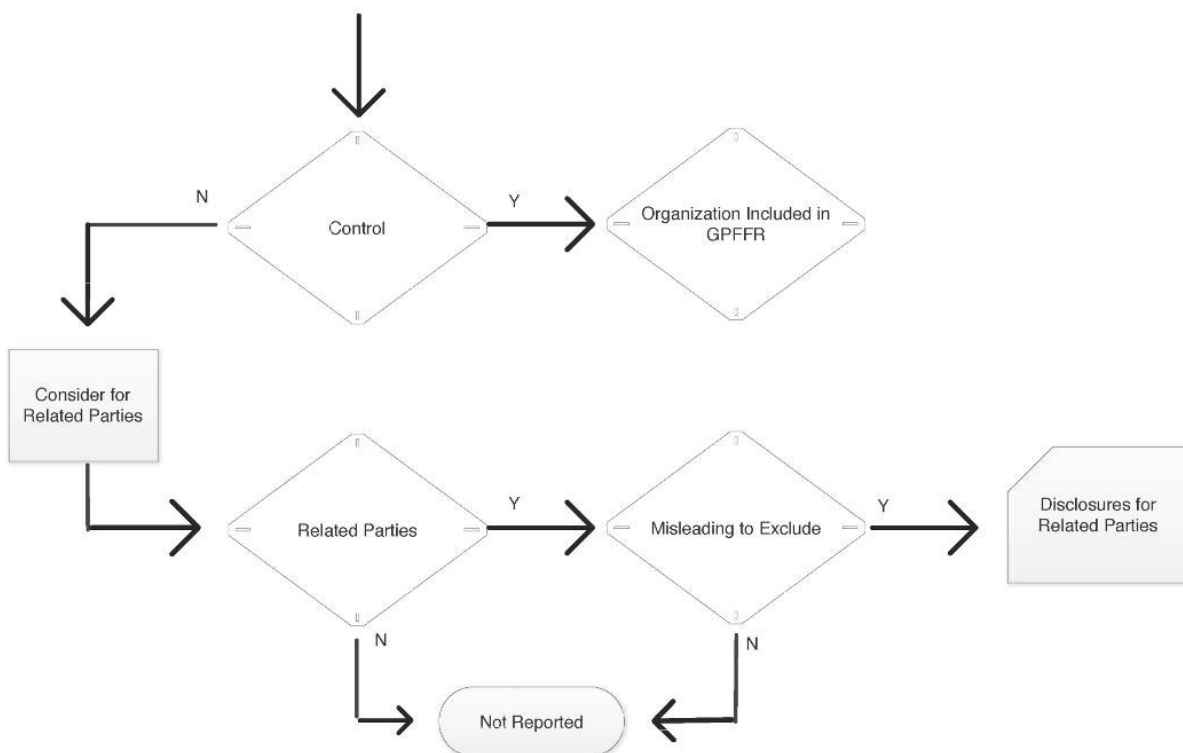
Kawan Taylor
Assistant Director
Office of Financial Reporting and Policy

Carole Y. Banks
Director
Office of Financial Reporting and Policy

Addendum A

Suggested modification to Flowchart (ED Appendix B)

Move “Misleading to Exclude” after “Related Parties”. The current placement is not appropriate for two reasons: (1) the question of whether a related party is misleading to exclude is not addressed, and (2) current placement would indicate that all related party entities could be excluded and not be misleading.



APPENDIX



Federal Accounting Standards Advisory Board

REPORTING ENTITY

Statement of Federal Financial Accounting Standards

Exposure Draft

Written comments are requested by July 3, 2013

April 3, 2013

THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

The Secretary of the Treasury, the Director of the Office of Management and Budget (OMB), and the Comptroller General, established the Federal Accounting Standards Advisory Board (FASAB or "the Board") in October 1990. FASAB is responsible for promulgating accounting standards for the United States Government. These standards are recognized as generally accepted accounting principles (GAAP) for the federal government.

An accounting standard is typically formulated initially as a proposal after considering the financial and budgetary information needs of citizens (including the news media, state and local legislators, analysts from private firms, academe, and elsewhere), Congress, federal executives, federal program managers, and other users of federal financial information. The proposed standards are published in an exposure draft for public comment. In some cases, a discussion memorandum, invitation to comment, or preliminary views document may be issued before an exposure draft is released on a specific topic. A public hearing is sometimes held to receive oral comments in addition to written comments. The Board considers comments and decides whether to adopt the proposed standard with or without modification. After review by the three officials who sponsor FASAB, the Board publishes adopted standards in a Statement of Federal Financial Accounting Standards. The Board follows a similar process for Statements of Federal Financial Accounting Concepts, which guide the Board in developing accounting standards and formulating the framework for federal accounting and reporting.

Additional background information is available from the FASAB or its website:

- ["Memorandum of Understanding among the Government Accountability Office, the Department of the Treasury, and the Office of Management and Budget, on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board."](#)
- ["Mission Statement: Federal Accounting Standards Advisory Board"](#), [exposure drafts](#), [Statements of Federal Financial Accounting Standards and Concepts](#), [FASAB newsletters](#), and other items of interest are posted on FASAB's website at: www.fasab.gov.

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Contact us:

Federal Accounting Standards Advisory Board
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www.fasab.gov



Federal Accounting Standards Advisory Board

April 3, 2013

TO: ALL WHO USE, PREPARE, AND AUDIT FEDERAL FINANCIAL INFORMATION

Your comments on the exposure draft of a proposed Statement of Federal Financial Accounting Standards, entitled *Reporting Entity*, are requested. Specific questions for your consideration appear on pages 4-9 but you are welcome to comment on any aspect of this proposal. If you do not agree with the proposed approach, your response would be more helpful to the Board if you explain the reasons for your position and any alternative you propose. Responses are requested by July 3, 2013.

All comments received by the FASAB are considered public information. Those comments may be posted to the FASAB's website and will be included in the project's public record.

Mail delivery is delayed by screening procedures. Therefore, please provide your comments in electronic form by e-mail to fasab@fasab.gov. If you are unable to email your responses, we encourage you to fax the comments to (202) 512-7366. Alternatively, you may mail your comments to:

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

We will confirm receipt of your comments. If you do not receive confirmation, please contact our office at (202) 512-7350 to determine if your comments were received.

The Board's rules of procedure provide that it may hold one or more public hearings on any exposure draft. A public hearing has been scheduled at 9:00 AM on **August 28, 2013**, in Room 7C13 at the GAO Building, 441 G Street, NW, Washington, DC. Please notify Melissa Loughan, FASAB Assistant Director, at loughanm@fasab.gov or (202) 512-5976, by July 29, 2013, if you wish to provide oral comments at the public hearing.

Sincerely,

Tom L. Allen
Chairman

EXECUTIVE SUMMARY

WHAT IS THE BOARD PROPOSING?

The Board is proposing principles to ensure organizations for which elected officials are accountable are included in general purpose federal financial reports (GPFFRs). The principles proposed to guide financial reporting recognize the complex diverse organizations possessing varying legal designations (for example, government agencies, not-for-profit organizations, corporations) that are used to address public policy challenges. The principles herein are not intended to establish whether an organization is or should be considered a federal agency for legal or political purposes. Rather, this exposure draft (ED) provides principles to guide preparers of financial statements at the government-wide and component reporting entity levels in determining what organizations should be included in the reporting entity's GPFFR for financial accountability purposes.

The government-wide GPFFR should include all organizations (1) budgeted for by elected officials of the federal government, (2) owned by the federal government, or (3) controlled by the federal government with risk of loss or expectation of benefits. 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. When any of these conditions exists, the Board believes information regarding the organization is necessary to provide accountability.

This ED provides for determining the most appropriate means—consolidated financial statements or disclosures—to include information about these organizations in GPFFRs. Determining the most appropriate means requires an assessment of the degree to which the following characteristics are met: the organization is financed by taxes or other non-exchange revenue, is governed by the Congress and/or the President, imposes or may impose risks and rewards on the federal government, and/or provides goods and services on a non-market basis. Note, however, not all characteristics are required to be met to the same degree; classification is based on the assessment as a whole.

Generally, consolidated financial statements presenting the financial position and results of operations are appropriate for those organizations financed by the taxpayer, governed by elected officials, imposing risks and rewards on the federal government, and providing goods and services on a non-market basis. Consolidated financial statements present the financial information as if the organizations were a single economic entity. Such a presentation is needed to show – in the aggregate – the net cost financed by taxpayers, the assets available for use, and the liabilities to be settled in the future. Organizations to be included in the consolidated financial statements within the GPFFR are referred to as “consolidation entities” and are subject to the hierarchy of generally accepted accounting principles established for “federal entities” in Statement of Federal Financial Accounting Standards 34.

Consolidation is not appropriate for organizations operating with a high degree of autonomy. Some organizations that meet the principles for inclusion are insulated from political influence and intended to be non-taxpayer funded. Presenting information about these discrete organizations in consolidated financial statements would obscure the operating results and

financial position of the reporting entity. Instead, information about these types of discrete organizations should be disclosed in notes to the consolidated financial statements of reporting entities applying federal financial accounting standards. The disclosures should reveal the nature of the relationship to the reporting entity, relevant activity during the reporting period, and the reporting entity's future exposures to risks and rewards resulting from the relationship. Organizations to be disclosed in the GPFFR are referred to as "disclosure organizations." While disclosure organizations are not subject to the hierarchy of generally accepted accounting principles established for federal entities, information about such organizations is needed for accountability purposes.

The Board proposes each component reporting entity's GPFFR include all organizations for which it is accountable. This includes all consolidation entities and disclosure organizations administratively assigned to it. The GPFFR for the government-wide reporting entity would be a consolidation of component reporting entity GPFFRs including information regarding disclosure organizations. One member would alter the proposal by not equating organizations in receivership, conservatorship, or owned or controlled as a result of an intervention to other disclosure organizations. This member notes that the Board is undertaking a project on risk assumed and believes that that project should establish the requirements for all receiverships, conservatorships, and interventions, not just those encompassed by these proposed standards. This member's alternative view is presented on page 54.

In addition to the relationships that lead to organizations being included in the GPFFR based on the principles described above, the federal government may have relationships with other parties. The Board also proposes to require disclosures if one party to an established relationship has the ability to exercise significant influence over the other party in making financial and operating decisions, and the relationship is of such significance that it would be misleading to exclude information about it. The parties engaged in these relationships are "related parties." The disclosures would provide information about the nature of the government's relationship with the related party and other information to aid in understanding the relationship and its potential financial reporting impact, including exposures to risk of loss or potential gain as a result of the relationship.

The proposed Statement would be effective for periods beginning after September 30, 2016. Earlier implementation is encouraged.

HOW WOULD THIS PROPOSAL IMPROVE FEDERAL FINANCIAL REPORTING AND CONTRIBUTE TO MEETING THE FEDERAL FINANCIAL REPORTING OBJECTIVES?

This Statement would improve federal financial reporting by improving guidance for identifying organizations to include in the GPFFRs of the government-wide reporting entity and component reporting entities. When implemented, GPFFRs will provide users with consolidated financial information about federal reporting entities, information about disclosure organizations owned or controlled by the federal government, certain disclosures about the central banking system, and information about significant related party relationships. This information will aid in meeting federal financial reporting objectives.

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QUESTIONS FOR RESPONDENTS

The FASAB encourages you to become familiar with all proposals in the Statement before responding to the questions in this section. In addition to the questions below, the Board also would welcome your comments on other aspects of the proposed Statement. The Board plans to hold a public hearing on August 28, 2013, and you are welcome to offer oral comments at that time. Please notify Melissa Loughan, FASAB Assistant Director, at loughanm@fasab.gov or (202) 512-5976, by July 29, 2013, if you wish to provide oral comments at the public hearing.

The Board believes that this proposal would improve federal financial reporting and contribute to meeting the federal financial reporting objectives. The Board has considered the perceived costs associated with this proposal. In responding, please consider the expected benefits and perceived costs and communicate any concerns that you may have in regard to implementing this proposal.

Because the proposal may be modified before a final Statement is issued, it is important that you comment on aspects that you favor as well as any that you do not favor. Comments that include the reasons for your views will be especially appreciated.

The questions in this section are available in a Word file for your use at <http://fasab.gov/board-activities/documents-for-comment/exposure-drafts-and-documents-for-comment/>. Your responses should be sent by e-mail to fasab@fasab.gov. If you are unable to respond electronically, please fax your comments to (202) 512-7366. Alternatively, you may mail your comments to:

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

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

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.**
- 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.**

- 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.**
- 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),**
 - ii. **the objectives for disclosures (see par. 72), and**
 - iii. **the examples provided (see par. 73)?**

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.**
- 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.**

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.

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.

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.**
- 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.**

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.
- 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.
- c. Are there additional organizations that generally should be considered related parties? Please provide the rationale for your answer.
- d. Do you agree or disagree with the list of exclusions? Please provide the rationale for your answer.
- e. Are there additional exclusions that should be considered? Please provide the rationale for your answer.

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.

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.

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

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.

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.**
- 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.**

INTRODUCTION

PURPOSE

1. The federal government and its relationships with organizations have become increasingly complex. Notwithstanding these complexities, **general purpose federal financial reports**¹ (GPFFR) for the government-wide reporting entity should be broad enough to reflect the Congress and/or the President's accountability for those organizations. In addition, **component reporting entity** GPFFRs should allow the Congress and/or the President to hold management accountable. Although Statement of Federal Financial Accounting Concepts (SFFAC) 2, *Entity and Display*, addresses identifying **reporting entities** and criteria for including components in a reporting entity, questions have continued in this area indicating the need for standards.² Standards that can be used to identify organizations to include in the GPFFR of the government-wide reporting entity and each component reporting entity are important to meet federal financial reporting objectives.
2. This Statement guides preparers of GPFFRs in determining what organizations to report upon, whether such organizations are considered "consolidation entities" or "disclosure organizations,"³ and what information should be presented. This guidance, together with existing guidance, will ensure that users of GPFFRs are provided with comprehensive financial information about federal reporting entities and their relationships so that federal financial reporting objectives are met. This Statement requires reporting entities to disclose certain information about disclosure organizations administratively assigned to them. It does not require new **disclosures** regarding consolidation entities administratively assigned to reporting entities. Any existing required disclosures for the consolidated financial statements of the reporting entity, which include the consolidation entities, would continue to apply. While not addressing the inclusion or classification of the components of the central banking system, the Statement does establish certain minimum disclosures regarding the central banking system.
3. This Statement also guides preparers of GPFFRs in identifying **related parties** and in determining what information to provide about related party relationships of such significance that it would be misleading to exclude information. There are specific disclosures regarding related parties that are in addition to those required regarding disclosure organizations.

¹ Terms defined in the Glossary are shown in **bold-face** the first time they appear.

² SFFAC 2 is a Concepts Statement and is considered Other Accounting Literature. See Statement of Federal Financial Accounting Standards (SFFAS) 34, *The Hierarchy of Generally Accepted Accounting Principles (GAAP), Including the Application of Standards Issued by the FASB* for more information regarding the hierarchy.

³ "Consolidation entities" and "disclosure organizations" are terms used to distinguish between entities based on the degrees to which the entity is (1) financed by taxes or other non-exchange revenue, (2) governed by elected or appointed officials, (3) imposing or may impose risks and rewards to the federal government and (4) providing goods and services on a market or non-market basis. See par. 36 - 52 for more information.

4. The guidance recognizes an organization's legal form may not reflect the substance of the relationship between the federal government and the organization. As such, the legal form or designation of an organization does not always determine whether it should be reported in the government-wide GPFFR. 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. Inclusion results from a need for accountability given the nature of the relationship between the federal government and the organization but inclusion does not change the legal form of the organization.

MATERIALITY

5. The provisions of this Statement need not be applied to immaterial items. The determination of whether an item is material depends on the degree to which omitting or misstating information about the item makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or the misstatement.

PROPOSED STANDARDS

SCOPE AND APPLICABILITY

6. This Statement applies to federal reporting entities that prepare general purpose federal financial reports (GPFFRs) in conformance with generally accepted accounting principles (GAAP) as defined by paragraphs 5 through 8 of Statement of Federal Financial Accounting Standards (SFFAS) 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*. Paragraph 66 of this Statement also applies to federal reporting entities that prepare GPFFRs in conformance with GAAP as provided by paragraphs 9 through 12 of SFFAS 34.
7. This Statement does not require any entity to prepare and issue GPFFRs. The purpose of this Statement is to enable federal reporting entities preparing and issuing GPFFRs to determine:
 - a. whether SFFAS 34 is applicable to an organization,
 - b. what organizations should be included in the GPFFR of federal reporting entities applying SFFAS 34,
 - c. the manner in which information should be presented for organizations included in the GPFFR, and
 - d. what disclosures, if any, are needed regarding related parties.

DEFINITIONS

Definitions in paragraphs 8 through 12 are presented within the standards because they are new terms intended to have a specific meaning when applying the standards.

8. **Reporting Entity** Reporting entities are organizations that issue a GPFFR because either there is a statutory or administrative requirement to prepare a GPFFR or they choose to prepare one. The term “reporting entity” may refer to either the government-wide reporting entity or a component reporting entity (see definitions below).

Statement of Federal Financial Accounting Concepts (SFFAC) 2 provides criteria for an entity to be a reporting entity.⁴ The criteria focus on whether an entity’s:

- a. management is responsible for controlling and deploying resources, producing outputs and outcomes, and executing the budget or a portion thereof (assuming that

⁴ SFFAC 2, par. 29-38, provides a discussion on Identifying the Reporting Entities for General Purpose Financial Reporting.

- the entity is included in the budget), and is held accountable for the entity's performance.
- b. financial statements would provide a meaningful representation of operations and financial condition.
 - c. financial information could be used by interested parties to help them make resource allocation and other decisions and hold the entity accountable.
9. **Government-wide Reporting Entity** The government-wide reporting entity's GPFFR includes all organizations for which the Congress and/or the President are accountable based on principles established in this Statement.
10. **Component Reporting Entity** "Component reporting entity" is used broadly to refer to a reporting entity within a larger reporting entity.⁵ Examples of component reporting entities include organizations such as executive departments, independent agencies, government corporations, legislative agencies, and federal courts. Component reporting entities would also include sub-components (those components included in the GPFFR of a larger component reporting entity) that may themselves prepare GPFFRs. One example is a bureau that is within a larger department that prepares its own standalone GPFFR.
11. **Control with risk of loss or expectation of benefit** "Control with risk of loss or expectation of benefit" is the power to impose will on and/or govern the financial and/or operating policies of another organization with the potential to be obligated to provide financial support or assume financial obligations or to obtain financial resources or non-financial benefits.⁶ See paragraphs 25 - 34.
12. **Related Parties** Organizations are considered to be related parties if the existing relationship or one party to the existing relationship has the ability to exercise significant influence over the other party in making financial and operating decisions.

ORGANIZATIONAL APPROACH TO DEFINING BOUNDARIES

13. The federal government is unique because its constitutionally established powers, motivations, and functions are different from those of all other organizations. It is an extremely complex organization responsible for the common defense and general welfare of the nation. Although there are various perspectives⁷ for viewing the federal government, an organizational approach was established in SFFAC 2⁸ as the most appropriate perspective for understanding the composition of the federal government. SFFAC 2 established that GPFFRs should include the aggregation of organizations⁹ for which the

⁵ The larger reporting entity could be the government-wide reporting entity or another component reporting entity.

⁶ For example, a non-financial benefit would be one where the federal government benefits from a service being provided to it or on its behalf.

⁷ SFFAC 2, par. 13-28, discusses the organizational, budget and program perspectives of the federal government, as well as the intertwining of the perspectives.

⁸ SFFAC 2, par. 29-38.

⁹ "Organization" is used broadly and may include among others departments, agencies, bureaus, divisions, commissions, corporations, and components.

federal government is financially accountable as well as other organizations for which the nature and significance of their relationship with the government are such that their exclusion would cause the federal government's financial statements to be misleading or incomplete.

14. Accountability demands comprehensive reporting. To provide comprehensive reporting, the federal government must report on organizations that serve varied purposes and have complex governance structures and finances. In some cases, disclosing financial and other information in the notes about an organization rather than consolidating financial and other information about all organizations may better meet federal financial reporting objectives.
15. This Statement first establishes the principles for identifying organizations to include in the government-wide GPFFR (see Principles for Inclusion in the Government-wide GPFFR beginning with paragraph 20) and then distinguishes between consolidation entities and disclosure organizations (see Reporting on Organizations—Consolidation Entities or Disclosure Organizations beginning with paragraph 37).
16. This Statement also establishes that component reporting entities' GPFFRs must include all consolidation entities and disclosure organizations for which they are accountable so that both the component reporting entity and government-wide GPFFRs are complete (see Identifying Organizations Component Reporting Entities Are Accountable For beginning with paragraph 54).
17. The Statement provides guidance for how to report on consolidation entities and disclosure organizations (see GPFFR Consolidation and Disclosure beginning with paragraph 64).
18. The Statement establishes minimum disclosure requirements regarding the central banking system (see paragraph 77).
19. Lastly, the Statement provides for disclosure of related party relationships of such significance that it would be misleading to exclude information about them (see Related Parties beginning with paragraph 78).

