Federal Accounting Standards Advisory Board

August 14, 2013

Memorandum

To: Members of the Board

From: Melissa Loughan, Assistant Director

Wendy M. Payne

Through: Wendy M. Payne, Executive Director

Subj: **Reporting Entity—Tab C**[1]

MEETING OBJECTIVES

- To consider comment letters, public hearing, and initial issues to be addressed.

BRIEFING MATERIAL

The transmittal memorandum identifies three threshold issues addressed by respondents and asks the Board's views. The questions address at a high level the framework of the proposal – the inclusion principles, the distinction between consolidation entities and disclosure organizations, and the alternative view. You may electronically access all of the briefing material at http://www.fasab.gov/board-activities/meeting/briefing-materials/

NEXT STEPS

Based on the Board's direction on the matters identified above and in this memo, staff will begin to address respondents' suggestions for improving the clarity of the standards and/or revising the outcome regarding certain matters. These high level answers and feedback will determine the framework for making revisions. Note that staff

[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.

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recommendations are not included in this memo as we are still gathering information from public hearing participants. Future memos will include staff recommendations.

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MEMBER FEEDBACK

If you require additional information or wish to suggest another alternative not considered in the staff proposal, please contact staff as soon as possible. In most cases, staff would be able to respond to your request for information and prepare to discuss your suggestions with the Board, as needed, in advance of the meeting. If you have any questions or comments prior to the meeting, please contact me by telephone at 202-512-5976 or by e-mail at loughanm@fasab.gov with a cc to paynew@fasab.gov.

Staff Analysis

Issue Area –Inclusion Principles (Question 1 in ED)

2 respondents disagreed with the inclusion principles. (SIPC #5, #23 SEC)

3 respondents disagreed the inclusion principles, and the related definitions and indicators, are helpful and clear. (SIPC #5, #23 SEC, #26 GSA)

3 respondents disagreed with the misleading to exclude principle (#14DHS, #19 CCC, #23 SEC)

3 respondents disagreed the inclusion principles can be applied to all organizations (#23 SEC, #26 GSA, #34 NRC)

While staff recognizes that approximately 40% of the respondents did not address the question, staff believes it may be because they agree or do not have any concerns. For example, the USPS OIG noted in their letter that they "do not disagree with remainder of the proposed Statement or have any suggestions for improving the text." In such cases, staff did not believe it was appropriate to put "YES" as in agreement to the questions since they did not respond directly to the questions posed in the ED. And while this statement is true for most of the other questions, staff will not repeat this assessment.

Issues

- **Disagree with "In the Budget"**

  SEC and SIPC disagreed because they do not believe "in the budget" should be used as an inclusion principle. 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. Although the FAF did not answer the question specifically, their response indicated the inclusion principles should be revised to either eliminate or modify the scope of the inclusion principle relating to an organization that is "in the Budget" because they believed 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.

  Staff also notes the Administrative Office of the US Courts (#25) objects to the judicial branch being included based on "in the budget."

- **Additional Guidance, Criteria and Examples**

  Several respondents believe there should be more guidance, criteria or examples for the misleading to exclude principle. This was communicated through the respondents that disagreed but also through additional comments provided by those that agreed and by those not answering the question directly. (#11 HUD, #13 NASA, #14 DHS, #15 NRC, #19 CCC, #26 GSA, #31 AGA FMSB, #33 Treasury FMS)

#11 HUD suggested 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.

#13 NASA recommended 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.

#14 DHS suggested "misleading to exclude" be either removed or better defined with some objective measures.

#15 NRC suggested examples around what it would mean to be misleading would, at a minimum, provide the practitioner with the intent of the standard.

#19 CCC suggested 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.

#26 GSA explained they do not think the inclusion principles, definitions and indicators are completely clear. Further, they believe the misleading concept is too vague.

#31 AGA FMSB suggested additional guidance should be included in the final document for misleading to exclude.

#33 Treasury FMS suggested providing examples of instances where it would be "misleading to exclude" would be helpful in guiding reporting entities.

- **<u>Other suggested revisions to inclusion principles</u>**

The GWSCPA FISC (#27) and Treasury CFO (#36) suggest that the second and third inclusion principles be expanded to indicate that *relationship must be other than temporary in nature.*

KPMG (#9) and Treasury CFO (#36) believe majority ownership should be a considered a presumptive indicator of control and not a separate principle.