PRINCIPLES FOR INCLUSION IN THE GOVERNMENT-WIDE GPFFR

20. This Statement provides three principles for determining which organizations should be included¹⁰ in the government-wide GPFFR and also requires inclusion of organizations if excluding them would be misleading (see paragraph 36).
21. An organization meeting any one of the three principles below is included in the government-wide GPFFR:
 - a. In the Budget
 - b. Majority Ownership Interest

¹⁰ "Included" means the information is either consolidated or disclosed.

c. Control with Risk of Loss or Expectation of Benefit

IN THE BUDGET

22. 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 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.

MAJORITY OWNERSHIP INTEREST

23. The federal government (directly or through its components) may have an ownership interest¹² in an organization. An ownership interest is a legal claim on the net residual assets of an organization such as holding shares or other formal equity instruments. The holding of an ownership interest usually but not always entitles the holder to an interest in voting rights.
24. Majority ownership interest exists with over 50 percent of the voting rights or net residual assets¹³ of an organization. When the federal government (directly or through its components) holds a majority ownership interest in an organization, it should be included as either a consolidation entity or a disclosure organization in the government-wide GPFFR.¹⁴

CONTROL WITH RISK OF LOSS OR EXPECTATION OF BENEFIT

25. An organization that is controlled by the federal government with risk of loss or expectation of benefit should be included in the government-wide GPFFR. For these purposes, control with risk of loss or expectation of benefit is defined as follows:

Control with risk of loss or expectation of benefit is the power to impose will on and/or govern the financial and/or operating policies of another organization with the potential to be obligated to provide financial support or assume financial obligations or obtain financial

¹¹ As defined by the Single Audit Act Amendments of 1996, federal financial assistance is assistance that non-federal organizations receive or administer in the form of grants, loans, loan guarantees, property, cooperative agreements, interest subsidies, insurance, food commodities, direct appropriations, or other assistance.

¹² “Ownership interest” is the possession of substantially all of the benefits and risks incident to ownership. *FASAB Handbook as of June 30, 2012--Glossary*.

¹³ For example, the federal government may hold more equity in preferred stock than all other stockholders but the preferred stock may be non-voting.

¹⁴ Ownership interests 50% or less should be accounted for in accordance with the appropriate accounting standards per the GAAP hierarchy. However, the organization should still be assessed against the control inclusion principle and the misleading to exclude principle.

resources or non-financial benefits.¹⁵ Both the power and either the risk of loss or expectation of benefits aspects of the definition should be met to justify inclusion of an organization. Hereafter, control with risk of loss or expectation of benefit is referred to as “control.”

26. Control refers to the ability to control, whether or not that ability is actively exercised, and should be assessed at the reporting date regardless of the federal government’s ability to change it in the future. In determining whether control exists, it is necessary to determine the substance of the relationship between the federal government and the organization as it may not be completely reflected by the legal form of the relationship.
27. Control does not necessarily mean the federal government has responsibility for the management of the day-to-day operations of an organization. Rather, it is the federal government’s authority to determine or influence the policies governing those activities that indicates control.
28. Determining whether control exists requires the application of professional judgment. The federal government achieves its objectives through a wide range of organizations which individually will fall on a continuum. At one end of the continuum, it is clear that an organization does not have the power to act independently and is controlled by the federal government—such as an executive department. At the other end, the organization has the power to act independently and, while the federal government may have a level of influence, it is clear that the federal government does not have control—such as a foreign government.

Indicators of Control

29. As discussed in the following paragraphs, there are indicators that should be considered in determining whether the federal government controls an organization. As noted above, consideration needs to be given to the nature of the relationship between the federal government and the organization and judgment applied to determine whether control exists.
30. Certain individual indicators provide persuasive evidence that control exists. Because each indicator provides strong evidence of control, meeting any one indicator would generally mean control is present. These indicators are when the federal government has the unilateral authority to:
 - a. establish or amend the fundamental purpose and mission of the organization,¹⁶ which may include authorizing the organization to exercise sovereign powers of the federal government and requiring the organization to carry out federal missions and objectives;

¹⁵ For example, a non-financial benefit would arise when the federal government receives a service or a service is provided to others on its behalf.

¹⁶ Congressionally chartered nonprofit organizations identified under United States Code (U.S.C.) Title 36, Subtitle II and III, should not be considered controlled solely because amendments to their federal charter must be enacted through legislation. Instead, such organizations should be considered controlled only if they meet the indicators in paragraph 31 or another indicator in this paragraph.

- b. appoint or remove a majority of the governing board members;
 - c. direct the governing body regarding the establishment and subsequent revision of financial and operating policies of the organization; or
 - d. dissolve the organization thereby having access to the assets and responsibility for the obligations.
31. Other indicators provide evidence that control may exist, but must be considered in the aggregate and often require the application of professional judgment in assessing. These indicators are when the federal government has the ability to or is obligated to:
- a. provide significant input into the appointment of members of the governing body of the organization or being involved in the appointment or removal of a significant number of members;
 - b. direct the ongoing use of the organization's assets;
 - c. direct investment decisions including the liquidation of investments;
 - d. appoint or remove key executives or personnel;
 - e. approve the budgets or business plans for the organization;
 - f. require audits;
 - g. veto, overrule, or modify governing board decisions or otherwise significantly influence normal operations;
 - h. finance the deficits of, provide financial support to, or settle liabilities of the organization;
 - i. direct the organization to work with the government to provide services to taxpayers which may include determining the outcome or disposition of matters affecting the recipients of services;
 - j. establish, rescind, or amend the organization's governance framework;
 - k. establish limits or restrictions on borrowing and investments of the organization; or
 - l. restrict the capacity to generate revenue of the organization, especially the sources of revenue.

Situations Where Control Does Not Exist

32. Because of the federal government's broad powers and economic influence, control should not be inferred from either:
- a. authority to exercise regulatory powers over an organization; or
 - b. economic dependency of the organization on the federal government.

33. The federal government has the power to regulate many organizations by use of its sovereign and legislative powers. For example, the federal government has the power to regulate the behavior of organizations by imposing conditions or sanctions on their operations. However, the governing bodies of the regulated organizations make decisions within the regulatory framework. Regulatory powers do not constitute control for purposes of this Statement because the federal government's interest in these organizations extends only to the regulatory aspects of the operations.
34. Certain organizations may be economically dependent on the federal government but ultimately retain discretion as to whether to accept funding or do business with the federal government. For example, many nonprofit organizations rely on federal government funding but that does not mean they are controlled by the federal government. Although the federal government may be able to influence organizations dependent on federal funding or business through purchasing power, the federal government typically does not govern their financial and operating policies.

MISLEADING TO EXCLUDE

35. There may be instances when an organization does not meet the inclusion principles in paragraphs 20 through 31 yet the government-wide GPFFR would be misleading or incomplete if the organization were excluded.¹⁷
36. Organizations should be included in the government-wide GPFFR if it would be misleading to exclude them.

REPORTING ON ORGANIZATIONS—CONSOLIDATION ENTITIES OR DISCLOSURE ORGANIZATIONS

37. The principles above should be used to assess what organizations to include in the GPFFR. Next, a distinction should be made between “consolidation entities” and “disclosure organizations” as that distinction determines how the organizations will be reported. This distinction is based on an assessment of the degree to which the following characteristics are met: the organization is financed by taxes and other non-exchange revenue, is governed by the Congress and/or the President, imposes or may impose risks and rewards to the federal government, and/or provides goods and services on a non-market basis.¹⁸ Note, however, not all characteristics are required to be met to the same degree; classification is based on the assessment as a whole.

CONSOLIDATION ENTITIES

38. The organizations that should be consolidated in the financial statements in the GPFFR are referred to as “consolidation entities.” Generally, an organization is considered a consolidation entity if, based on an assessment of the following characteristics as a whole, the organization is:

¹⁷ Although such situations would be rare, this Statement provides for situations that may arise.

¹⁸ Goods and services are provided on a non-market basis when they are provided free of charge or at charges that bear little relationship to the cost of providing such goods or services.

- a. financed through taxes, and other non-exchange revenues.
 - b. governed by the Congress and/or the President.
 - c. imposing or may impose risks and rewards to the federal government.
 - d. providing goods and services on a non-market basis.
39. Organizations listed in the budget, except for non-federal organizations receiving federal assistance (see par 22), are presumed to qualify as consolidation entities while greater judgment will be needed to classify other organizations.
40. For consolidation entities, the governance structure is vertically integrated, such that the chain of command and manner of decision-making leads directly to elected officials. Vertical integration may include the establishment of organizational authorities, development and/or approval of budgets, and the appointment of organizational leaders by the Congress and/or the President.

DISCLOSURE ORGANIZATIONS

41. The federal government has relationships with organizations afforded a greater degree of autonomy than consolidation entities. Some organizations may exercise powers that are reserved to the federal government as sovereign. Other organizations may not themselves carry out missions of the federal government but, instead, are owned or controlled by the federal government as a result of regulatory actions, such as organizations in **receivership**. To avoid obscuring information about these more autonomous organizations while still providing accountability, such organizations are to be disclosed rather than consolidated in GPFFRs. Hereafter, these organizations are referred to as “disclosure organizations.”
42. Disclosure organizations may maintain a separate legal identity, have a governance structure that vests most decision-making authorities in a governing body to insulate the organization from political influence, and/or have relative financial independence.
43. Disclosure organizations receive limited or no funding from general tax revenues. The Congress and/or the President have less direct involvement in decision-making (governance) than in consolidation entities. Limited risks and rewards fall to the federal government. Disclosure organizations may provide the same or similar goods and services that consolidation entities do, but are more likely to provide them on a market basis.¹⁹
44. Disclosure organizations may include but are not limited to: quasi-governmental and/or financially independent organizations, organizations in receiverships and **conservatorships**, and organizations owned or controlled through federal government intervention actions. In some cases, the relationship with the federal government is not expected to be permanent. The following disclosure organization types are presented to

¹⁹ Goods and services are provided on a market basis when prices are based on the prices charged in a competitive marketplace between willing buyers and sellers.

assist in identifying organizations that are disclosure organizations. The accompanying Appendix C—Illustrations offers non-authoritative hypothetical examples that may be useful in understanding the application of the standards.

Quasi-Governmental and/or Financially Independent Organizations

45. Quasi-Governmental and/or Financially Independent Organizations have relationships with the federal government that are not temporary but differ from consolidation entities with regard to governance and/or financial arrangements. Such disclosure organizations are on a continuum that considers such factors as whether the governance is through appointed officials versus a structure that vests most decision-making authorities in a governing body to insulate the organization from political influence; whether the organization is financed primarily through taxes and other non-exchange revenues versus limited or no such financing; and whether it provides goods and services on a non-market basis versus provide goods and services on a market basis.
46. Governance differences typically lead to greater independence. Characteristics may include the following:
 - a. Longer appointments of key executives or governing boards to allow these appointees a degree of independence from the Congress and/or the President
 - b. Delegated operational authority to provide a service or execute a program in a manner similar to private business enterprises
 - c. Private sector legal characteristics, such as not-for-profit status under the Internal Revenue Code
 - d. Exemption by statute from laws or regulations dealing with the federal budget, funds, personnel, ethics, acquisition, property, or works
 - e. Voluntary association with the federal government and shared purposes to implement government policies
47. Financial differences typically lead to greater fiscal autonomy. Characteristics may include the following:
 - a. Primarily funded from a source other than appropriations
 - b. Delegated financial authority to provide a service or execute a program in a manner similar to private business enterprises
 - c. Principally engaged in selling goods and/or services to organizations outside of the federal government
 - d. Intended, in the normal course of its operations, to maintain its operations and meet its liabilities from revenues received from sources outside of the federal government
48. Not all organizations of a given type will meet the characteristics above. Examples of the types of organizations that could be consolidation entities or could be quasi-governmental

and/or financially independent organizations are **Federally Funded Research and Development Centers**, museums, performing arts organizations, universities, and venture capital funds. Each organization should be assessed objectively since there are likely to be differences among the organizations within these example types such that some should be consolidation entities and others disclosure organizations.

Receiverships and Conservatorships²⁰

49. The federal government may take control or ownership of failed financial institutions, such as banks, with no goal to maintain control or ownership. Receiverships or conservatorships are established to liquidate failing financial institutions or to guide such institutions back to safe and sound conditions.²¹ Organizations controlled or owned through receiverships or conservatorships are likely to be disclosure organizations.

Federal Government Intervention Actions Resulting in Control or Ownership

50. In exceptional circumstances such as economic instability or a national security crisis, the federal government may intervene in organizations not previously meeting the inclusion principles. Interventions arise because of the federal government's broad responsibility for the well-being of the country. Some, but not all, interventions establish ownership or control such that the organization then meets the inclusion principles. Although intervention actions are not expected to be permanent, they may not include a specific time limit.
51. Typically federal government intervention actions are not routine activities. Strategic planning documents are unlikely to include objectives to routinely initiate such interventions or to permanently operate organizations acquired through interventions.
52. Examples of intervention actions resulting in control or ownership include:
- a. The federal government provides financial support and, in doing so, obtains control of an established organization but expects to relinquish or cede control.
 - b. The federal government acquires an ownership interest in an organization but expects to end its interest as soon as practicable.
53. Intervention actions that exist at fiscal year-end must be assessed to confirm the resulting control or ownership is not expected to be permanent. If the intervention activities are not expected to be permanent or other characteristics of disclosure organizations exist, organizations controlled or owned as a result of intervention actions would be disclosure organizations.

²⁰ This type differs slightly from federal interventions. Receivership and conservatorship activities are considered part of the mission of the federal reporting entities that perform them.

²¹ For example, the Federal Deposit Insurance Corporation (FDIC) is an independent agency created by the Congress with the mission "to maintain stability and public confidence in the nation's financial system by: insuring deposits; examining and supervising financial institutions for safety and soundness and consumer protection; and, managing receiverships."

IDENTIFYING ORGANIZATIONS COMPONENT REPORTING ENTITIES ARE ACCOUNTABLE FOR

54. The government-wide reporting entity is the only federal reporting entity that is an independent economic entity²² and the inclusion principles are expressed from the perspective of the federal government. However, GPFFRs for the government-wide reporting entity represent a consolidation of component reporting entity GPFFRs. Therefore, component reporting entities must identify and include in their GPFFRs all consolidation entities and disclosure organizations for which they are accountable so that both the component reporting entity GPFFRs and government-wide GPFFR are complete.
55. A component reporting entity's GPFFR should include all organizations that would allow the Congress and/or the President to hold the component reporting entity's management (appointed officials or other agency heads) accountable for implementation of public policy decisions. Inclusion would also reveal the risks inherent in component reporting entity operations, and enhance accountability to the public. Each component reporting entity is accountable for all consolidation entities²³ and disclosure organizations administratively assigned to it.
56. Administrative assignments to component reporting entities are typically made in laws and policy documents such as statutes, budget documents, regulations, or strategic plans. Administrative assignments can be identified by evaluating:²⁴
 - a. Scope of the Budget Process
 - b. Accountability Established Within a Component Reporting Entity
 - c. Misleading to Exclude and/or Misleading to Include

SCOPE OF THE BUDGET PROCESS

57. Consolidation entities and disclosure organizations subject to the budget approval and oversight process of the component reporting entity head should be included in the component reporting entity GPFFR. Each component reporting entity should include:
 - a. all consolidation entities listed within its section of the *Budget of the United States Government: Analytical Perspectives--Supplemental Materials* schedule entitled "Federal Programs by Agency and Account" and
 - b. all disclosure organizations included within its congressional budget justification.²⁵

²² SFFAC 2, par. 38.

²³ A component reporting entity comprises all consolidation entities administratively assigned to it and should present information about disclosure organizations assigned to it.

²⁴ Component reporting entities should develop processes to ensure they identify and assess any organizations (1) within the scope of their budget process, (2) for which accountability is established within their component reporting entity, or (3) which are misleading to exclude. It is anticipated that central agencies will determine if there is a need for coordinated guidance to ensure government-wide consistency.

ACCOUNTABILITY ESTABLISHED WITHIN A COMPONENT REPORTING ENTITY

58. Consolidation entities and disclosure organizations for which a component reporting entity has been assigned accountability responsibilities should be included in the GPFFR of that entity. Determining whether accountability was established or assigned to a component reporting entity requires the consideration of certain indicators and the application of professional judgment. Indicators²⁶ that accountability has been established in the component reporting entity include:
- a. Statutes or regulations establishing an organization state that it is assigned to or part of a larger federal organization.²⁷
 - b. An organization is included in the component reporting entity's published organization chart.
 - c. The component reporting entity acquires and/or monitors²⁸ ownership interests in organizations where there are ongoing responsibilities²⁹ such as:
 - i. coordinating and/or conveying input on strategic plans,
 - ii. providing appropriated funds to the organization and receiving requests for funding in the current and/or future years,
 - iii. administering any federal grants or contracts awarded to the organization,
 - iv. monitoring activities and/or reporting on outcomes, or
 - v. monitoring the value of the ownership interest.
 - d. A controlled organization³⁰ was established by statute or by action of the component reporting entity to support the mission of the component reporting entity, and a continuing relationship exists. Examples of continuing relationships include those in which the component reporting entity:
 - i. approves bylaws including any amendments,
 - ii. is represented on the governing board (for example, as an ex-officio member),
 - iii. appoints members of the governing board,

²⁵ A congressional budget justification is a document submitted annually to Congress to justify an organization's budget request.

²⁶ These indicators provide evidence that accountability was established or was assigned to a component reporting entity. Meeting any one would typically mean accountability was established.

²⁷ For example, the U.S. Census Bureau (officially the Bureau of the Census, as defined in Title 13 U.S.C. § 11) is part of the U.S. Department of Commerce.

²⁸ Such responsibilities may be assigned to a program office.

²⁹ These responsibilities are examples of actions or activities performed by the component reporting entity that are indicative of monitoring an ownership interest in an organization, which is an indicator of accountability.

³⁰ Where control exists at the government-wide level based on paragraphs 25-34.

- iv. coordinates and/or conveys input on strategic plans,
 - v. monitors organizational performance,
 - vi. approves budgets, operating plans, or contracts with others,
 - vii. establishes and executes cooperative agreements with the organization,
 - viii. administers federal grants to or contracts with the organization,
 - ix. testifies before Congress regarding organization performance and objectives, or
 - x. has significant financial transactions or balances that indicate ongoing managerial involvement.
59. If more than one component reporting entity is assigned responsibilities as described above, the following guidance applies:
- a. Disclosure organizations should be included in the GPFFR of each component reporting entity assigned such responsibilities.
 - b. Consolidation entities should be administratively assigned to only one component reporting entity.³¹ The component reporting entity assigned the largest share³² of responsibilities described in paragraph 58 generally should include the consolidation entity.
60. If a disclosure organization has not been administratively assigned to a consolidation entity, the disclosure organization should be reported by a component reporting entity (a) assigned responsibility for transferring funds to the disclosure organization or (b) with which its mission most closely aligns.

MISLEADING TO EXCLUDE AND / OR MISLEADING TO INCLUDE

61. There may be instances where an organization is not administratively assigned to the component reporting entity based on the principles in paragraphs 57-60 yet the component reporting entity GPFFR would be misleading or incomplete if the organization were excluded. If so, such organizations should be included in the component reporting entity's GPFFR.³³
62. There may be instances where applying the principles in paragraphs 57-60 to consolidation entities would result in misleading presentation for the component reporting entity. For example, an organization may have been legally established within a larger organization while authorized to operate independently. While such conditions are expected to be rare, if it would be misleading to consolidate the organization in the

³¹ Note that the component reporting entity to which a consolidation entity is administratively assigned may also be administratively assigned to a higher-level component reporting entity.

³² Largest share as used here is based on the most significant administrative role.

³³ Although such situations would be rare, this Statement provides for situations that may arise.

component reporting entity GPFFR, the organization may be excluded so long as it is consolidated in another component reporting entity or directly in the government-wide reporting entity.

63. Determining whether it would be misleading to include a consolidation entity administratively assigned to a component reporting entity requires the application of professional judgment. Examples³⁴ of indicators that it may be misleading to include an organization are:
- a. The budget submission is combined for procedural purposes only, as indicated by:
 - i. the budget request not being approved by component reporting entity management, or
 - ii. the absence of involvement by component reporting entity management regarding budget execution, investments, or strategic planning.
 - b. The component reporting entity provides no direct oversight of the organization.
 - c. The organization's funding is separate from the component reporting entity's funding.
 - d. Inclusion of the organization's financial information in the component reporting entity's financial statement could be misleading as to the entity's responsibilities for the organization's liabilities and other obligations.
 - e. The organization has established itself as a stand-alone organization since its inception and has routinely prepared audited financial statements since that time.
 - f. The organization provides financial data directly to the Department of the Treasury for the government-wide GPFFR.

GPFFR CONSOLIDATION AND DISCLOSURE

CONSOLIDATION ENTITIES

64. Consolidation entities' financial statements should be consolidated for the government as a whole to facilitate an assessment of the financial position³⁵ of the federal government and the cost of operations financed by taxes and other non-exchange revenue. Component reporting entities should consolidate the financial information for all

³⁴ The indicators listed in 63 a. – f. are examples and there may be other indicators not included on this list. Further, no specific number of indicators need be present to determine an organization would be misleading to include. This determination is based on the assessment as a whole after considering all facts and often requires professional judgment in making such decisions.

³⁵ The consolidated financial statements should include amounts and balances, consistent with applicable accounting standards, even if the amounts and balances arise from or are supported by different funding sources (e.g., appropriations or donations).

consolidation entities administratively assigned to them. Consolidation³⁶ aggregates the individual financial amounts of organizations that constitute a reporting entity and results in presentation of information for a single economic entity representing taxpayer-supported activities, resources, and obligations.

65. Consolidation entities as defined herein are considered federal reporting entities and should apply GAAP as defined in SFFAS 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*. This Statement does not establish new disclosure requirements regarding consolidation entities but acknowledges existing standards require disclosures.
66. SFFAS 34 recognizes that a limited number of federal reporting entities prepare and publish financial reports pursuant to the accounting and reporting standards issued by the Financial Accounting Standards Board (FASB). SFFAS 34 provides that GPFFRs prepared in conformity with accounting standards issued by the FASB also may be regarded as in conformity with GAAP. Consolidation entities (i.e. the consolidated government-wide reporting entity or a consolidated component reporting entity) should consolidate component reporting entity or sub-component financial statements for consolidation entities prepared in accordance with SFFAS 34 without conversion for any differences in accounting policies among the organizations. Nonetheless, any component reporting entity that publishes financial reports pursuant to the accounting and reporting standards issued by the FASB should disclose intragovernmental amounts measured in accordance with federal financial accounting standards to facilitate elimination entries in preparation of the government-wide financial statements.

REPORTING ON DISCLOSURE ORGANIZATIONS

67. Maintaining a distinction between the finances of consolidation entities and disclosure organizations will more effectively meet federal financial reporting objectives. Such a distinction allows for separate presentation of financial information for organizations where there is a difference in purpose, governance structure, and financial relationships. Disclosing financial and other information in the notes about disclosure organizations rather than consolidating financial and other information about all organizations included in a GPFFR may better meet federal financial reporting objectives. Although disclosure organizations are not subject to the hierarchy of GAAP established for federal reporting entities, information about such organizations are needed for accountability purposes and to meet federal financial reporting objectives.
68. For those organizations classified as disclosure organizations, the preparer should exercise judgment in determining the appropriate disclosures based on the factors and principles provided herein. Information regarding disclosure organizations should be disclosed in accordance with **Disclosure Requirements** as detailed in par. 70 to 73 below after considering the factors listed in par. 69.

³⁶ Consolidation is a method of accounting that combines the accounts of those entities line by line on a uniform basis of accounting and eliminates balances and transactions among the entities. For selected financial statements such as the statement of budgetary resources, a combined financial statement which does not eliminate balances and transactions among the entities is acceptable.

Factors in Determining Disclosures

69. Materiality is an overarching consideration in financial reporting. Preparers should consider both qualitative and quantitative materiality in determining the information that should be presented regarding disclosure organizations. Beyond materiality, the following factors³⁷ should be considered in making judgments about the extent of appropriate disclosures:
- a. **Relevance to reporting objectives** – Significance of the disclosure organization to meeting the reporting objectives established in SFFAC 1, *Objectives of Federal Financial Reporting*, with regard to the reporting entity. In particular, this would include the significance of the information regarding results of operations and financial position to meeting the operating performance and stewardship reporting objectives.
 - b. **Nature and magnitude of the potential risks/exposures or benefits associated with the relationship** – Information is needed to provide an understanding of the potential operational or financial impact, including financial-related exposures to risk of loss and potential gain, to the consolidation entity resulting from the disclosure organization's operations.
 - c. **Disclosure organization views/perspective** – 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.
 - d. **Complexity of the relationship** – More complex relationships would involve additional detailed disclosures to ensure the relationship is understood by the readers.
 - e. **Extent to which the information interests, or may be expected to interest, a wide audience** – Due to the sensitivity of the relationship, materiality of the transactions, media attention, or other reasons, interested parties may expect more extensive information regarding the disclosure organization or its relationship with the federal government.
 - f. **Extent to which there are no alternative sources of reliable information** – An objective of GPFFRs is to meet the needs of users who may have limited access to information or statements and lack the ability to demand the desired information.

Disclosure Requirements

70. In addition to the factors presented in par. 69 regarding the extent of disclosures, both qualitative and quantitative factors should be considered in determining whether information regarding a disclosure organization should be presented separately due to its

³⁷ The factors are presented in a list for consideration in the aggregate; no individual weights should be assigned or interpreted.

significance or aggregated with the information regarding other disclosure organizations. If information is aggregated, aggregation may be based on disclosure organization type, class, investment type, or a particular event deemed significant to the reporting entity.

71. Disclosures should be integrated so that concise, meaningful and transparent information is provided. Integration is accomplished by providing a single comprehensive note regarding the disclosure organization and related balances or by incorporating references to relevant notes elsewhere in the GPFFR but relating to the disclosure organization. For example, a reference may be made to a note regarding investments in the disclosure organization.
72. For each significant disclosure organization and aggregation of disclosure organizations, information should be disclosed to meet the following objectives:³⁸
 - a. **Relationship and Organization**: The nature of the federal government's relationship with the disclosure organization(s)
 - b. **Relevant Activity**: Nature and magnitude of relevant activity during the period and balances at the end of the period
 - c. **Future exposures**: A description of financial and non-financial risks and potential benefits and, if possible, the amount of the federal government's exposure to gains and losses from the past or future operations of the disclosure organization
73. Examples of information that may meet the above objectives and provide the necessary understanding of the disclosure organization's relationship and organization, relevant activities, and future exposures specific to the federal government are provided below.³⁹ In determining what information is needed to meet the objectives in paragraph 72, the factors in paragraph 69, including the complexity and nature and magnitude of the relationship, should be considered. The list of examples below may not be exhaustive and additional items of information necessary to meet the objectives should be disclosed even if not specifically identified in the list below.
 - a. The name and description of the disclosure organization,⁴⁰ including 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
 - b. The nature of the relationship between the federal government and the disclosure organization including relevant information regarding:
 - i. How any control or influence over the disclosure organization is exercised

³⁸ The objectives are not listed in any order of preference.

³⁹ No individual example is itself a required disclosure. Nor are the examples required in the aggregate. Therefore, the examples are not alternatives or substitutes one for another. Rather, a disclosure that meets the objectives in paragraph 72 should be provided.

⁴⁰ For simplicity, information is described in relation to a single disclosure organization. Nonetheless, the information may be presented for an aggregation of similar disclosure organizations.

- ii. Key terms of contractual agreements, statutes, or other legal authorities
 - iii. The percentage of ownership interest and/or voting rights
 - c. For intervention actions, the primary reasons for the intervention and a brief description of the federal government's plan relative to monitoring, operating and/or disposing of the disclosure organization and/or a statement that the intervention is not expected to be permanent
 - d. A description and summary of assets, liabilities, revenues, expenses, gains, and losses recognized in the financial statements of the reporting entity as a consequence of transactions with or interests in the disclosure organization and the basis for determining the amounts reported (or a reference to other disclosures where such information is provided)
 - e. A discussion of the disclosure organization's key financial indicators and changes in key financial indicators
 - f. Information regarding the availability of the disclosure organization's annual financial report and how it can be obtained
 - g. In the event that contractual agreements, statutes, or other legal authorities obligate the reporting entity to provide financial support to the disclosure organization in the future, information regarding potential financial impacts (including those terms of the arrangements to provide financial support and liquidity, including events or circumstances that could expose the federal government to a loss)
 - h. The nature of, and changes in, the risks and benefits associated with the control of, or other involvement with, the organization during the period
 - i. The amount that best represents the federal government's maximum exposure to gain or loss from its involvement with the disclosure organization, including how the maximum exposure to gain or loss is determined (If this cannot be quantified, a narrative discussion could be offered.)
 - j. Other information that would provide an understanding of the potential financial impact, including financial-related exposures to risk of loss or potential gain to the reporting entity, resulting from the disclosure organization's operations including important existing, currently-known demands, risks, uncertainties, events, conditions and trends—both favorable and unfavorable
74. Any disclosure organization's financial information presented in the reporting entity's GPFFR should be based on accrual-basis standards provided in generally accepted accounting principles or an other comprehensive basis of accounting developed for its

specific type of entity.⁴¹ This includes generally accepted accounting principles for the relevant domain (FASAB, Governmental Accounting Standards Board, or FASB).

75. When information is derived from the disclosure organization's financial report, it is preferable but not mandatory that the report be for the same reporting period as the government-wide reporting entity. If a disclosure organization's reporting period differs from the government-wide reporting entity's and it is not cost-beneficial to align the reporting periods, any financial information disclosed from the disclosure organization's financial report should be for a reporting period ending within the government-wide reporting entity's reporting period.
76. Significant changes in information occurring from the end of the disclosure organization's reporting period 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*.

MINIMUM DISCLOSURES REGARDING THE CENTRAL BANKING SYSTEM⁴²

77. The following information regarding the central banking system should be disclosed⁴³ in the government-wide GPFFR and the GPFFR of any reporting entity to which it may be primarily associated or administratively assigned:
 - a. Governance structure with particular emphasis on matters affecting its independence and insulation from political influence
 - b. Significant roles and responsibilities (and how these relate to federal policy objectives)
 - c. A discussion of the significant financial actions, and changes in those actions, undertaken by the central banking system to achieve monetary and fiscal policy objectives, such as adjusting the discount rate, purchasing securities (for example, Treasury securities and mortgage backed securities), or undertaking central bank liquidity swaps
 - d. Amounts of significant types of transactions and balances between the central banking system and the reporting entity

⁴¹ Consolidation entities should apply the GAAP hierarchy established in SFFAS 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*.

⁴² Central banking system functions are currently carried out by the Federal Reserve System (FRS). The FRS comprises the Board of Governors, the Federal Open Market Committee, the regional Federal Reserve Banks, and the Bureau of Consumer Financial Protection (established in 2010 as an independent bureau within the FRS pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act).

⁴³ Depending on the circumstances, some of the listed information may be disclosed due to other requirements. The resulting disclosures should be integrated so that concise, meaningful and transparent information is provided and information is not repetitive.

- e. A description of any significant financial risks or benefits to the federal government (including significant changes) and, if possible, the amount of the federal government's exposure to gains and losses from operations
- f. The availability of annual financial reports and how they can be obtained

RELATED PARTIES

- 78. In addition to organizations for which the Congress and/or the President are accountable,⁴⁴ the federal government may have relationships with other parties. Only relationships of such significance that it would be misleading to exclude information about such relationships warrant disclosure.⁴⁵ Guidance is provided below but judgment will also be required to identify relationships that warrant disclosure as related parties.
- 79. Related parties: Organizations are considered to be related parties if the existing relationship⁴⁶ or one party to the existing relationship has the ability to exercise significant influence over the other party in making financial and operating decisions.
- 80. Significant influence (for the purpose of this Statement) is the power to participate in the policy decisions of an entity, but not control those policies. Significant influence may be exercised in several ways, sometimes by representation on the board of directors or equivalent governing body but also by, for example, participation in the policy-making process, interchange of managerial personnel, or dependence on technical information. Significant influence may be gained by a minority ownership interest, statute, or agreement.
- 81. Significant influence does not arise from regulatory actions or economic dependency alone. However, regulation or economic dependency, together with other factors, may give rise to significant influence and therefore a related party relationship. Judgment is required in assessing the impact of regulation and economic dependence on a relationship.
- 82. Although component reporting entities of the federal government may significantly influence each other, component reporting entities are subject to the overall control of the federal government and operate together to achieve the policies of the federal government and are not considered related parties. Therefore, component reporting entities need not be disclosed as related parties by other component reporting entities.
- 83. Related parties *generally* would include (see paragraph 84 for organizations *generally* not included) but are not limited to:
 - a. **Government sponsored enterprises** not meeting the Inclusion Principles

⁴⁴ Entities for which the Congress and President are accountable are in the budget, majority owned, or controlled and would meet the inclusion principles and be reported as either a consolidation entity or disclosure organization and not be subject to related party reporting.

⁴⁵ Significance is assessed at the reporting entity and may differ among component reporting entities and the government-wide reporting entity.

⁴⁶ Relationship as used in this context refers to material transactions or events involving both parties.

- b. Organizations governed by representatives from each of the governments that created the organization, including the United States, wherein the federal government has agreed to ongoing or contingent financial support to accomplish shared objectives (for example, multi-lateral development banks)
- 84. In the context of this Statement, the following generally would not be considered related parties:
 - a. Organizations meeting the Inclusion Principles
 - b. Organizations with which the federal government transacts a significant volume of business resulting in economic dependence such as government contractors, state and local governments, collegial institutions, and non-profit organizations⁴⁷
 - c. Key executives of the federal government and organizations owned or managed by key executives, other employees of the federal government, or members of their families
 - d. Foreign governments
 - e. Organizations created through treaties or trade agreements that define common goals and means for joint action where the U.S. role in governing and financing the organizations is not significant
 - f. Special interest groups⁴⁸
- 85. Although paragraph 84 discusses the potential exclusion of certain organizations as related parties, other factors may create a need for related party disclosures for such organizations. The use of judgment will be necessary in identifying those factors consistent with the information needs described in paragraph 86.
- 86. Certain information regarding significant related party relationships may enable users to better understand the financial statements of the reporting entity because:
 - a. Related party relationships might expose the federal government to risks or provide opportunities that would not have existed in the absence of the relationship;
 - b. Related party relationships can influence the way in which the federal government operates with other entities in achieving its individual objectives; or
 - c. Related parties may enter into transactions that unrelated parties would not enter into, or may agree to transactions on different terms and conditions than those that would normally be available to unrelated parties.

⁴⁷ However, economic dependency, together with other factors, may give rise to significant influence and, therefore, a related party relationship.

⁴⁸ Special interest groups refers broadly to organizations whose members share common concerns and try to influence government policies. Examples include but are not limited to labor unions, trade associations, religious organizations, membership organizations, and lobbying organizations.

87. For related party relationships of such significance to the reporting entity that it would be misleading to exclude information, the following should be disclosed:
- a. Nature of the federal government's relationship with the party, including the name of the party or if aggregated, a description of the related parties. Such information also would include, as appropriate: the percentage of ownership interest.
 - b. Other information that would provide an understanding of the relationship and potential financial reporting impact, including financial-related exposures to risk of loss or potential gain to the reporting entity resulting from the relationship.

EFFECT ON EXISTING CONCEPTS—PROPOSED AMENDMENTS TO SFFAC 2, *ENTITY AND DISPLAY*

88. The purpose of this section of the Statement is to propose conforming amendments to Statement of Federal Financial Accounting Concepts (SFFAC) 2, *Entity and Display*, as described in the following paragraphs. Conforming changes were not needed in paragraphs 11- 37 and these paragraphs were retained in SFFAC 2 as they provide concepts regarding reporting entity. Conforming changes were not considered regarding paragraphs 54 – 77 and paragraphs 79 – 112 because they address concepts outside the scope of this Statement.

89. Paragraph 2 is replaced with the following paragraph which describes the amended purpose and contents of the Statement.

The purpose of this statement is to establish concepts regarding what would be encompassed by a Federal Government entity's financial report. The statement specifies the types of entities for which there should be financial reports (hereinafter called "reporting entities"), establishes an organizational perspective for considering the makeup of each type of reporting entity, identifies types of financial reports for communicating the information for each type of reporting entity, suggests the types of information each type of report would convey, and identifies the process and factors the Board may consider in determining whether information should be basic information, required supplementary information (RSI), or other accompanying information (OAI).

90. Paragraphs 3 - 5 are rescinded because the preamble applicable to all concepts statements, which was adopted at the time SFFAC 5, *Definitions of Elements and Basic Recognition Criteria for Accrual-Basis Financial Statements* was issued, addresses the topics covered.

91. Paragraph 6a below is inserted following paragraph 6 to recognize the importance of accountability in determining organizations to be included in the reporting entity GPFFR:

6a. SFFAC 1 also discusses accountability and users' information needs as the foundation for the objectives of federal financial reporting. Specifically, par. 71 states "It may be said that 'accountability' and its corollary, 'decision usefulness,' comprise the two fundamental values of governmental accounting and financial reporting. They provide the foundation for the objectives of federal financial reporting. ...The assertion of accountability therefore leads to identifying, first, those to whom government is accountable and, second, the information needed to maintain and demonstrate that accountability." Based on the concepts established

in SFFAC 1, it is clear that accountability is a fundamental goal of financial reporting to be considered in establishing the boundaries of general purpose federal financial reports.

92. Paragraph 7 is rescinded because the preamble applicable to all concepts statements addresses the topics covered.
93. Paragraph 10, first bulleted item is amended by replacing it with the following bulleted item addressing an understanding of what the reporting entity entails:
- ensure information at each reporting level includes information about all relevant organizations to support accountability by including organizations that are in the budget, owned, or controlled with risk of loss or expectation of benefit;

94. Paragraph 38 is amended to exclude references to other paragraphs amended by this Statement. Paragraph 38 is replaced with the following:

The ultimate aggregation of organizations is into the Federal Government which, in reality, is the only independent economic entity. The Federal Government encompasses all of the resources and responsibilities existing within the component reporting entities. The aggregation would include organizations for which the Federal Government is financially accountable as well as other organizations for which the nature and significance of their relationship with the Federal government are such that their exclusion would cause the Federal Government's financial statements to be misleading or incomplete.

95. Paragraphs 39 -50 are rescinded because the standards herein provide guidance on the same matters. It is not necessary or appropriate to retain the guidance in SFFAC 2.
96. The sub-heading before paragraph 51 - "Other Aspects Concerning Completeness of the Entity" - is revised to read "Other Aspects Concerning Completeness of the Component Reporting Entity."
97. Paragraph 51 is replaced with the following:

Identifying the organizations to include in the reporting entity is one aspect of ensuring that the users of a reporting entity's financial reports are provided with all the information relevant to the reporting entity. However, because the only independent economic entity is the entire Federal Government, financial resources or free services are often provided from one component in the government to another component without a quid pro quo. For example, a portion of the retirement costs of Federal employees is reported by the Office of Personnel Management rather than the organizational entities employing the persons. Thus, within parameters more appropriately established in accounting standards, it is important to ensure that the reporting entity's financial reports include amounts that are attributable to the reporting entity's activities, even though they are recorded elsewhere. This is particularly important for costs associated with the use of human resources; personnel services are such a major part of most government activities. It is also important for the costs of services provided by other reporting entities, such as computer services provided by another unit.

98. Paragraphs 52 – 53 are rescinded because these paragraphs relate to issues covered in standards and are not necessary for understanding the notion of the reporting entity.
99. A new sub-heading "Need to Distinguish between Consolidation Entities and Disclosure Organizations" is inserted at paragraph 53A.

100. Insert Paragraphs 53A – 53 E under the sub-heading: “Need to Distinguish between Consolidation Entities and Disclosure Organizations” - The proposed language provides a high level explanation of consolidation entities and disclosure organizations. These are new terms introduced in the proposed Statement and critical to understanding the reporting entity concept in the federal government. More importantly, the proposed language describes the need to distinguish them and the reason for this distinction in terms of financial statement presentation.

53A. The Federal Government is a large and complex organization. In order to fulfill public policy objectives, the Federal Government may use both consolidation entities (such as departments and agencies) and organizations that are distinct from consolidation entities to fulfill public policy objectives (such as financially independent organizations). These distinct organizations are referred to collectively as “disclosure organizations.”

53B. Disclosure organizations may maintain a separate legal identity, have a governance structure designed to insulate the organization from political influence, and/or be granted relative financial independence. Despite disclosure organizations’ relative operational and financial independence, accountability for all organizations owned or controlled by the Federal Government rests with the Congress and/or the President. So, both consolidation entities and disclosure organizations should be included in financial reports to provide accountability.

53C. It may be difficult to provide accountability, by meeting financial reporting objectives, through consolidated financial statements because they blur the distinction between consolidation entities and disclosure organizations. Consolidated financial statements may obscure the fact that resources and resource allocation decisions for disclosure organizations are more independent than similar decisions for consolidation entities. While consolidation entities are financed by taxpayers and governed by elected officials, disclosure organizations often do not rely on taxpayers for financing or elected officials for spending authority. For example, a single-column presentation of information for all organizations likely would create a risk of incorrect inferences. Such inferences may include the amount of assets and revenues available for consolidation entities to use in general government activities, and the extent to which taxpayers stand ready to liquidate liabilities and meet expenses of disclosure organizations.

53D. Maintaining a distinction between consolidation entities and disclosure organizations may more effectively meet federal financial reporting objectives. Such a distinction may be maintained through discrete presentation of information regarding disclosure organizations. Nonetheless, disclosures are not a substitute for consolidation entities recognizing the financial effects of transactions with disclosure organizations.

53E. Consolidated financial statements for only consolidation entities will facilitate an assessment of the financial position of the federal government and the cost of operations financed by taxpayers. Consolidation aggregates the individual financial statements of organizations that constitute a reporting entity and results in presentation of information for a single economic entity representing consolidated taxpayer supported activities, resources, and obligations. Consolidation entities are considered federal entities and should apply GAAP as defined in SFFAS 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*. The following sections discuss display of information in consolidation entity financial reports.

101. Paragraph 78 is rescinded because it is not conceptual guidance. It identifies an expectation that material differences between the recognition and measurement requirements under the Financial Accounting Standards Board and the FASAB standards will be adjusted before consolidation.

EFFECTIVE DATE

102. This Statement is effective for periods beginning after September 30, 2016. Earlier implementation is encouraged.

The provisions of this Statement need not be applied to immaterial items.

APPENDIX A: BASIS FOR CONCLUSIONS

This appendix discusses some factors considered significant by Board members in reaching the conclusions in this Statement. It includes the reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others. The standards enunciated in this Statement—not the material in this appendix—should govern the accounting for specific transactions, events, or conditions.

Introduction

- A1. The federal government and its relationships with other organizations have become increasingly complex. These complex relationships make it difficult to identify federal entities for financial accountability purposes. In addition, some organizations may be viewed as “non-federal” and yet be owned or controlled by the federal government. Identifying the organizations to be included in the government-wide and component reporting entity general purpose federal financial reports (GPFFRs) is necessary to ensure the completeness of GPFFRs.
- A2. GPFFRs should include the varied organizations for which the Congress and/or the President are accountable regardless of their form. Therefore, the primary reason for developing standards for the government-wide and component reporting entity GPFFRs is to ensure that users will be provided with complete financial information about the federal government. While SFFAC 2, *Entity and Display*, provides criteria for determining if an organization should be included in the entity, questions have continued in this area that resulted in the need for standards.

Project History /Task Force

- A3. In 2008, the Board formed a task force to support the project. The objective of the task force was “to assist in developing the proposed standards on the boundaries of the reporting entity and specific criteria for determining whether an organization should be included.”
- A4. The task force met several times over the course of the project and also exchanged numerous ideas and recommendations electronically. The task force views and recommendations were presented to the Board for its consideration during the development of these proposed standards. The task force’s assistance was essential and its views carefully considered by members during deliberations. (See Appendix E for a list of task force members.)

Organizational Approach to Defining Boundaries

Underlying Concepts

- A5. The federal government is complex and therefore defining the boundary of GPFFRs may be difficult. Its constitutionally established powers and often its motivations and functions are different from other organizations. Despite these complexities, difficulties, and differences, accountability is a fundamental goal of financial reporting. As noted in SFFAC 1:

The federal government derives its just powers from the consent of the governed. It therefore has a special responsibility to report on its actions and the results of those actions. These reports must accurately reflect the distinctive nature of the federal government and

must provide information useful to the citizens, their elected representatives, federal executives, and program managers. Providing this information to the public, the news media, and elected officials is an essential part of accountability in government.⁴⁹

- A6. SFFAC 1 discusses accountability and users' information needs as the foundation of governmental financial reporting. Specifically, paragraphs 71 and 72 state "It may be said that 'accountability' and its corollary, 'decision usefulness,' comprise the two fundamental values of governmental accounting and financial reporting. They provide the foundation for the objectives of federal financial reporting. ...The assertion of accountability therefore leads to identifying, first, those to whom government is accountable and, second, the information needed to maintain and demonstrate that accountability."
- A7. SFFAC 1 explains that the federal government has a special responsibility to report on its actions and the results of those actions. SFFAC 1 discusses the information needs of both internal and external users including the citizens, their elected representatives, federal executives, and program managers because meeting user information needs is an essential part of accountability in government.
- A8. An organizationally based approach to defining boundaries supports accountability to all users but particularly to external users who may be unaware of the nature of organizational relationships. Focusing on organizations helps to identify who is accountable and for what. In addition, an organizational approach provides meaningful financial statements by aligning boundaries with defined organizations for which there would likely be users of GPFFRs.⁵⁰

Identifying and Classifying Organizations

- A9. The Board considered several alternative approaches to identifying organizations for which elected officials – the Congress and/or the President – are accountable. This Statement provides that reporting entities should first identify what organizations⁵¹ are to be included⁵² in the reports. The three principles for including organizations in the government-wide GPFFR are: In the Budget, Majority Ownership Interest, and Control with Risk of Loss or Expectation of Benefit. The Statement also includes a provision requiring inclusion of an organization if it would be misleading to exclude it.
- A10. Next, for those organizations to be included, a distinction is made between consolidation entities and disclosure organizations. This distinction determines how financial information is to be presented in the GPFFR. Consolidation entity financial information is to be presented in consolidated financial statements and related notes. Disclosure organization financial information is to be disclosed in notes to the financial statements.
- A11. Professional judgment is required in the application of the standards proposed in this Statement. This Statement presents a principles-based approach to determining which

⁴⁹ SFFAC 1, paragraph 8.

⁵⁰ See SFFAC 2, paragraphs 29-38, for a discussion of the organizational approach.

⁵¹ "Organization" is used broadly and may include among others departments, agencies, bureaus, divisions, commissions, corporations, and components. In certain instances, a specific program or "fund" may be subject to certain reporting requirements or have characteristics such that a GPFFR for the program or fund is needed. Examples may include the Highway Trust Fund or the General Fund. See SFFAC 2, par. 25 – 28.

⁵² "Included" means an organization's information is either consolidated or disclosed.

organizations should be included⁵³ in the government-wide GPFFR because of the wide and varying relationships of the federal government. General purpose federal financial reports for the government-wide reporting entity should be broad enough to report the Congress' and the President's accountability for organizations. This ensures that the financial reports contain all the information essential for fair presentation of the government's financial position and results of operations.

Principles for Inclusion in the Government-wide GPFFR

In the Budget

- A12. Identification of an organization in the President's Budget is the clearest evidence that an organization should be included in the government-wide report. Absent budgetary actions – originating with the President's Budget and leading to appropriations – federal organizations would be unable to conduct operations. Financial reporting objectives – budgetary integrity, operating performance, stewardship, and systems and controls – could not be met if organizations identified in the budget were not included in the financial reports. Therefore, the most efficient means to identify organizations for inclusion in the GPFFR is by their participation in the budget process as evidenced by being listed in the *Budget of the United States Government: Analytical Perspectives—Supplemental Materials* schedule entitled “Federal Programs by Agency and Account.”
- A13. Although the legislative and judicial branches (and most organizations within those branches) are not currently required to prepare financial statements, based on this principle (*In the Budget*) those organizations would be reported upon in the government-wide report.⁵⁴
- A14. Organizations should include any financing accounts associated with the organization although such accounts may not be specifically identified in the schedule. For example, the schedule entitled “Federal Programs by Agency and Account” may not identify federal credit reform financing accounts, but those accounts should be included in the GPFFR for the organization.

Organizations Receiving Federal Financial Assistance

- A15. The schedule entitled “Federal Programs by Agency and Account” also sometimes identifies specific recipients of federal financial assistance. SFFAC 2 acknowledges that the “Federal Programs by Agency and Account” schedule sometimes names an organization to receive a “subsidy” and states “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.” Thus, “subsidy” is the term used in SFFAC 2 to distinguish such “non-federal” organizations from the organizations intended to be included in the GPFFR.
- A16. While the provision in SFFAC 2 was correct, the Board is proposing standards, and believes terms used in this Statement should be defined. The Board considered ways to

⁵³ Note that this Statement does not specify which organizations must prepare and issue financial statements.

⁵⁴ As the source of GAAP for federal reporting entities, FASAB GAAP would be the appropriate accounting standards for these entities to adopt to the extent they prepare GAAP-based financial statements.

define “subsidy” but concluded it was more appropriate to rely on the existing definition of “federal financial assistance.”

- A17. The proposed language ensures organizations that receive federal financial assistance⁵⁵ as defined by the Single Audit Act Amendments of 1996 but listed under an appropriation in the schedule entitled “*Federal Programs by Agency and Account*” aren’t automatically included in the GPFFR. Most grants are provided through programs and the recipient organizations are not necessarily listed in the budget. However, in some cases, an organization may be listed. The Board believes a means to confirm whether specifically identified recipient organizations are “non-federal organizations receiving federal financial assistance” is needed. When such organizations are listed in the budget, they should be assessed against the “majority ownership interest” and “control with risk of loss or expectation of benefit” principles before being excluded from the government-wide GPFFR.
- A18. Generally, the Board believes preparers can identify organizations that are in fact receiving “subsidies” as described by SFFAC 2. The Statement provides that, although these may be listed in the budget, they are neither automatically included based on the first inclusion principle nor automatically excluded based on the assumption or perception that they would not be owned or controlled. The Board does not believe it would be appropriate to articulate how subsidies are presented in the “*Federal Programs by Agency and Account*” schedule or refer to other budget documents because such treatments may change.

Organizations Partially in the Budget

- A19. The Board deliberated the issue of certain organizations being partially in the budget (i.e., some of their operations or accounts are not in the President’s Budget), such as a museum receiving substantial donor support. The Board determined the organization should be included in the government-wide GPFFR based on the “in the budget” principle. The Board further decided that such organizations should be presented in the same manner as other consolidation entities or disclosure organizations, as discussed later in the Statement. Therefore, the language in the principle (“in the budget”) does not provide separate and distinct guidance for organizations partially funded by non-budgetary sources. This means the organization is either a consolidation entity or a disclosure organization and should be reported as one or the other, in its entirety. Further, paragraph 39 provides that organizations listed in the budget are presumed to be consolidation entities.

Need for Additional Principles

- A20. While the principle “in the budget” is the most efficient means to identify organizations for inclusion, there are additional principles to be considered to identify other organizations that should be included in the government-wide GPFFR. The budget principle represents a starting point in analysis but accountability goals could not be met solely through that principle. Because the budget’s purposes differ from financial reporting objectives in many respects (such as the focus on the allocation of budgetary resource flows versus costs of operations), it is possible that organizations or activities might be excluded from the budget for reasons that do not justify exclusion from financial reports. For example, some organizations may be established to operate in a manner similar to businesses and

⁵⁵ “Federal financial assistance” is assistance that non-federal entities receive or administer in the form of grants, loans, loan guarantees, property, cooperative agreements, interest subsidies, insurance, food commodities, direct appropriations, or other assistance.

excluded from the budgetary process. Therefore, additional inclusion principles are necessary to ensure completeness in the context of the federal financial reporting objectives.

Majority Ownership Interest

A21. Ownership interests typically provide owners access to resources and exposure to risks while supporting their desired goals. Federal financial reporting objectives require that information about service efforts, costs, and accomplishments be made available. To ensure such information is included, when the federal government holds a majority ownership in an organization, it should be included in the GPFFR. As described in the Statement, majority ownership interest exists with over 50 percent of the voting rights or the net residual assets of an organization.

A22. The Board noted that some may question how to account for minority ownership interests (less than 50 percent). The Board agreed addressing minority interests through the project is likely to be less effective than allowing the GAAP hierarchy to fill any void. To address the potential question, the Board included within the Statement a footnote stating ownership interests 50 percent or less should be accounted for in accordance with the appropriate accounting standards per the GAAP hierarchy.

Control with Risk of Loss or Expectation of Benefit

A23. When the federal government controls an organization with risk of loss or expectation of benefit, the organization should be included in the government-wide GPFFR to provide accountability. As detailed in the Statement, control involves the power to impose will on and/or govern the financial and/or operating policies of another organization with the potential to obtain financial resources or non-financial benefits or be obligated to provide financial support or assume financial obligations as a result of those actions. Both the power and the risk of loss or expectation of benefit aspects of the control definition should be present to justify inclusion of the organization in the GPFFR.

A24. For example, the Statement provides for situations where the risk of loss or expectation of benefit does not exist—in the instance of the federal government exercising regulatory powers over an organization. In these cases, the federal government is unable to exercise that power for its own benefit and rarely explicitly assumes risk of loss. Therefore, including such an organization in the GPFFR would misrepresent the financial position and results of operation of the government. This would not support achievement of the objectives of financial reporting.

A25. For financial reporting purposes, assessment of control is made at the reporting date and based on current legislation, rather than legislation that may or may not be enacted in the future.

A26. Determining control requires judgment, and the Statement provides indicators to assist in making determinations. The first set of indicators is “persuasive” as the federal government has the authority to control and any one of the listed items would generally mean control is present. The second set of indicators requires more judgment because the set of indicators is considered in the aggregate to assess whether the federal government has the ability to control the organization.

A27. Because the government does not usually seek only financial benefits, the expected benefit associated with control does not have to be a financial benefit. Instead, it may be non-financial. For example, it may be in the form of a service provided on the federal government's behalf or the ability to direct the work of the other organization to deliver goods and services.

Misleading to Exclude

A28. The Statement includes a general provision requiring inclusion of an organization if it would be misleading to exclude it. Certain Board members believed this may be problematic because no criteria are offered. However the Board ultimately agreed the general provision could accommodate rare situations that may arise in the future. This is consistent with provisions of SFFAC 2.

A29. The Board also believes the provision is consistent with the Governmental Accounting Standards Board Statement 14, *The Financial Reporting Entity*. It provides for those unique situations where the preparer and auditor agree an organization should be included that was not otherwise incorporated as a result of the three principles. Judgment would be required in this area. Therefore, the Board provides for judgment rather than attempting to anticipate these types of situations and develop criteria.

Reporting on Organizations—Consolidation or Disclosure

A30. Differences in purposes and governance structures by organizations may require different presentation of related financial information. This Statement provides that the reporting entity should first determine which organizations are to be included in the reports. Next the reporting entity should classify each included organization as a consolidation entity or a disclosure organization. Consolidation entities are subject to the hierarchy of GAAP established for “federal entities” in Statement of Federal Financial Accounting Standards (SFFAS) 34. While disclosure organizations are not subject to the hierarchy of GAAP established for federal entities, information about such organizations is needed for accountability purposes.

A31. Different means of presenting relevant information are provided for consolidation entities and disclosure organizations.⁵⁶ The distinction between consolidation entities and disclosure organizations is based on the degree to which the following characteristics are met: the organization is financed by taxes and other non-exchange revenue, is governed by the Congress and/or the President, imposes or may impose risks and rewards to the federal government, and/or provides goods and services on a non-market basis. Maintaining a distinction between consolidation entities where financial and operational decisions are more directly governed by the Congress and/or the President, and disclosure organizations that are more financially (or operationally) independent will provide information to users that is more understandable and relevant. In some cases, disclosure of information regarding an individual organization is more useful than consolidation of the individual organization's financial statements in the government-wide financial statements. In other instances, consolidation of individual organizations' financial statements is needed to provide fair

⁵⁶ Consolidated financial statements provided for “consolidation entities” will include all disclosures and required supplementary information required by existing standards. Existing standards will ensure that adequate information is provided regarding the nature and organizational structure of consolidation entities as well as the activities and future exposures.

presentation of activities financed by the taxpayers, and/or relying on the taxpayers to settle liabilities.

A32. While principle-based standards do not explicitly classify specific organizations as consolidation entities or disclosure organizations, the Board considered the need to illustrate how the inclusion principles and the criteria for classification as a consolidation entity or disclosure organization might be applied to certain significant individual organizations or classes of organizations. For many classes of organizations, illustrations are provided in Appendix C of this exposure draft. With respect to certain significant organizations with particularly unique characteristics, such as the central banking system (Federal Reserve System (FRS)),⁵⁷ a majority of the Board did not believe illustrations would be appropriate because the illustrations might become de facto requirements regarding that entity's classification.

A33. The role of preparers and auditors is to assess each organization against the principles in paragraphs 20 – 53 and reach their own conclusions. In contrast, the role of standards-setters is to set accounting standards and consider the potential implications. In doing so, the Board acknowledges some members believe the Board should explicitly address inclusion and classification (as a consolidation entity or disclosure organization) of the FRS in GPFFRs because of the magnitude of its operations. While different individuals could reach different conclusions due to the unique and changing role of the central banking system, most members believe explicitly classifying the FRS, or any entity, at a point in time would be inappropriate and result in the Statement becoming outdated as circumstances change.

A34. Despite the decision not to explicitly classify the FRS, the Board considered each possible classification of the FRS. This consideration did not take into account all the facts and circumstances that would be considered by the preparer and auditor. Instead, like the illustrations in Appendix C, high-level facts were considered in sufficient detail to provide reasonable assurance to the Board that preparers and auditors would consider the appropriate matters in making decisions. The majority of the Board believes the proposed principles are sufficient to aid preparers and auditors in assessing any organization, including the FRS, and in making decisions regarding inclusion and classification as a consolidation entity or disclosure organization.

A35. If the assessment of the FRS resulted in its classification as a consolidation entity, the government-wide consolidated financial statements and related notes would present information as if the FRS and other consolidation entities operate together as a single economic entity. Any balances and transactions among the consolidation entities would be eliminated. For example, all Treasury securities held as investments by the FRS and reported as liabilities by the Department of the Treasury would be eliminated. Significant additions to the government-wide balance sheet as a result of consolidating the FRS would be liabilities for deposits of depository institutions and Federal Reserve notes outstanding as

⁵⁷ The FRS comprises the Board of Governors, the Federal Open Market Committee, the regional Federal Reserve Banks, and the Bureau of Consumer Financial Protection (established in 2010 as an independent bureau within the FRS pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act). For simplicity, the basis for conclusions discusses the system as a whole rather than its individual components.

well as assets for investments in non-federal organizations. Consolidation would also affect the reported operating results of the government; interest expense would be reduced by the amount paid by the U.S. Treasury to the FRS and revenue would be reduced by the amount paid by the FRS to the U.S. Treasury.

A36. If the assessment of the FRS resulted in its classification as a disclosure organization, disclosures regarding the FRS would aid users in understanding the FRS, its relationship with the federal government, any significant activities, and any risks posed to the federal government. Such disclosures would allow the reader to consider monetary policy and fiscal policy as distinct activities. The government-wide consolidated financial statements would present the results of fiscal policy. Consolidation of fiscal and monetary policy financial information, as described above, would result in elimination of some Treasury securities. Thus, the use of Treasury securities to conduct monetary policy and their elimination upon consolidation could obscure the Treasury securities (debt) that result from the fiscal policies of the federal government. Further, liabilities for Federal Reserve notes outstanding and deposits by depository institutions differ in character from liabilities arising from fiscal policy. In contrast, disclosures may provide an understanding of the relationship between monetary and fiscal policy and support consideration of these distinct activities.

A37. The Board recognizes the FRS performs a unique federal function—central banking—and there is only one organization of this type. The FRS is unique not only in its mission, but also in its governance, structure, activities and the need to maintain independence in practices. Its responsibilities are broad reaching because of the impact of monetary policy on the country (government, businesses, and citizens) thereby leading to great interest in its activities. The magnitude of its role and transactions led the Board to propose certain minimum disclosures about the FRS. The minimum disclosures recognize that there is special interest in the activity of the central banking system. The minimum disclosures are in addition to any other reporting requirements in the government-wide financial report and any reporting entity to which it may have been administratively assigned. The minimum disclosures focus on governance, significant roles and responsibilities, actions to achieve monetary and fiscal policy objectives, transactions with the reporting entity, risks to the federal government and future exposures to gains and losses. The disclosures should be integrated, and depending on the circumstances, also may be required by other provisions in this Statement or other GAAP requirements.

Consolidation entities

A38. Consolidation entities generally provide goods and services on a non-market basis. That is, prices are not established solely through market transactions where supply and demand determine price. Goods and services provided on a non-market basis may be free of charge or provided at prices that are either not economically significant or bear little relationship to the cost of the goods or services.

A39. Consolidation entities are financed through taxes and other non-exchange revenue as evidenced by inclusion in the budget. Significant risks and rewards fall to the federal government for consolidation entities. Inclusion in the budget is the clearest evidence an organization is relying on the taxpayer and that elected officials are key decision makers.

A40. The budget is a political document serving many purposes. The 1967 *Report of the President's Commission on Budget Concepts* indicates that “the budget must serve simultaneously as an aid in decisions about both the efficient allocation of resources among competing claims and economic stabilization and growth.” On the topic of coverage of the budget, the Commission recommended that “the budget should, as a general rule, be comprehensive of the full range of Federal activities.” Because the budget includes “federal activities,” entities listed in the budget, except those receiving federal financial assistance, are presumed to qualify as consolidation entities.

A41. The assessment of whether an organization meets the attributes for a consolidation entity is based on the assessment of all the attributes and the degree to which each is met. As such, not all attributes are required to be met; classification is based on the assessment as a whole.

Disclosure organizations

A42. Disclosure organizations receive limited or no funding from general tax revenues. Disclosure organizations, in contrast to consolidation entities, are often structured so there is a clear barrier or limit on taxpayer financing of the entity. Disclosure organizations have relative financial independence and often provide goods and services on a market basis. This may be an effort to shield the federal government from risk.

A43. Another contrast with consolidation entities is that with disclosure organizations, the Congress and/or the President have much less direct involvement in decision-making. Decision-making may rest with a governing board insulated from political influence and there may be situations where disclosure organizations have a separate legal identity.

A44. It is important to recognize the continuum that exists among disclosure organizations. For example, despite a greater degree of autonomy, some disclosure organizations may still exercise powers that are reserved to the federal government as sovereign. Other disclosure organizations may not themselves carry out missions of the federal government but, instead, are owned or controlled by the federal government as a result of regulatory or intervention actions.

A45. The Statement provides categories of disclosure organizations primarily as a way to help identify disclosure organizations. However, the Statement does not require presentation by any specific class or category and allows flexibility in presenting information about disclosure organizations. The categories of disclosure organizations include quasi-governmental and/or financially independent organizations, receiverships and conservatorships, and federal government intervention actions.

Quasi-Governmental and/or Financially Independent Organizations

A46. The Statement describes quasi-governmental and/or financially independent organizations as those disclosure organizations where governance and/or financial differences lead to greater independence. The Statement identifies both governance and financial characteristics that would be found in this type of disclosure organization.

A47. Quasi-governmental and/or financially independent organizations may include certain FFRDCs, museums, performing arts organizations and universities, and venture capital funds. Because details may differ among organizations in each example type, an objective

assessment may classify some individual organizations as consolidation entities rather than disclosure organizations. Appendix C- Illustrations offers examples that may be useful in application.

Receiverships and Conservatorships

A48. The Statement describes receiverships and conservatorships as disclosure organizations. This includes those failed financial institutions and banks the federal government takes control or ownership of with no goal to maintain the relationship. Absent a decision to make control permanent, such controlled or owned organizations would be disclosure organizations and are not subject to the GAAP hierarchy for federal entities included in the GPFFR.

Federal Government Intervention Actions

A49. The Statement describes federal government intervention actions as disclosure organization involvements resulting from exceptional circumstances where the involvements are not expected to be permanent. SFFAC 1 acknowledges the unique nature of federal government activity and its broad responsibilities. Paragraph 50 explains “The federal government is unique, when compared with any other entity in the country, because it is the vehicle through which the citizens of the United States exercise their sovereign power. The federal government has the power through law, regulation, and taxation to exercise ultimate control over many facets of the national economy and society...” SFFAC 1 describes the federal government’s responsibility for the general welfare of the nation in paragraph 53-54 as “a broad responsibility that involves multiple goals.”

A50. With these broad responsibilities, the federal government may decide to take certain actions or intervene in certain situations. Examples may include actions to provide stability to the financial markets, key industries, states, cities, counties, or military occupation of another country.⁵⁸ These types of federal government interventions are considered rare.⁵⁹ Historically the federal government has been involved in few commercial enterprises on an equity basis or shared ownership basis.⁶⁰ Although the federal government may not act to maximize profits, the federal government may intervene and act in capacities to protect citizens. This may ultimately lead to taking control of organizations or acquiring some form of ownership.

A51. The federal government may also intervene by providing assistance through extending loans or debt guarantees that do not meet the inclusion principles established in this Statement. Such transactions should be accounted for in accordance with the appropriate accounting standards per the GAAP hierarchy. This Statement does not include additional disclosures for such intervention actions.

A52. Currently SFFAC 2 provides an exception for situations where the criteria leading to consolidation are met temporarily. Specifically, paragraph 45 of SFFAC 2 states “The entity

⁵⁸ After the signing of the Japanese Instrument of Surrender in 1945, Japan was supervised for 6 years by the Allied (primarily American) forces and subject to military control, with General MacArthur at the head of the Occupation administration. (Takemae, Eiji; 2002, p. xxvi)

⁵⁹ The financial crisis that began in 2007 is considered to be the most severe since the Great Depression. (White Paper on Changes to Financial Regulations)

⁶⁰ Congressional Research Service (CRS) Report for Congress RL30533, *The Quasi Government: Hybrid Organizations with Both Government and Private Sector Legal Characteristics*

or any of the above criteria are likely to remain in existence for a time, i.e., the interest in the entity and its governmental characteristics are more than fleeting.” “Fleeting” may imply periods of one year or less to some and the Board considered how to clarify the term “fleeting.” Ultimately, the Board decided terms such as “fleeting” and “temporary” imply a time limit.

A53. However, there may be instances where an intervention is longer than one year due to the extreme factors of the national crisis. In most instances, it is difficult to establish and meet a timeline for ending an intervention. In these instances, the focus continues to be on governance and protection, rather than maximizing profits or establishing new federal government lines of business. Although the actions may be longer than one year, the interventions are “not expected to be permanent.” The Board established this “non-permanent” expectation as a characteristic of disclosure organizations rather than relying on “temporary” or “fleeting” to avoid the implication that a time limit could be established.

A54. A further implication the Board wishes to avoid is that organizations owned or controlled as a result of interventions are considered “federal entities.” The Statement recognizes that such interventions create a need for accountability but they do not make the disclosure organizations arising from intervention actions “federal entities.” Hence, the Statement proposes that disclosure organizations not be subject to the GAAP hierarchy for federal entities.

Component Reporting Entities

A55. The Board believes there should be consistency in treatment of organizations at the government-wide and the component reporting entity levels. The reasons for including organizations at the component reporting entity level should be consistent with the reasons in the government-wide entity GPFFR. Further, classification as consolidation entities or disclosure organizations would be consistent in government-wide and component reporting entity GPFFRs. The Board believes a single set of principles for inclusion and classification presented from the government-wide perspective provides for the desired consistency. This is appropriate and necessary because the government-wide reporting entity is the only federal reporting entity that is an independent economic entity.

A56. Nonetheless, implementation of these principles will involve the component reporting entities because the government-wide report is a consolidation of the reports provided by component reporting entities. Therefore, component reporting entities must identify and include in their GPFFR all consolidation entities and disclosure organizations for which they are accountable so that both the component reporting entity GPFFR and government-wide GPFFR are complete.

A57. The Board believes that component reporting entities should identify consolidation entities and disclosure organizations administratively assigned to the component reporting entity. Standards that are based on organization and accountability provide a more realistic view of how component reporting entities become accountable for organizations and how component entity boundaries are likely to be determined. The result will be component reporting entity GPFFRs that include all organizations for which the component reporting entity management (for example, appointed officials) are expected to be accountable.

A58. Administrative assignments to component entities are typically made in policy documents such as laws, budget documents, regulations, or strategic plans. Ultimately, component reporting entities would identify and include in their GPFFR all consolidation entities and disclosure organizations for which they are accountable so that both the component reporting entity and government-wide GPFFRs would be complete.

A59. Administrative assignments can be identified by evaluating the following three areas:

- a. Scope of the Budget Process
- b. Accountability Established Within a Component Entity
- c. Misleading to Exclude and/or Misleading to Include

A60. Component reporting entities should develop processes to ensure they identify and assess any organizations (1) within the scope of their budget process, (2) for which accountability is established within their component reporting entity, or (3) which are misleading to exclude. Central agencies are anticipated to determine if there is a need for coordinated guidance to be developed to ensure government-wide consistency.

A61. Although there may be a one-time review to ensure completeness and consistency, the Board believes this method is reasonably consistent with current practice. Further, a coordinated effort from the central agencies could promote a process to ensure the component reporting entities are performing the necessary procedures to capture the material organizations from their perspectives and also for consideration at the government-wide level. The effective date considered this and allowed sufficient time for a coordination of efforts.

GPFFR Consolidation and Disclosure

A62. As noted above, decisions about the government-wide GPFFR require determining what organizations are to be included in the reports and identifying appropriate means to present relevant information about organizations. The final determination of the presentation of financial information through consolidation or disclosure is based upon the results of two assessments—first if the organization is included and second, if those included organizations are classified as consolidation entities or disclosure organizations.

A63. The Flowchart at Appendix B is a useful tool in applying the principles established. It is helpful in the assessment and applying the standards in order. It includes paragraph references to underlying principles and major decision points.

Consolidation Entities

A64. The Statement provides that consolidation entities should apply SFFAS 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*. In addition, it provides for the consolidation of the financial statements of consolidation entities so citizens may assess the financial position and the cost of operations of the federal government. Consolidation of financial information regarding the activities financed by taxes and other non-exchange revenue, resources, and obligations where governance rests with the Congress and/or the President ensures that the reporting objectives of SFFAC 1 are met.

A65. Existing guidance may also require additional information—either through disclosures or required supplementary information—regarding consolidation entities. While the term “disclosure organizations” is used to refer to organizations included in GPFFRs through disclosures, readers should not infer that disclosures would not also be provided regarding consolidation entities and related activities and transactions consistent with existing standards.

Consolidation of FASB-based and FASAB-based Information

A66. The Board has considered the potential ramifications when some federal entities follow GAAP for nongovernmental entities promulgated by the private sector Financial Accounting Standards Board (FASB GAAP) and their information is consolidated with information based on FASAB standards. For example, federal government corporations, the U.S. Postal Service, certain component reporting entities of the U.S. Department of the Treasury, and some other organizations in the executive and legislative branches have historically applied FASB GAAP and continue to do so. SFFAS 34 recognizes that “general purpose financial reports prepared in conformity with accounting standards issued by the FASB also may be regarded as in conformity with GAAP for those entities that have in the past issued such reports.” SFFAS 34 also provides that a federal reporting entity preparing audited financial statements for the first time may adopt FASB standards in the rare case that the needs of its primary users would be best met through the application of FASB standards. The acceptance of these practices raises the question of whether the information prepared under FASB standards may be consolidated with information prepared under FASAB standards in consolidated reports prepared by other component reporting entities and in the consolidated government-wide reporting entity.

A67. The Board has considered such issues on several occasions and provided concepts as follows:

The reporting entities of which the components [preparing reports under FASB or regulatory accounting standards] are a part can issue consolidated, consolidating, or combining statements that include the components’ financial information prepared in accordance with the other accounting standards. They need to be sensitive, however, to differences resulting from applying different accounting standards that could be material to the users of the reporting entity’s financial statements. If these differences are material, the standards recommended by FASAB and issued by OMB and GAO should be applied. The components would need to provide any additional disclosures recommended by FASAB and included in the OMB issued standards that would not be required by the other standards.⁶¹ (SFFAC 2, *Entity and Display*, par. 78 (excerpt from section on “Financial Reporting For An Organizational Entity”))

A68. The Board determined in SFFAS 34 that FASB-based statements are acceptable in certain circumstances. While there are significant differences between FASB and FASAB standards, both standards result in accrual-basis information and disclosures that aid users in understanding the information. Converting FASB-based information to FASAB-based information for consolidated financial reports of larger organizations may not be justifiable since conversion may not aid users.

⁶¹ In October 1999, FASAB was recognized as the Rule 203 standards-setting body for the federal government. As such, FASAB now issues the standards, rather than issuing recommendations to OMB and GAO for issuance of the standards.

A69. Users may be confused by the presentation of different amounts for a component in its own financial report and in the consolidated financial reports of larger organizations; particularly when both amounts would be in accordance with GAAP for federal entities per SFFAS 34. In addition, conversion imposes a cost and it is not clear that the cost is justifiable based on benefits to the user. Therefore, this Statement proposes that amounts derived for component reporting entities in compliance with SFFAS 34 be consolidated without adjustment.

A70. However, if this leads to consolidation in a single line item of amounts measured differently due to differences between FASB and FASAB principles, then one would anticipate disclosures of the different accounting policies and the related amounts to aid the reader in understanding the information provided. The Board considered adopting requirements for such disclosures but believes that existing requirements and long-standing professional practices are sufficient.

Disclosure Organizations

A71. The Board believes consolidation of disclosure organizations would not result in information meeting the basic qualitative characteristics of information in financial reports because it would not provide the most relevant, understandable, or consistent information. The Board believes consolidation of disclosure organizations may obscure the boundaries of the risks and rewards intended to be assumed or gained. Further, assets that are not available for purposes other than the specific business operation of the non-consolidated organization might be commingled with federal assets, and liabilities not fully guaranteed by the federal government might be added to federal liabilities. Instead, financial balances and amounts for organizations having the characteristics of disclosure organizations should be kept separate from balances and amounts for those organizations having the characteristics of consolidation entities to prevent distortions to the consolidated financial statements.

A72. The Board believes SFFAC 1 recognizes the challenges that may arise in applying traditional approaches to financial reporting. SFFAC 1 par. 49 states "...Federal accounting and financial reporting are shaped by, and need to respond to, the unique characteristics and environment of the federal government." SFFAC 1 par. 105 further explains "reports must accurately reflect the distinctive nature of the federal government and must provide information useful to the people, their elected representatives, and federal executives..." SFFAC 1 also provides the qualitative characteristics of information in financial reports, by identifying these basic characteristics: understandability, reliability, relevance, timeliness, consistency, and comparability.⁶²

A73. The Statement provides flexibility in identifying needed information regarding disclosure organizations because the range of disclosure organizations is broad and different information may need to be disclosed to meet the reporting objectives. Providing this flexibility allows the preparer to present information judged most necessary to meet reporting objectives while also providing an understanding of the potential effect of the relationship on the consolidation entity's financial statements.

⁶² SFFAC 1, par. 156.

Factors in Determining Disclosures

- A74. Because of the flexibility needed regarding disclosures, preparers are provided a list of factors to assist in determining what disclosures to include. Materiality is an overarching consideration in financial reporting. Preparers should consider both qualitative and quantitative materiality in determining disclosure organization presentation and disclosure. Beyond materiality, the factors provided in the Statement assist in determining the nature and extent of information regarding a disclosure organization to be provided.
- A75. The factors are to be considered in the aggregate; no individual weight should be assigned or interpreted. The assessment of the appropriate disclosures should be made after considering all the factors.

Disclosure Requirements

- A76. The Board recognizes that although the Statement provides flexibility in meeting the disclosure objectives, there is a wide variety of information listed as examples that may be disclosed to meet the intended objectives and there are not requirements for how information must be aggregated. Qualitative and quantitative factors are considered in determining whether information regarding a disclosure organization is presented separately due to its significance or aggregated with the information regarding other disclosure organizations. If information is aggregated, aggregation may be based on disclosure organization type, class, investment type, or a particular event deemed significant to the reporting entity. For example, one reporting entity may determine it appropriate to aggregate by investment types, such as equity or loan, another by disclosure organization type, such as receiverships, and yet another by class, such as museum.
- A77. Further, disclosures should be integrated so that concise, meaningful and transparent information is provided. Integration is accomplished by providing a single comprehensive note regarding the disclosure. Care should be taken to ensure the objectives are met, without producing unintended consequences. Preparers should keep in mind there are associated costs and potential audit implications with any information included in a GPFFR. Incorporating by reference or including summary financial statements or summary financial information generally would result in an auditor being required to gain audit assurance on that information and thereby may result in additional audit costs.
- A78. The Board believes any financial information about disclosure organizations in the reporting entity's GPFFR should be based on accrual basis standards specific to the type of organization while minimizing additional costs on the disclosure organization. There will be instances where information about disclosure organizations is produced for reporting periods that differ from the reporting entity's reporting period. To minimize additional costs, the Board agreed that if disclosure organizations have a different reporting period than the reporting entity's GPFFR, disclosure of information from a reporting period ending within the reporting entity's reporting period is acceptable. The Board performed outreach on this issue to the audit community and to the federal entity task force. Generally, the feedback supported this approach.
- A79. However, due to the fact there could be a large time lag, there should be a provision for disclosing significant changes in the information as a result of events occurring after the issuance of the disclosure organization's audited financial statements and before the issuance of the reporting entity's audited financial statements for a later fiscal year-end. The

Board notes this would only be necessary if a disclosure organization's summarized financial statements or summarized financial information were presented. Otherwise normal transactions would be captured throughout the year so this would be a somewhat narrowed focus.

A80. The Board is especially concerned with the interpretation by the users and preparers regarding the requirements for disclosure organizations and ultimately how they would affect the display and disclosures. The Board believed this would be an important consideration during deliberations and invited the assistance of the Department of the Treasury and a potential included organization in preparing a draft Illustration of a disclosure based on the draft requirements.

A81. Although the Board believed some enhancement of the draft standards was in order to encourage concise and transparent disclosures, the Board agreed the inclusion principles were appropriate. Further, the flexibility provided within the disclosure requirements, along with the factors to consider, were preferable to prescribing information required regarding specific disclosure organizations.⁶³ The Board noted the need to emphasize the aggregation of information, referencing other disclosures when possible, additional focus on risk and other enhancements to the draft disclosures. This need arose because of the complexity of the relationships being described, transactions affecting multiple assets and liabilities being reported, and the desirability of an integrated set of disclosures. The Board subsequently modified the draft disclosure requirements to emphasize integration of disclosures.

Related Parties

A82. The Board determined it should define "related parties" and address them within this Statement for several reasons. Related party reporting is such a fundamental notion within GAAP and the auditing standards that addressing how related party concepts apply in the federal domain is important. Absent clear related party standards in the federal domain, the Board believes the private sector concepts would be applied by default.

A83. Because of the extent of the federal government's relationships – whether already established or implied – "related parties" concepts may result in numerous relationships requiring disclosure. Therefore, the Board proposes disclosure of related party relationships of such significance to the reporting entity that it would be misleading to exclude information about them. For clarity of intent, the standards rely heavily on listing parties to be included and excluded. In addition, the proposal provides room for judgment because one cannot anticipate all types of relationships the federal government may have or might have in the future that should be reported. The related parties category is needed to provide for disclosure of those organizations that are not included under the inclusion principles but where there is an existing relationship of such significance that it would be misleading to exclude.

⁶³ As discussed in paragraph A37 about the Federal Reserve System, the magnitude of its role and transactions led the Board to propose certain minimum disclosures about the central banking system in paragraph 77 of the Statement. However, these are minimum disclosures and depending on the circumstances, some of the listed information may need to be disclosed due to other requirements. The disclosures should be integrated so that concise, meaningful and transparent information is provided and Information is not repetitive

A84. Component reporting entities of a single controlling entity are generally subject to related party reporting requirements in other standard-setting domains. The Board discussed whether jointly controlled component reporting entities should disclose information about their relationships. Presently, component reporting entities are required by OMB guidance to state in the management's discussion and analysis section that: "The statements should be read with the realization that they are for a component of the U.S. Government, a sovereign entity." In addition, existing standards require recognition of inter-entity costs to ensure that cost information is not misstated as a result of relationships between component reporting entities. While members noted that readers may need additional contextual information to understand what these complex relationships imply about component reporting entity information, they preferred that OMB explore options for additional guidance through Circular A-136, *Financial Reporting Requirements*, so that it is integrated with existing disclosure requirements. Addressing additional disclosures in this Statement would likely expand its scope into areas adequately addressed in established practice.

Proposed Amendments to SFFAC 2, Entity and Display

A85. The Statement proposes amendments to SFFAC 2, *Entity and Display*. The Statement provides a description of the change to SFFAC 2 and an explanation as to why the change is being made. Most of the conforming changes are rescissions that result from movement of criteria for determining what organizations are required to be included in the federal reporting entity's GPFFR from a concepts statement to standards statement.

A86. Paragraphs 54—77 and 79 – 112 of SFFAC address concepts outside the scope of this Statement and are not amended.

A87. In addition, no changes are proposed to paragraphs 11-37 of SFFAC 2 because the Board believes these paragraphs provide the conceptual underpinning for understanding the structure of the federal government and how this relates to reporting entities for general purpose federal financial reporting. Although there may be some small differences in terminology in those paragraphs, the Board did not believe they were significant enough to warrant amendments.

A88. Paragraphs 47-50 of SFFAC 2 identify certain organizations or types of organizations (the Federal Reserve System, Government Sponsored Enterprises, and Bailout Entities) that could be included in the government-wide reporting entity based on the SFFAC 2 concepts but that should not be included. This Statement establishes principles to ensure users of GPFFRs are provided comprehensive financial information while recognizing the complexity of the federal government and its relationships with varied organizations. The principles can be applied to the organizations previously excluded and conclusions reached to include the organizations—either as consolidation entities or disclosure organizations—or to continue to exclude the organizations. SFFAC 2 is being amended to ensure that concepts provide a framework for standards-setting but do not themselves establish standards by listing specific exclusions.

Alternative View

A89. Individual members sometimes choose to express an alternative view when they disagree with the Board's majority position on one or more points in a Statement. The alternative view discusses the precise point or points of disagreement with the majority position and

the reasons therefore. The ideas, opinions, and statements presented in the alternative view are those of the individual member. However, the individual member's view may contain general or other statements that may not conflict with the majority position, and in fact may be shared by other members. The following material was prepared by Mr. Steinberg and is presented as an alternative view.

A90. Mr. Steinberg believes that in the case of receiverships, conservatorships, and interventions, which Statement of Federal Financial Accounting Concepts (SFFAC) 2 *Entity and Display* determined to be “bail-out entities,” there is a conflict with the Concepts statement. He also believes that using the ownership and control principles to explicitly equate the receiverships, conservatorships, and interventions with the other disclosure organizations gives the impression that the receiverships, conservatorships, and interventions are part of the federal government.

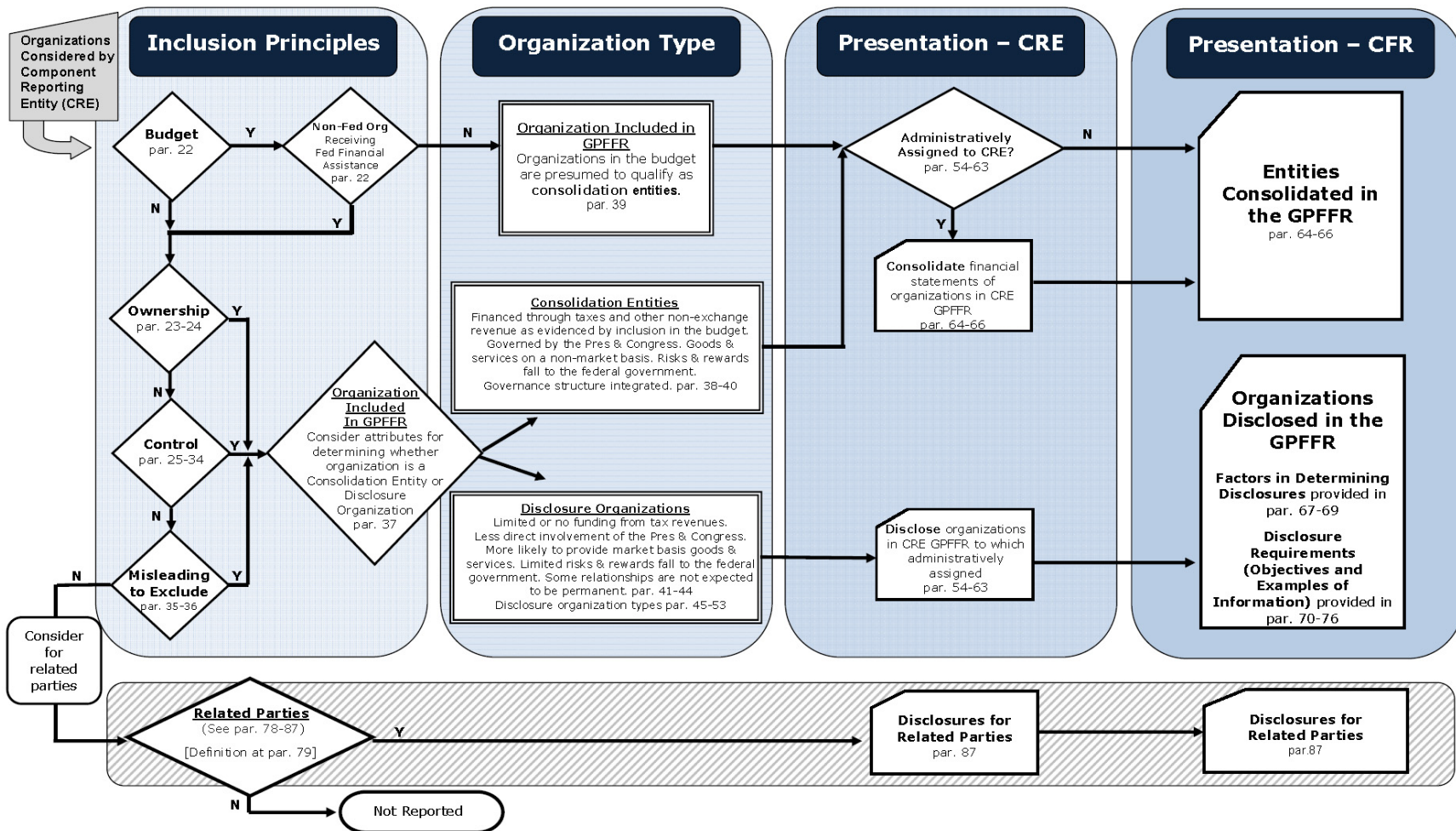
A91. The reason Mr. Steinberg does not believe receiverships, conservatorships, and interventions should be equated with other disclosure organizations is actually presented in the proposed Statement. They represent less than permanent arrangements resulting from Federal government actions to avoid adverse impacts on the nation's economy, commerce, national security, etc. (paragraphs 49, 50, 51, A53). Permanence of a relationship is a fundamental concept when defining parts of an organization. Furthermore, these organizations were established in the private sector, and they carry out activities not intended to be performed by the federal government (paragraphs A48, A50). Equating them with the other disclosure organizations could be viewed as a broadening of the reach of the federal government into the private sector.

A92. Mr. Steinberg points out that eliminating receiverships, conservatorships, and interventions as a defined class of disclosure organization within the proposed standard does not mean there should or would not be disclosure of the financial risks and expectations of benefits associated with these organizations. There are extensive disclosures now, required by both existing accounting standards and the GAAP hierarchy. These disclosures would continue.

A93. Moreover, not all interventions entail ownership or control. An example is an intervention using loan guarantees. Mr. Steinberg believes that a single standard that address all types of interventions and the manner in which they should be reported would be significantly more effective than the proposed standard which addresses only interventions in which there is temporary ownership and/or control. He points out that the Board has started a Risk Assumed project that is likely to encompass interventions. The project could ensure that the disclosures for interventions would address not only the types of disclosures expected for all disclosure organizations in this proposed standard, but also the additional disclosures appropriate for interventions. Examples of the latter are key transactions, financial assistance provided by the central banking system, costs incurred to date, the extent of contingent liabilities associated with the interventions, etc.

APPENDIX B: FLOWCHART

FLOW CHART (Appendix B)



APPENDIX C: ILLUSTRATIONS

Preamble

These illustrations demonstrate how the provisions of the standards could be applied to organizations given simplified hypothetical circumstances. They are for illustrative purposes only and are nonauthoritative. They do not:

1. represent actual organizations.
2. provide a thorough analysis of all the facts and circumstances that are needed to reach a conclusion in practice.
3. indicate a preferred method of analyzing facts and circumstances.
4. substitute for the application of professional judgment to actual facts and circumstances.

These illustrations follow the sequence presented in the decision flowchart in Appendix B. All tentative conclusions are based primarily on the hypothetical circumstances presented. In most illustrations, the tentative conclusions refer to consideration of other factors by management and the auditor. This reference is included to emphasize that, in practice, consideration of all relevant facts and circumstances would be needed to reach conclusions. The reader should assume that the general reference to “other factors” means that such factors, in aggregate, supported the conclusions implied by the necessarily limited assumed facts and circumstances presented in each illustration.

Application of the proposed standards to actual organizations requires consideration of the circumstances specific to each organization and the exercise of professional judgment. Although the limited assumed facts and circumstances presented in the illustrations may be similar to situations at a particular reporting entity, they should not be used in practice as a substitute for a complete and thorough consideration of all of the relevant facts and circumstances, which may lead to a conclusion different from the tentative conclusions in these illustrations. For example, the illustrations make certain assumptions that, in practice, require judgment of the specific facts and circumstances to make appropriate determinations.

All of the illustrations discuss administrative assignments to component reporting entities where there is only one component reporting entity relationship described. In reality, more than one component reporting entity may have a relationship with the illustrative organization. In such cases, additional information would need to be considered to determine whether other administrative assignments exist.

ABC Department

(In the Budget—Consolidation Entity)

Assumed Facts and Circumstances

Congress established ABC Department (ABC), a federal organization, to promote entrepreneurship and innovation as a means to address national economic and environmental challenges. Provisions that govern ABC are generally prescribed in legislation and ABC accomplishes its mission through the activities of various bureaus, grants to research institutions, and contracts with universities and not-for-profit organizations.

The executive leadership of ABC consists of a secretary, deputy secretary, and three assistant secretaries. The President nominates and the Senate confirms each of these officials. These officials serve at the pleasure of the President. ABC is subject to all laws and regulations applicable to executive branch agencies.

ABC relies on appropriated public funds to conduct its mission and is listed in the *Budget of the United States Government: Analytical Perspectives—Supplemental Materials* schedule entitled “Federal Programs by Agency and Account.” The President and the Congress consider ABC’s requests for resources and determine the amount that should be budgeted to provide services. Furthermore, ABC is not considered to be a non-federal organization receiving federal financial assistance.

Tentative Conclusions

Based on the assumed facts and circumstances, management determined and the auditor concurred that ABC should be included in the government-wide GPFFR because it (1) meets the first of the three inclusion principles (being listed in the budget) and (2) is not a non-federal organization receiving federal financial assistance.

Classification as a Consolidation Entity or Disclosure Organization

Further, because it is listed in the budget, ABC is presumed to qualify as a consolidation entity assuming no information to the contrary. In this example, management determined and the auditor concurred that there were no facts contradicting the assumption that ABC is a consolidation entity. As a consolidation entity, ABC’s financial statements should be consolidated in the government-wide GPFFR.

Administrative Assignments

The assumed facts and circumstances do not indicate ABC should be consolidated with another component reporting entity. Further consideration of ABC’s relationships with other consolidation entities would be needed to determine if ABC has been administratively assigned to another component reporting entity. Further consideration would also be needed to identify any consolidation entities or disclosure organizations administratively assigned to ABC.

Epsilon Corporation

(In the Budget – Consolidation Entity)

Assumed Facts and Circumstances

The Congress and the President established Epsilon Corporation as an independent government corporation to insure consumer funds placed in trust with certain types of institutions. Federal legislation established provisions that govern Epsilon's activities. Epsilon is governed by a seven member board of directors and each board member is appointed by the President and confirmed by the Senate. The Congress monitors Epsilon's activities by conducting hearings on Epsilon's programs and requesting Government Accountability Office (GAO) and Office of Inspector General (OIG) audits.

Epsilon is listed in the in the *Budget of the United States Government: Analytical Perspectives—Supplemental Materials* schedule entitled “Federal Programs by Agency and Account.” Epsilon receives its funding based on legislation permitting it to receive and spend premiums from the institutions it insures. Legislation limits how Epsilon can invest proceeds from premiums and, to help ensure that Epsilon remains financially viable, legislation requires Epsilon to have a reserve fund. The board of directors determines the level of the reserve fund. If Epsilon encounters a shortfall, the organization may borrow a limited amount from the U.S. Department of the Treasury, but any additional funding requirements must be obtained from premium assessments.

Epsilon is required to periodically report to the Congress and the President on matters such as:

- Program performance results
- Financial position, results of operations, and cash flows
- Adequacy of internal controls and systems

Furthermore, Epsilon is not considered to be a non-federal organization receiving federal financial assistance.

Tentative Conclusions

Based on the assumed facts and circumstances, management determined and the auditor concurred that Epsilon Corporation should be included in the government-wide GPFFR because it meets the first of the three inclusion principles (being listed in the budget) and is not a non-federal organization receiving federal financial assistance.

Classification as a Consolidation Entity or Disclosure Organization

Further, because it is listed in the budget, Epsilon is presumed to qualify as a consolidation entity assuming no information to the contrary. In this example, management determined and the auditor concurred that there were no facts rebutting or contradicting the assumption that Epsilon is a consolidation entity. As a consolidation entity, Epsilon's financial statements should be consolidated in the government-wide GPFFR.

Administrative Assignments

There is no information included in the assumed facts and circumstances indicating that Epsilon should be consolidated with another component reporting entity. Further consideration of Epsilon's relationships with other consolidation entities would be needed to determine if Epsilon has been administratively assigned to another component reporting entity or has had consolidation entities administratively assigned to it. Also, further consideration would be needed to identify any disclosure organizations administratively assigned to Epsilon for which disclosures are needed.

Sigma Association

(Control based on Persuasive Indicator - Disclosure Organization (Financially Independent))

Assumed Facts and Circumstances

The Congress and the President established Sigma Association (Sigma) as a not-for-profit, non-taxpayer funded organization to market innovative U.S. agricultural technology worldwide and to respond to any claims of damage arising from new technology. The fundamental purpose of the corporation is specified in legislation and its mission statement is “to open new markets for U.S. agricultural technology through a cooperative marketing strategy and risk-sharing approach for market participants.”

Sigma is governed by a ten-member board of directors. Five members are appointed by the President and confirmed by the Senate. Four members are elected by industry members. The Secretary of Agriculture (or his/her designee) serves as a voting ex-officio member of the board. No more than three of the appointed members may be from the same political party. Board members serve seven-year terms and can only be removed for cause (meaning they may not be removed for policy decisions). Also, Congress monitors Sigma’s activities by conducting hearings on Sigma’s programs and requesting GAO audits.

Sigma is financed by fees imposed on industry members. Sigma’s board of directors must establish an annual budget and legislation limits how Sigma can invest proceeds from fees and, to help ensure that Sigma remains financially viable, legislation requires Sigma to have a reserve fund. The board of directors determines the level of the reserve fund after considering input from industry members. If Sigma encounters a shortfall, it may borrow a limited amount from the U.S. Department of the Treasury (Treasury), but any additional funding requirements must be obtained from future fee assessments on industry members.

Tentative Conclusions

Based on the assumed facts and circumstances, and other considerations, management determined and the auditor concurred that Sigma should be included in the government-wide GPFFR because Sigma meets the third inclusion principle (control with expected benefits or risk of loss). Indicators that the federal government can control Sigma are that the Congress and/or the President (1) established its fundamental purpose and mission through legislation and (2) appoint a majority of the members of its board of directors (its governing body). Each of these facts individually would be sufficient to indicate control such that Sigma would be included.

Classification as a Consolidation Entity or Disclosure Organization

For this illustration, management determined and the auditor concurred that, based on the assumed facts and circumstances as well as other considerations not described in the illustrations, Sigma should be reported as a disclosure organization because it is a financially independent organization. Management and the auditor considered the assumed facts and circumstances presented below in the aggregate, weighed them against other considerations, and used professional judgment.

Evidence suggesting that it is a disclosure organization includes:

1. Tax revenue is not appropriated for ongoing operations.

2. The corporation is relatively financially independent because it is primarily funded from a source other than appropriations. Its budget and fees are not subject to Congressional or Presidential approval.
3. Having seven-year terms for directors who are not subject to removal for policy decisions indicate a higher degree of autonomy than executive branch appointees. This governance structure vests greater decision-making authority with the board while insulating it from political influence. As a result, Congressional and Presidential oversight is less direct since they are not involved in decisions such as the level of reserves needed.
4. While Sigma is permitted to borrow from the Treasury, such borrowing is limited. This means risks to the federal government are limited. Instead, Sigma is expected to maintain its operations and meet its liabilities with revenues received from sources outside of the federal government.

Evidence suggesting that Sigma may be a consolidation entity includes:

1. The President and the Senate, who appoint and confirm, respectively, members of the board of directors as well as establish organizational authorities in legislation, have a governance role.
2. Sigma provides a service that is not available from market participants. Its fees are adjusted to recover losses rather than to respond to market influences. Hence, its fees are not market-based.

Administrative Assignment

Because each disclosure organization must be reported by at least one consolidation entity, management considered whether Sigma has been administratively assigned to the Department of Agriculture. Evidence suggesting administrative assignment to the Department of Agriculture includes that the secretary serves as an ex-officio member of the board.

As a result, management determined and the auditor concurred that the Department of Agriculture should disclose information regarding Sigma in its GPFFR. If Sigma is also administratively assigned to other component reporting entities, then those component reporting entities should also consider the need to disclose information in their GPFFRs.

Scholars University

(Not Included)

Assumed Facts and Circumstances

The Congress and the President chartered Scholars University as a small, private, independent, not-for-profit educational institution and legislation describes the mission of the university. The legislation also indicates that the university is not an instrumentality of the federal government and that the federal government does not assume any liabilities of the university.

Scholars University is governed by a 29-member board of trustees. The Secretary of Education is an ex-officio member of the board and the remaining members are elected by the board for three-year terms. The board controls and directs the university's affairs such as determining the university's tuition and fee structure, adding or removing colleges within the university, and establishing new research institutions.

To support its mission, Scholars University receives most of its revenue from student tuitions and fees, and private contributions. The university receives appropriations to support some of its academic programs. The university is listed in the in the *Budget of the United States Government: Analytical Perspectives—Supplemental Materials* schedule entitled “Federal Programs by Agency and Account” under a Department of Education program because an amount is appropriated for Scholars University each year. Although the appropriations discuss limitations on how the funds may be used, the university generally has discretion over how it chooses to allocate funds for its academic programs and construction activities.

Tentative Conclusions

Based on the assumed facts and circumstances and other information, management determined and the auditor concurred that Scholars University should not be included in the government-wide GPFFR. Although listed in the Budget, management asserts that Scholars University is a non-federal organization receiving federal financial assistance in the form of a grant. Any non-federal organization listed in the budget should be assessed against the other two principles. So, management must determine if the other inclusion principles are met or if it would be misleading to exclude the university.

The initial analysis is summarized below:

- **Ownership** – The Congress and the President chartered Scholars University as a private, independent organization. There is no evidence that the federal government has an ownership interest in the university.
- **Control** – Based on the assumptions presented, the persuasive indicators of control have not been met. While the federal government chartered Scholars University, the standards provide that further indicators of control must be present to conclude that the organization is controlled. The remaining persuasive indicators—appointing or removing a majority of the governing board members, establishing financial and operating policies, and dissolving the university and having access to its assets—are not met. The available facts and circumstances suggest that Scholars is not controlled. [Note, however, for brevity this illustration does not present an analysis of indicators of control that in the

aggregate may reveal that Scholars is controlled. Such an analysis may be needed in practice.]

- Misleading to exclude – Scholars University is a small not-for-profit that is listed in the Budget solely as a program within the Department of Education. Management determined and the auditors concurred that it is both quantitatively and qualitatively immaterial. Also, there were no other facts and circumstances that would suggest that Scholars University should be included in the GPFFR. As a result, it would not be misleading to exclude.

Based on the assumed facts and circumstances and other considerations, management determined and the auditor concurred that Scholars University should not be included in the government-wide GPFFR.

Education Research Institute (ERI)

(Control based on Persuasive Indicator – Consolidation Entity)

Assumed Facts and Circumstances

The purpose of the Education Research Institute (ERI) is to assist state and local officials in making informed decisions regarding effective education methods. ERI was established by the Congress and the President through a public law specifying the organization's:

- status as a tax exempt not-for-profit,
- purpose and duties,
- governance structure,
- sources of financing, and
- reporting requirements.

The public law establishing ERI requires reauthorization of its operations every five years. If the Congress and the President do not authorize continued operation, ERI must cease operations and distribute its net assets to a successor organization designated by the federal government. If ERI is unable to satisfy its liabilities prior to dissolution, the federal government will assume its liabilities.

ERI is governed by a seven-member board of directors; five of whom are voting. Two members are specific federal officials within the Department of Education who serve part-time and do not have voting rights. The remaining five serve full-time, are appointed by the Association of Local School Boards, and serve six-year terms. One of these five members is elected by the board to serve as chairperson.

The legislation creating ERI designates funding of \$1 per elementary school student per year to be made available from the general fund of the U.S. Treasury to the ERI trust fund. An annual transfer to ERI is not listed in the *Budget of the United States Government: Analytical Perspectives—Supplemental Materials* schedule entitled “Federal Programs by Agency and Account” but is included in the Department of Education’s Congressional Budget Justification. The board of directors is authorized to establish an annual budget not to exceed the amounts available in the trust fund. ERI may fund up to 25% of its annual budget through donations but may not use federal funds to solicit donations.

The Department of Education approves the ERI annual budget. The department also reports information related to ERI activities in its annual performance report and Congressional Budget Justification.

ERI must provide annually an audited financial report to the Department of Education and relevant Congressional committees.

Tentative Conclusions

Based on the assumed facts and circumstances and other considerations, management determined and the auditor concurred that ERI should be included in the government-wide

GPFFR because the third inclusion principle (control) is met. A persuasive indicator of control exists because the federal government can unilaterally dissolve the organization and have access to its assets and responsibility for its liabilities.

Classification as a Consolidation Entity or Disclosure Organization

For this illustration, management determined and the auditor concurred that, based on the assumed facts and circumstances as well as other considerations not described in the illustrations, ERI should be reported as a consolidation entity. In arriving at this conclusion, management and the auditor considered the assumed facts and circumstances presented below in the aggregate and, finding no other facts that in the aggregate contradict these, used professional judgment to determine that ERI is a consolidation entity.

Evidence suggesting that ERI is a consolidation entity includes:

1. It is primarily financed by taxes.
2. Federal government has assumed the risks associated with ERI's liabilities.
3. The purpose of ERI is to assist state and local officials by providing consultation services on a non-market basis.
4. ERI's annual budget is approved by the Department of Education and the Department also provides information related to ERI activities in its annual performance report and Congressional Budget Justification. These activities show that elected officials, acting with and through politically appointed officials, make decisions regarding ERI's budget.

Evidence suggesting that ERI is a disclosure organization includes:

1. A majority of the members of the board of directors is appointed by non-federal officials.
2. ERI is able to access donations to sustain some of its operations.

Administrative Assignment

The Department of Education should consider whether or not ERI is administratively assigned to it. Evidence that indicates ERI is administratively assigned includes Education's participation in ERI's budgetary process and inclusion of information regarding ERI in its own Congressional Budget Justification. Having considered the above information and other available evidence, the Department of Education determined and its auditor concurred that it should consolidate ERI's financial statements in its GPFFR.

Mediation Corporation

(Control based on Indicators in the Aggregate –Disclosure Organization)

Assumed Facts and Circumstances

Mediation Corporation (Mediation) was established as a 501(c)(3) non-member not-for-profit organization through a public law specifying the organization's:

- status and operating location,
- purpose and duties,
- governance structure,
- sources of financing, and
- reporting requirements.

The purpose of Mediation is to ensure that low-income individuals have access to mediation services to resolve non-criminal legal disputes. An assigned duty is to develop and maintain a network of state and local government organizations to deliver services financed by grants. Network members may raise funds to finance delivery of services through taxes, donations, and other grants without limitation.

The governing board comprises 13 members including Mediation's executive secretary. The President nominates candidates to fill the board member positions. A panel of local government officials participating in the network selects new members of the governing board from among the nominees. No more than seven members may be affiliated with the same political party. The members elect their chairperson from among the members. The President appoints the executive secretary and the Senate confirms the appointment. The executive secretary's term is fifteen years during which the President may only remove the appointee for cause.

Mediation is financed by an annual appropriation, interest earnings, and grants from any public or private grant-making organization. Grants must not finance more than 20 percent of its annual budget. The U.S. Attorney General approves the annual budget. Any liabilities incurred by Mediation must be settled from its assets and are not backed by the full faith and credit of the U.S. Government.

An annual appropriation is provided in the *Budget of the United States Government: Analytical Perspectives—Supplemental Materials* schedule entitled "Federal Programs by Agency and Account" for "Grants to the Mediation Corporation." The appropriation is made to the Department of Justice which transfers budget authority to Mediation. Mediation manages its cash balances similar to other not-for-profits and may retain any interest earned on unspent funds. In addition, it may apply for and receive grants from any grant making organization—public or private—subject to the 20 percent limitation.

The public law creating Mediation requires it to make annual audited financial reports publicly available. Mediation also files annual tax returns with the Internal Revenue Service. Furthermore, Mediation is considered to be a non-federal organization receiving federal financial assistance.

Tentative Conclusions

Although Mediation is listed in the Budget, it is a non-federal organization receiving federal financial assistance. To determine if Mediation should be included in the government-wide GPFFR, management considered the remaining inclusion principles—ownership and control. It is unclear, based on the assumed facts and circumstances, whether Mediation is owned by the federal government. Therefore, management must consider the control indicators to determine if the third inclusion principle is met. None of the persuasive indicators of control are present based on the assumed facts and circumstances so considerable professional judgment is required to determine whether – in the aggregate – the indicators provide evidence of control. The indicators suggesting federal government control over Mediation include:

1. The federal government provides significant input regarding selection of the organization's governing board members since a selection can only be made from among candidates identified by the President.
2. The President appoints a key executive – the executive secretary – and may remove him or her for cause.
3. Federal law restricts Mediation's capacity to generate revenues since only appropriations, interest earned, and grants may be used. In addition, only 20 percent of its annual needs may be met through grants.
4. The U.S. Attorney General approves the annual budget.
5. Federal law requires annual audited financial reports.
6. Federal law directs Mediation to work through a network of government agencies to provide services.

Based on the assumed facts and circumstances and other considerations, and using professional judgment, management determined and the auditor concurred that Mediation should be included in the government-wide GPFFR.

Classification as a Consolidation Entity or Disclosure Organization

For this illustration, management determined and the auditor concurred that, based on the assumed facts and circumstances as well as other considerations not described in the illustrations, Mediation should be reported as a disclosure organization. In arriving at this conclusion, management and the auditor considered the assumed facts and circumstances presented below in the aggregate and, finding no other facts that in the aggregate contradict these, used professional judgment to determine that Mediation is a disclosure organization.

Evidence suggesting that Mediation is a consolidation entity includes:

1. It is primarily funded by taxes.
2. Elected officials determine Mediation's budget, because at least 80 percent of its funding is appropriated to Justice. In addition, an appointed federal official, the U.S. Attorney General, approves Mediation's annual budget.

Evidence suggesting that Mediation is a disclosure organization includes:

1. Members of its governing body are selected by non-federal officials, serve longer terms than political appointees, must include members from different political parties, and may only be removed for cause. These conditions insulate the governing body from political influence.
2. Mediation has some access to non-federal funding through grants and its network of service providers is free to access non-federal funding for service delivery (subject to the 20 percent limitation).
3. Federal government has not assumed risks related to Mediation's liabilities.

Administrative Assignments

The Department of Justice should consider whether or not Mediation is administratively assigned to it. Evidence that indicates it is administratively assigned includes the Department of Justice's participation in Mediation's budgetary process. After considering the above and other factors, and using professional judgment, management at the Department of Justice determined and the auditor concurred that disclosures regarding Mediation should be presented in its GPFFR.

Bicycle America, Inc. (Scenario A)

(Not Included)

Assumed Facts and Circumstances

Individual bicycle shop owners determined that a nation-wide network of shops and trails was needed to encourage greater reliance on bicycles for transportation and invested in a new corporation, Bicycle America (BA). BA's mission was to create a coast-to-coast network and ensure wide access to bicycling. Shares in the venture are held by local bicycle shops in all major cities.

BA is governed by a board of directors. The board controls and directs the organization's affairs and interests. Board members are elected by the shareholders to serve three-year terms.

Until recently, BA was able to finance its operations from user fees. A recent lawsuit led to serious financial challenges and cash was unavailable to meet pressing needs. Absent a cash inflow, BA was considering closing the trails. Due to exceptional citizen reliance on the trails for transportation and recreation, the federal government intervened and enacted legislation to provide funding.

The federal government provided a short-term loan to BA. The federal financial intervention to preserve BA was not separately identified in the Budget, but was part of a larger federal program within the Department of Transportation.

The funding legislation also established a temporary advisory committee to monitor BA's financial condition and inform Congress of potential issues that may warrant additional actions. In addition, the advisory committee will develop a plan to aid BA in returning to financial solvency and refinancing the short-term loan.

Tentative Conclusions

Based on the assumed facts and circumstances and other considerations, management determined and the auditor concurred that BA should not be included in the government-wide GPFFR. Specifically, BA is not listed in the Budget. Further, based on the available information and other considerations, management determined and the auditor concurred BA does not meet either the remaining ownership or control inclusion principle because BA continues to be owned by common shareholders and governed by the existing board of directors. The advisory committee offers advice to the Congress and does not have authority to direct BA to act. 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 exclude BA.

Bicycle America, Inc. (Scenario B)

(Ownership – Disclosure Organization (Intervention))

Assumed Facts and Circumstances

Same as above except that in addition to the actions in Scenario A above, the federal government received shares that carry 51 percent of the voting rights of BA common stock and the advisory committee will develop a plan to sell the shares.

Tentative Conclusions

Based on the changed assumptions and no information to the contrary, and using professional judgment, management determined and the auditor concurred that BA should be included in the government-wide GPFFR. When the federal government holds a majority ownership interest, albeit temporary, the owned organization should be included in the government-wide GPFFR.

Classification as a Consolidation Entity or Disclosure Organization

The available facts and circumstances indicate that the federal government's involvement with BA is an intervention not expected to be permanent. Based on the assumed facts and circumstances and other considerations, management determined and the auditor concurred that BA should be reported as a disclosure organization because ownership resulted from an intervention. The initial determination would need to be evaluated periodically to determine if the intervention continues to be intended to be temporary.

Administrative Assignments

Department of Transportation was assigned responsibility for transferring funds to BA which indicates an administrative assignment. As a result, management determined and their auditor concurred that the department should disclose information regarding BA in its GPFFR. If BA is also administratively assigned to other component reporting entities, then those component reporting entities should also disclose information in their GPFFRs.

Chatham Laboratory

(Control based on Persuasive Indicator – Consolidation Entity (FFRDC))

Assumed Facts and Circumstances

Federal Department of ABC (ABC) organized Chatham Laboratory as a federally funded research and development center (FFRDC) to conduct specialized engineering research that supports ABC's mission related to infrastructure and leads to improved services. As specified in the agreement, ABC provides the physical capital and ongoing funding for the FFRDC and sets research goals for Chatham.

ABC selects a contractor to operate Chatham and conduct research consistent with the established goals. ABC is not involved in the day-to-day operations of Chatham. ABC routinely evaluates Chatham's performance and maintains a research office to review strategic plans, consider progress, and serve as a liaison to other federal institutions. ABC reports on Chatham's efforts in its own performance reports.

Chatham operations are funded entirely through appropriations provided to ABC. ABC identifies Chatham in its Congressional Budget Justification but Chatham is not specifically identified in the *Budget of the United States Government: Analytical Perspectives—Supplemental Materials* schedule entitled "*Federal Programs by Agency and Account*." Instead, amounts for Chatham are included in a larger research program which makes payments to the contractor consistent with the terms of the contract. Chatham's contract operator must submit financial and performance reports to ABC periodically. All Chatham assets belong to the federal government and the results of Chatham research are the property of the federal government. In addition, ABC would be responsible for liabilities arising from use of the facilities to conduct research such as environmental cleanup liabilities. ABC is also responsible for employee benefits in the event Chatham operations are terminated.

Tentative Conclusions

Based on the assumptions and other considerations, management determined and the auditor concurred that Chatham should be included in the government-wide GPFFR. While contracting for the operation of Chatham, officials at ABC also act as the governing body by establishing the purpose and mission of Chatham. Further, ABC continues in this role through its involvement in Chatham's strategic planning and monitoring of performance. Establishing the purpose and mission of an organization is a persuasive indicator that control exists.

Classification as a Consolidation Entity or Disclosure Organization

For this illustration, management determined and the auditor concurred that, based on the assumed facts and circumstances as well as other considerations not described in the illustrations, Chatham should be reported as a consolidation entity. In arriving at this conclusion, management and the auditor considered the assumed facts and circumstances presented below in the aggregate and, finding no other facts that in the aggregate contradict these, used professional judgment to determine that Chatham is a consolidation entity.

Evidence suggesting that Chatham is a consolidation entity includes:

1. It is primarily financed by taxes.

2. The federal government has assumed the risks associated with Chatham's liabilities.
3. Chatham's annual budget is developed by ABC officials and information related to Chatham activities is provided in ABC's performance report and Congressional Budget Justification. This indicates that decision-making regarding the budget is exercised by elected officials through politically appointed officials and the budget process.

Evidence suggesting that Chatham is a disclosure organization includes:

1. Day-to-day operating decisions are made by a contractor.

After considering the above analysis and other factors, management determined and the auditor concurred that Chatham is a consolidation entity.

Administrative Assignment

ABC should consider whether or not Chatham is administratively assigned to it. In the example, evidence suggesting Chatham is administratively assigned includes ABC's role in Chatham's strategic planning, budgeting, and administration. Having considered the assumed facts and circumstances and other available evidence, the Department of ABC determined and its auditor concurred that it should consolidate Chatham's financial statements in its GPFFR.

Gotham Laboratory

(Not included – Economic Dependency Insufficient to Show Control)

Assumed Facts and Circumstances

The Department of XYZ (XYZ), a department within the executive branch of the federal government, contracted with Gotham Laboratory (Gotham) to conduct specialized engineering research that fulfills a federal mission related to infrastructure and leads to improved services of XYZ. As specified in the agreement, XYZ provides funding to Gotham and Gotham's management team plans, manages, and executes the assigned research program.

XYZ serves on a panel providing input on the appointment of the board of directors for Gotham. However, the board of directors elects new members and the board manages Gotham's research. Gotham also may engage in any outside research activities approved by its board of directors.

Gotham performs services for various federal and non-federal organizations but receives 90 percent of its funding from XYZ. XYZ receives appropriated funds to support the Gotham research program. The remaining 10 percent of Gotham funding is derived from contracts with other federal agencies and private industry as well as donations. Gotham's budget is not reviewed or approved by any federal officials. Gotham is subject to the usual federal contract oversight and reporting requirements.

Tentative Conclusions

Based on the assumptions and other considerations, management determined and the auditor concurred that Gotham should not be included in the government-wide GPFFR. Gotham is not listed in the *Budget of the United States Government: Analytical Perspectives—Supplemental Materials* schedule entitled “*Federal Programs by Agency and Account*.” Further, based on the assumed facts and circumstances and other considerations, Gotham does not meet the inclusion principles of either majority ownership or control with risk of loss or expectation of benefit. Although Gotham appears to be economically dependent on the federal government, it ultimately retains discretion as to whether to accept funding or do business with the federal government. Despite the influence resulting from this dependency, the federal government does not govern Gotham's financial and operating policies. Further, 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 exclude Gotham.

Andromeda Prime Power Systems

(Related Party- GSE)

Assumed Facts and Circumstances

The federal government created Andromeda Prime Power Systems (APPS) as a government sponsored enterprise (GSE) to facilitate commercial space travel. APPS controls interplanetary travel among a network of commercial space stations and is subject to federal regulations regarding safety and technology transfers to other nations.

APPS is governed by a nine-member board of directors elected by common stock shareholders. Board members serve three-year terms.

APPS issued common stock and received a federal government grant to finance its initial capital and startup costs. The APPS is under no obligation to return the grant funds but is expected to promote U.S. competitive interests in the emerging space travel industry.

During the reporting period, APPS' board approved a strategic plan to expand its systems to accommodate increased commercial demands and APPS issued bonds to finance the initiative. The interest rate required by lenders indicates that the market assumes the federal government has implicitly guaranteed the payment of principal and interest. In its regulatory capacity, the federal government required APPS to establish a capital reserve and created a five-member APPS Advisory Board to monitor and advise Congress on APPS' fiscal operations.

APPS derives its revenues from fees charged to commercial organizations and receives no ongoing federal support through the Budget.

Tentative Conclusions

Based on the assumptions and other considerations, management determined and the auditor concurred that APPS should not be reported in the government-wide GPFFR as a consolidation entity or disclosure organization. APPS is not listed in the *Budget of the United States Government: Analytical Perspectives—Supplemental Materials* schedule entitled “*Federal Programs by Agency and Account*” and the federal government does not have a majority ownership interest in the company.

Further, management conducted a thorough assessment of control indicators and determined the federal government does not exercise control of APPS. Regulation of APPS does not, by itself, establish control.

However, based on the assumptions and other considerations, management determined and the auditor concurred that APPS should be disclosed as a related party. Related parties generally include GSEs not meeting the inclusion principles, especially those organizations for which the relationship is of such significance that it would be misleading to exclude information about it.

U.S. Museum (Scenario A)

(In the Budget – Consolidation Entity)

Assumed Facts and Circumstances

The U.S. Museum (the Museum) was organized to bring history and lessons about the United States to individuals through educational outreach, teacher training, traveling exhibitions, and scholarship.

The Museum is an independent establishment of the federal government and is governed by a board of trustees, known as the Museum Council. The Council has 13 voting members and 2 nonvoting members. Of the voting members, 11 are appointed by the President and serve 10-year terms (appointments are staggered) and the other 2 are appointed from among members of Congress to serve during their term. The non-voting members are selected by the Council.

The Museum receives an annual appropriation as well as private donations. Annual appropriations account for approximately 90 percent of operations and activities, with the remaining 10 percent coming from donor activities and museum sales. The museum is listed in the *Budget of the United States Government: Analytical Perspectives—Supplemental Materials* schedule entitled “*Federal Programs by Agency and Account.*” All donations are considered to be available for use unless specifically restricted by the donor or by time. Furthermore, the Museum is not considered to be a non-federal organization receiving federal financial assistance.

Tentative Conclusions

Based on the assumptions and other considerations, management determined and the auditor concurred that the Museum should be included in the government-wide GPFFR because the Museum is listed in the Budget (the first inclusion principle). Further, the President and the Congress appoint the Museum Council which indicates the federal government controls the Museum (the third inclusion principle).

Classification as a Consolidation Entity or Disclosure Organization

Because it is listed in the budget, the Museum is presumed to qualify as a consolidation entity assuming no information to the contrary. In this example, management determined and the auditor concurred that there were no facts rebutting or contradicting the assumption that the Museum is a consolidation entity. As a consolidation entity, its financial statements should be consolidated in the government-wide GPFFR. The financial statements included should be for the entire organization and thus include the sources and uses for both the appropriations and the donated funds.

Administrative Assignment

Based on a review by management, no other component reporting entity has been assigned administrative responsibilities for the Museum. Therefore, the Museum is consolidated only directly into the government-wide GPFFR.

U.S. Museum (Scenario B)

(Control based on Persuasive Indicator –Disclosure Organization (Financially Independent))

Assumed Facts and Circumstances

The U.S. Museum (the Museum) was organized by volunteers to bring history and lessons about the United States to individuals through educational outreach, teacher training, traveling exhibitions, and scholarship. The Museum is intended to be a self supporting operation. Shortly after its founding, it entered into a cooperative relationship with the Department of Federal Museums, a department within the executive branch.

The Museum is incorporated as a not-for-profit organization governed by the Museum Council. The Council has 15 voting members referred to as trustees. The presidentially-appointed head of the Department of Federal Museums serves as the Council chairperson. Of the remaining voting trustees, nine are appointed by the President and five are selected and approved by the Council. Except for the chairperson, all trustees serve ten-year terms which are staggered. The Council selects a Board of Directors for the Museum and appoints the Chief Executive Officer.

The Museum is a public-private partnership which receives an annual appropriation as well as private donations, rental income, and sales revenue. No fees are charged for educational events or museum tours. Rental income from the Museum facilities is derived from rates competitive with other venues for similar events. Rental of the facilities is intended to support museum activities such that the museum can eventually be self supporting. Presently, annual appropriations account for approximately 15 percent of operations and activities, with the remaining 85 percent coming from donor activities, rental income, and museum sales. The museum is listed in the *Budget of the United States Government: Analytical Perspectives—Supplemental Materials* schedule entitled “Federal Programs by Agency and Account.” The funding received from donations is restricted to use by the Museum and the trustees approve the annual budget including rental income and fundraising goals.

The Museum’s employees are not federal employees. The Museum is required to fully fund any deferred compensation programs and to advise its employees that the federal government has not guaranteed their deferred compensation.

Tentative Conclusions

Based on the assumed facts and circumstances and other consideration, management determined and the auditor concurred the Museum should be included in the government-wide GPFFR because it is controlled by the federal government. Although the Museum is listed in the Budget, it is a non-federal organization receiving federal financial assistance. An assessment of the remaining inclusion principles shows that the Museum is controlled by the federal government since a majority of the trustees are appointed by the President; a persuasive indicator of control.

Classification as a Consolidation Entity or Disclosure Organization

For this illustration, management determined and the auditor concurred that, based on the assumed facts and circumstances as well as other considerations not described in the illustrations, the Museum should be reported as a disclosure organization. In arriving at this conclusion, management and the auditor considered the assumed facts and circumstances

presented below in the aggregate and, finding no other facts that in the aggregate contradict these, used professional judgment to determine that the Museum is a disclosure organization.

Evidence suggesting that U. S. Museum is a consolidation entity includes:

1. Appointments to the Council are made by elected officials.
2. Museum services, educational events and tours, are provided on a non-market basis to the general public.

Evidence suggesting that U.S. Museum is a disclosure organization includes:

1. The Museum is a separate legal organization – a not-for-profit – and terms for a majority of Council members are ten-years. This insulates the organization from political influence. Further, day-to-day operations are governed by a board of directors whose members are not directly appointed by elected officials.
2. The Museum is intended to receive limited financing from taxes and market rates are charged for facility rentals.
3. The Museum is required to make explicit that any liability for deferred compensation of its employees is not guaranteed by the federal government. This indicates that limited risks are imposed on the federal government.

Disclosure organizations should be presented by the component reporting entity to which they are administratively assigned and, if material, by the government-wide entity.

Administrative Assignment

Management determined and the auditor concurred the Department of Federal Museums should present the Museum as a disclosure organization in its GPFFR because the department is assigned administrative responsibility for the Museum based on appointment of its head to serve as chairperson of the Council.

Firefighters' Housing Limited Partnership

(Owned and Controlled - Consolidation Entity)

Assumed Facts and Circumstances

Agency 123 has been authorized to establish pre-positioned housing and equipment storage facilities on federal land to ensure immediate and efficient deployment of firefighting resources in response to wildfires in remote areas. The enabling legislation allows Agency 123 to enter into a wide range of financial agreements with private-sector participants to provide housing and equipment storage for the firefighters.

The agency and a private developer formed a limited partnership—Firefighters' Housing Limited Partnership (FHLP)—to develop, operate, maintain, and own all housing and storage units and facilities within a designated area for 25 years. Agency 123 leased land to FHLP under a 25-year ground lease. At the end of the 25-year ground lease, the agency has the option to renew the partnership for another 25 years. If it does not renew, all structures and land revert back to Agency 123, in accordance with the agency's residual ownership interest. During the 25-year ground lease, Agency 123 will provide an annual payment to FHLP from its appropriated funds for management services, use of the housing by Agency 123 employees during the fire season, and equipment storage year-round.

The private sector partner is guaranteed a minimum payment from FHLP and has no ownership interest in FHLP properties. The private sector partner also is entitled to a share of profits from non-fire season vacation rentals of the housing so long as the facilities meet established condition requirements. Profits not distributed to the private sector partner are retained by FHLP and can be used for capital improvements including development of new housing in adjacent parks under similar terms.

As part of the partnership agreement, Agency 123 has significant authority to determine the policies governing FHLP's activities and to affect day-to-day decisions such as design and construction. Any debt incurred by FHLP must be authorized by the agency. Furthermore, capital and operating budgets require agency approval and financial transactions are monitored on a monthly basis by the agency's contract administration office. The partnership is required to produce audited financial statements annually.

Tentative Conclusions

Based on the assumed facts and circumstances and other considerations, management determined and the auditor concurred that FHLP should be included in the government-wide GPFFR. A substantial ownership interest is present via the agency's continuing ownership interest. In addition, several control indicators are met as summarized in the following analysis of available information.

1. Agency 123 may be able to direct the partnership regarding the establishment and subsequent revision of financial and operating policies through its review and approval of operating budgets, designs, and condition of the facilities. If so, this would be a persuasive indicator of control. Management should weigh the impact of its role in directing the FHLP's financial and operating policies and consider how much discretion falls to the private sector partner.

2. Other indicators in the aggregate may indicate control. Agency 123 has significant authority to:
 - a. direct the ongoing use of assets.
 - b. approve the budgets and business plans for FHLP.
 - c. require audits.
 - d. limit borrowing and investment by FHLP.

Classification as a Consolidation Entity or Disclosure Organization

For this illustration, management determined and the auditor concurred that, based on the assumed facts and circumstances as well as other considerations not described in the illustrations, FHLP should be reported as a consolidation entity. In arriving at this conclusion, management and the auditor considered the assumed facts and circumstances presented below in the aggregate and, finding no other facts that in the aggregate contradict these, used professional judgment to determine that FHLP is a consolidation entity.

Evidence suggesting that FHLP is a consolidation entity includes the following:

1. FHLP provides housing to firefighters as its primary function on a non-market basis.
2. It is financed by tax revenues supplemented by any retained profits from non-fire season rentals.
3. Decisions are made by organizational leaders at Agency 123 who are appointed by the President and confirmed by the Senate.
4. Funds transferred to FHLP will be approved through the usual budgetary process so that FHLP funding will be included in the budget approved by the Congress and the President.

Evidence suggesting that FHLP is a disclosure organization includes the following:

1. FHLP has a legal identity separate from Agency 123.
2. FHLP is authorized to provide vacation housing services to customers on a market basis and use the proceeds to first compensate the private sector partner and then reduce the cost of firefighter housing borne by the taxpayer.

As a consolidation entity, FHLP's financial statements should be consolidated by the component reporting entity to which it is administratively assigned.

Administrative Assignment

Management determined and the auditor concurred Agency 123 should consolidate FHLP's financial statements because it is assigned administrative responsibility for FHLP based on its inclusion of FHLP funding in its budget request and its coordination and monitoring of FHLP's plans and performance.

The Blue Mountain Observatory

(Control based on Indicators in the Aggregate – Disclosure Organization (FFRDC))

Assumed Facts and Circumstances

Agency XYZ created a federally funded research and development center (FFRDC), the Blue Mountain Observatory (BMO), to provide facilities and leadership needed to conduct scientific research in a wide range of fields, including the study of black holes. Agency XYZ is BMO's primary sponsor. University Cooperative (UC) is a non-profit membership corporation created by 50 universities conducting research that would benefit from use of BMO facilities. UC was created to seek the role of managing, operating, and maintaining BMO under a cooperative agreement with Agency XYZ. UC subsequently entered into a cooperative agreement with Agency XYZ.

UC is governed by a board of trustees appointed to represent each of the 50 member universities. UC trustees appoint an individual to serve as president of BMO. The trustees also oversee BMO operations including providing input on strategic plans, approving the annual program plan before its submission to Agency XYZ for approval, responding to Agency XYZ input, and monitoring financial activities including establishing investment policies. UC employs staff to perform all BMO activities and these individuals are referred to as 'BMO employees.' Member universities fund any non-BMO activities of UC.

The cooperative agreement between UC and Agency XYZ ensures close coordination between Agency XYZ and BMO employees. The agreement contains requirements necessary for Agency XYZ's oversight of both BMO's programs and UC's management activities, including the following provisions:

1. Provide input to a strategic plan developed by BMO employees in collaboration with UC trustees. The strategic plan sets the overall direction and priorities for BMO.
2. Agency XYZ must approve the annual program plan and budget for use of resources.
3. UC must provide to Agency XYZ an annual scientific report and audited financial statements.
4. Agency XYZ participates in developing a five-year strategic plan.
5. BMO and Agency XYZ must meet annually to review progress and ensure that scientific and facility priorities remain consistent with those of Agency XYZ.

UC works cooperatively with Agency XYZ to ensure the effective implementation of the strategic mission of BMO to the benefit of the research community. Mid-way through the current cooperative agreement, Agency XYZ will conduct comprehensive reviews of science, facilities, and management to inform future decisions regarding recompetition of the cooperative agreement for the facility. UC is under no obligation to continue in its role in managing, operating, and maintaining BMO.

In the most recent fiscal year, BMO received \$100 million in funding from Agency XYZ through its cooperative agreement with UC. Agency XYZ proposed the \$100 million in funding in its Congressional Budget Justification and described how the funds would be used to support the

research programs at BMO. In administering the funds provided by Agency XYZ for BMO programs, UC may:

1. expend funds to meet ongoing operational needs.
2. make annual cash contributions to employee benefits programs (accrued leave and pension plans).
3. make annual payments due under long-term leases.
4. construct or purchase new assets so long as all resulting property is titled to BMO.

In the event the cooperative agreement with UC is terminated, Agency XYZ would assume management responsibility for the facility. Further, Agency XYZ would seek appropriations for termination expenses such as post-retirement benefit liabilities for BMO employees. However, Agency XYZ would be obligated to pay termination benefits only if funds were appropriated for that purpose.

Tentative Conclusions

Based on the assumed facts and circumstances and other considerations, management determined and the auditor concurred that BMO should be included in the government-wide GPFFR. BMO is not listed in the *Budget of the United States Government: Analytical Perspectives—Supplemental Materials* schedule entitled “Federal Programs by Agency and Account” so other inclusion principles must be considered. BMO facilities are owned by the federal government and new assets are titled to the federal government. With respect to the control inclusion principle, Agency XYZ establishes the fundamental purpose and mission of BMO through its participation in strategic planning and the overall effort to ensure BMO goals are consistent with Agency XYZ research goals. This effort includes annual actions to approve BMO’s annual program plan and operating budget. These actions are persuasive indicators of control.

Classification as a Consolidation Entity or Disclosure Organization

Evidence suggesting that BMO is a consolidation entity includes the following:

1. BMO provides, as its primary function, research facilities and leadership to university members of UC on a non-market basis. It is financed by taxpayer funds supplemented by non-government donors.
2. Key operational decisions are made by organizational leaders at Agency XYZ who are appointed by the President and confirmed by the Senate.
3. Funds transferred to BMO will be approved through the usual budgetary process so that use of tax revenues to support BMO is ultimately decided by the Congress and the President.

Evidence suggesting that BMO is a disclosure organization includes the following:

1. BMO has a legal identity separate from Agency XYZ.

2. The governance structure ensures that universities have substantial input regarding BMO's strategic plans and annual program plan. The significant involvement of non-governmental organizations lessens political influence.
3. BMO's liabilities are not obligations of the U.S. government.
4. BMO is authorized to accept donations from non-government organizations.

Based on the assumed facts and circumstances and other information, management determined and the auditor concurred that BMO should be reported as a disclosure organization. As a disclosure organization, BMO should be presented by the component reporting entity to which it is administratively assigned.

Administrative Assignment

Management determined and the auditor concurred that Agency XYZ should disclose information about BMO because it is assigned administrative responsibility for BMO based on its inclusion of BMO funding in its budget request and its coordination and monitoring of BMO's plans and performance.

Table 1: Summary Application of Proposed Standard

| NAME | IS THE ORGANIZATION INCLUDED IN THE GOVERNMENT-WIDE GPFFR? | | | | | CONSOLIDATION ENTITY OR DISCLOSURE ORGANIZATION | |
|-------------------------------------|---|-------|---|---|-------------------------------|--|---------------------------------------|
| | IN THE BUDGET | OWNED | CONTROL | MISLEADING TO EXCLUDE | IS THE ORGANIZATION INCLUDED? | A CONSOLIDATION ENTITY (CONSOLIDATED) | A DISCLOSURE ORGANIZATION (DISCLOSED) |
| ABC Department | Yes | | | | Yes | Organizations listed in the Budget are presumed to be consolidation entities. | |
| Epsilon Corporation | Yes | | | | Yes | Organizations listed in the Budget are presumed to be consolidation entities. | |
| Sigma Association | No | No | Yes. A majority of the governing board members is appointed by the President and confirmed by the Senate and they established its fundamental purpose and mission through legislation. | | Yes | | Financially independent organization |
| Scholars University | Yes but as a non-federal organization receiving federal financial assistance. | No | No. Scholars' board of trustees elects its respective board members. Scholars' board of trustees primarily directs the university's affairs and the university seeks sources of revenue to operate virtually in a self-sustaining manner. | Management and auditor agreement based on facts and circumstances it was not misleading to exclude. | No | | |
| Education Research Institute | No | No | Yes, the federal government can unilaterally dissolve ERI and have access to its assets and responsibility for its liabilities. | | Yes | The ERI Trust Fund is primarily funded through taxes, elected officials establish ERI's budget, services are provided on a non-market basis, and federal government assume risk. | |

| NAME | IS THE ORGANIZATION INCLUDED IN THE GOVERNMENT-WIDE GPFFR? | | | | | CONSOLIDATION ENTITY OR DISCLOSURE ORGANIZATION | |
|---|--|--|---|---|---|--|---|
| | IN THE BUDGET | OWNED | CONTROL | MISLEADING TO EXCLUDE | IS THE ORGANIZATION INCLUDED? | A CONSOLIDATION ENTITY (CONSOLIDATED) | A DISCLOSURE ORGANIZATION (DISCLOSED) |
| Mediation Corporation | Yes but as a non-federal organization receiving federal financial assistance. Therefore, must assess against other principles. | No | Yes. Considering the control indicators in the aggregate, the federal government controls Mediation. It provides significant input on the selection of governing board members, appoints a key executive, limits Mediation's capacity to generate revenue, approves the annual budget, requires audited financial statements, and directs Mediation to work with other governments. | | Yes | | Mediation's governing body is insulated from political influence and risks are not assumed by the federal government. |
| Bicycle America, Inc. (Scenario A) | No | No. BA is owned by shareholders. | No, governing board members are elected by shareholders rather than subject to political appointment | No, Management and auditor agreement based on facts and circumstances it was not misleading to exclude. | No. Advisory committee offers advice but does not have the authority to direct BA to act. | | |
| Bicycle America, Inc. (Scenario B) | No | Yes, the federal government acquired 51% of the voting rights in BA. | | | Yes | | Intervention intended to be temporary |
| Chatham Laboratory (FFRDC) | No | The assets and research results are owned. | Yes. The federal government establishes the purpose and mission of Chatham. | | Yes | Yes, Chatham is primarily funded by taxes, and governance rests with the President and Congress. | |

| NAME | IS THE ORGANIZATION INCLUDED IN THE GOVERNMENT-WIDE GPFFR? | | | | | CONSOLIDATION ENTITY OR DISCLOSURE ORGANIZATION | |
|--|--|--------------------------|--|---|---|--|---|
| | IN THE BUDGET | OWNED | CONTROL | MISLEADING TO EXCLUDE | IS THE ORGANIZATION INCLUDED? | A CONSOLIDATION ENTITY (CONSOLIDATED) | A DISCLOSURE ORGANIZATION (DISCLOSED) |
| Gotham Laboratory | No | No | No | No, Management and auditor agreement based on facts and circumstances it was not material to exclude. | No. Although it may be economically dependent, Gotham has discretion as to whether to accept funding from the government. | | |
| Andromeda Prime Power Systems (GSE) | No | No | No, APPS' governing body is elected by common shareholders. The APPS Advisory Board advises Congress and does not direct APPS' operations. | | No, Management determined and the auditor concurred APPS should be disclosed as a related party. | | |
| U.S. Museum (Scenario A) | Yes | | | | Yes | Yes. The Museum is in the budget and primarily funded by taxes and governance rests with the President and Congress. | |
| U.S. Museum (Scenario B) | Yes but as a non-federal organization receiving federal financial assistance | No | Yes. The President appoints a majority of the governing body's members. | | Yes | | The museum is a financially independent organization. |
| Firefighters' Housing Limited | No | Ownership of property is | Yes. Agency 123 has significant authority to direct the limited partnership's activities and to | | Yes | Yes. Taxes fund the housing and risks have | |

| NAME | IS THE ORGANIZATION INCLUDED IN THE GOVERNMENT-WIDE GPFFR? | | | | | CONSOLIDATION ENTITY OR DISCLOSURE ORGANIZATION | |
|-----------------------------------|--|--|--|-----------------------|-------------------------------|---|---|
| | IN THE BUDGET | OWNED | CONTROL | MISLEADING TO EXCLUDE | IS THE ORGANIZATION INCLUDED? | A CONSOLIDATION ENTITY (CONSOLIDATED) | A DISCLOSURE ORGANIZATION (DISCLOSED) |
| Partnership | | retained. | affect day-to-day activities such as in design and construction and the partnership's purpose is to carry out federal missions and objectives. | | | been assumed | |
| Blue Mountain Observatory (FFRDC) | No | Property is owned by the federal government. | Yes. The federal government establishes the purpose and mission of BMO. | | Yes | | BMO is a separate legal entity and UC plays a significant role in its governance without political influence. |

APPENDIX D: ABBREVIATIONS

| | |
|--------|--|
| AICPA | American Institute of Certified Public Accountants |
| C.F.R. | Code of Federal Regulations |
| CFR | Consolidated Financial Report of the U.S. Government |
| CRE | Component Reporting Entity |
| CRS | Congressional Research Service |
| ED | Exposure Draft |
| FAR | Federal Acquisition Regulation |
| FASAB | Federal Accounting Standards Advisory Board |
| FASB | Financial Accounting Standards Board |
| FDIC | Federal Deposit Insurance Corporation |
| FFRDC | Federally Funded Research and Development Center |
| FRS | Federal Reserve System |
| GAAP | Generally Accepted Accounting Principles |
| GAO | Government Accountability Office |
| GPFFR | General Purpose Federal Financial Report |
| OAI | Other Accompanying Information |
| OIG | Office of Inspector General |
| OMB | Office of Management and Budget |
| RSI | Required Supplementary Information |
| SFFAC | Statement of Federal Financial Accounting Concepts |
| SFFAS | Statement of Federal Financial Accounting Standards |
| U.S. | United States |
| U.S.C. | United States Code |

APPENDIX E: TASK FORCE MEMBERS

Owen Barwell, (formerly of) Department of Energy

Lieutenant Colonel Richard Brady, USMC DOD

Terry Bowie, (formerly of) NASA

James L. Chan, University of Illinois at Chicago

Naresh Chopra, Department of Labor

Wendy Calvin, DOT

Tom Daxon, Former Oklahoma State Auditor

Ann Davis, U.S. Department of Treasury

Lynda Downing, GAO

Abe Dymond, GAO

Joel Grover, U.S. Department of Treasury, OIG

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Karen Kelbly, NCUA

Dan Kovlak, KPMG

Andrew Lewis, KPMG

Rick Loyd, Department of Energy

Ned Maguire, (formerly of) Office of the Dir. of National Intelligence, OIG

Sam Papenfuss, CBO

Reginald Royster, HUD

Fred Selby, U.S. Department of Treasury, OFS

Gary Solamon, (formerly of) Department of Commerce, Bureau of Economic Analysis

Sandy Van Booven, National Reconnaissance Office (CIA)

Denise Williams, U.S. Department of Treasury, FMS

Adrienne E. Young, (formerly of) National Science Foundation

APPENDIX F: GLOSSARY

Component Reporting Entity “Component reporting entity” is used broadly to refer to a reporting entity within a larger reporting entity.⁶⁴ Examples of component reporting entities include organizations such as executive departments, independent agencies, government corporations, legislative agencies, and federal courts. Component reporting entities would also include sub-components (those components included in the GPFFR of a larger reporting entity) that may themselves prepare GPFFRs. One example is a bureau that is within a larger department that prepares its own standalone GPFFR.

Conservatorship A conservatorship is the legal process in which a person or entity is appointed to establish control and oversight of a company to put it in a sound and solvent condition. In a conservatorship, the powers of the company’s directors, officers, and shareholders are transferred to the designated conservator.⁶⁵

Control with risk of loss or expectation of benefit Control with risk of loss or expectation of benefit is the power to impose will on and/or govern the financial and/or operating policies of another organization with the potential to be obligated to provide financial support or assume financial obligations or to obtain financial resources or non-financial benefits.⁶⁶

Disclosures Information in notes or narrative regarded as an integral part of the basic financial statement.

Federally Funded Research and Development Center Federally Funded Research and Development Center (FFRDC) is a government-funded entity that has a long-term contractual relationship with one or more federal agencies.⁶⁷ FFRDCs can be privately owned or government-owned, and they serve to meet the long-term research and development needs of federal agencies that could not otherwise be met as effectively in-house or through existing contractors. 49 Fed. Reg. at 14,464; 48 C.F.R. § 35.017(a). FFRDCs are established either specifically in statute or under the statutory authority of agencies to enter into contracts, which can be inherent or specific authority, and are used to perform research and development and related tasks.

General Purpose Federal Financial Reports General purpose federal financial reports (GPFFRs) is used throughout this Statement as a generic term to refer to the report that contains the reporting entity’s financial statements that are prepared pursuant to generally accepted accounting principles. In the federal government, the report for the U.S. government-wide reporting entity is known as the consolidated financial report of the U.S. Government

⁶⁴ The larger reporting entity could be the government-wide reporting entity or another component reporting entity.

⁶⁵ Federal Housing Finance Agency Fact Sheet, Questions and Answers on Conservatorship

⁶⁶ For example, a non-financial benefit would be one where the federal government benefits from a service being provided to it or on its behalf.

⁶⁷ The Office of Federal Procurement Policy (OFPP) and Federal Acquisition Regulation (FAR) policies for FFRDCs apply to executive agencies, which includes “an executive department, a military department, or any independent establishment within the meaning of 5 U.S.C. 101, 102, and 104(1), respectively, and any wholly owned Government corporation within the meaning of 31 U.S.C. § 9101.” 48 C.F.R. § 2.101; see also 5 U.S.C. § 403.

(CFR) and for component reporting entities it is usually included in the performance and accountability report, the agency financial report, or the annual management report.

Government Sponsored Enterprise Government Sponsored Enterprise (GSE) is created by Congress with its particular attributes defined in its enabling legislation and charter. Despite this diversity, there are at least four readily observable characteristics of GSEs: (1) private sector ownership, (2) limited competition, (3) activities limited by congressional charter, and (4) chartered privileges that create an inferred federal guarantee of obligations.⁶⁸

Receivership Receivership is the legal procedure for winding down the affairs of an insolvent institution.⁶⁹

Related Parties Organizations are considered to be related parties if the existing relationship or one party to the existing relationship has the ability to exercise significant influence over the other party in making financial and operating decisions.

Reporting Entity Reporting entities are organizations that issue a GPFFR because either there is a statutory or administrative requirement to prepare a GPFFR or they choose to prepare one. The term “reporting entity” may refer to either the government-wide reporting entity or a component reporting entity.

Statement of Federal Financial Accounting Concepts (SFFAC) 2 provides criteria for an entity to be a reporting entity.⁷⁰ The criteria focus on whether an entity’s:

- a. management is responsible for controlling and deploying resources, producing outputs and outcomes, and executing the budget or a portion thereof (assuming that the entity is included in the budget), and is held accountable for the entity’s performance.
- b. financial statements would provide a meaningful representation of operations and financial condition.
- c. financial information could be used by interested parties to help them make resource allocation and other decisions and hold the entity accountable.

⁶⁸ CRS Report for Congress *Government-Sponsored Enterprises (GSEs): An Institutional Overview*

⁶⁹ *Managing the Crisis: The FDIC and RTC Experience*, Appendix B - List of Abbreviations and Glossary of Terms; available online at <http://www.fdic.gov/bank/historical/managing/>; last accessed October 11, 2012.

⁷⁰ SFFAC 2, par. 29-37, provides a discussion on Identifying the Reporting Entity for General Purpose Financial Reporting.

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