KPMG (#9) and Treasury CFO (#36) believe misleading to exclude should be considered after related party and not be considered a principle for inclusion. Further, KPMG noted "the concept of misleading to include should be deleted from the statement because it undermines the overall principles stated."

Other Points

Request made by KPMG (#9) to include the concept of exclusivity for purposes of identifying and reporting on "consolidated and disclosure organizations" for control. For example, it was suggested the following sentence be added:

> *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.*

The SEC (#23) believes the proposed standards include numerous "pro" and "con" indicators, but don't 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 and the ED appears to be somewhat biased towards inclusion.

Request made to clarify FFRDCs by #8 NSF and #13 NASA.

Request made to clarify Public-Private Partnerships by #26 GSA and #28 Joyce Dillard.

Request made to clarify Memorandums of Understanding by #28 Joyce Dillard.

Request made to clarify museums and heritage assets by #18 DOD.

KPMG also suggested the ED be restructured.

Staff notes there may be other suggestions and editorial remarks, but these were deemed most significant.

Public Hearing

Staff notes the following participants will be providing testimony at the public hearing and may be providing relevant testimony about the above issues specific to inclusion principles and available to answer questions:

- John Lynskey, National Science Foundation #8
- Caryn Kauffman and Eileen W. Parlow, Securities and Exchange Commission #23
- Andrew Lewis, GWSCPA #27
- Joyce Dillard, Presenting as a Citizen, not on behalf of an organization #28
- Ed Mazur, AGA, Financial Management Standards Board #31
- James Gould and Amanda Nelson, KPMG #9
- Carole Banks, Treasury #36

This testimony will provide additional insight and understanding of the issues and concerns surrounding the inclusion principles before deciding next steps.

QUESTION FOR THE BOARD:

DOES THE BOARD BELIEVE THE THREE INCLUSION PRINCIPLES SHOULD BE RETAINED IN SUBSTANCE?

Issue area-Consolidation entities and disclosure organizations (Question 2 in ED)

None of the respondents who answered questions directly disagreed with the concept of distinguishing between consolidation entities and disclosure organizations which ultimately determines how they will be reported.

2 respondents disagreed with the attributes used to make the distinction between consolidation entities and disclosure organizations. (#14DHS, #23 SEC)

3 respondents disagreed the attributes are adequate to make a determination of whether organizations are consolidation entities or disclosure organizations. (#14DHS, #23 SEC, #34 NRC)

NOTE: The broader issue of disclosures for disclosure organizations (including the examples provided in the ED) will be discussed at the October meeting.

Issues

- **Too much Flexibility and Judgment Permitted**

  #14 DHS disagrees with the more "flexible" attributes. For example DHS believes 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.

- **Inconsistent and Potential Implementation Issues at the Component Level**

  #23 SEC CFO disagrees with aspects of Q2 because they believe "the inclusion principles, in particular for component reporting entities, are confusing and appear to be inconsistent." They suggested it "unclear what the standard means by a component entity being assigned accountability" for another organization. They believe the proposed standards may result in implementation at the component level. For example, SEC explained "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."

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.

- **<u>Judicial and Legislative branches</u>**

#34 NRC CFO disagreed with aspects of Q2 because they state it should 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 these standards apply to all 3 branches of the Federal government.

- **<u>Additional Guidance, Criteria and Examples</u>**

Several respondents believe there should be more guidance or criteria or examples in how to apply the attributes. (#8 NSF CFO, # 9 KPMG , #13 NASA , #14 DHS, #31 AGA FMSB)

#13 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. The example provided by NASA: "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.

#8 NSF CFO believes 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. 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.

9 KPMG believes the standard should be clear about whether all characteristics must be met to trigger the consolidation requirement. For example, they do not understand the characteristic 38d ('providing goods and services on a nonmarket basis') and they 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, they believe that the characteristic, other than temporary control, should be added to this section.

#14 DHS believes there should be a hard line test developed when choosing between consolidation and disclosure.

#31 AGA FMSB conveyed although they agree with the attributes used to make the distinction between consolidating entities and disclosing organizations, they have concerns about some of the "Indicators" provided in the ED. They believe that some of the indicators in paragraph 31 (*staff notes these are the control indicators*) are too wide ranging and can be applied to organizations not within the federal entity. AGA FMSB suggested that these be clearly labeled as some form of lesser indicator for the preparer and auditor to consider in reaching their conclusion.

Other Points

#11 HUD CFO 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.

#13 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.

#20 Joseph H. Marren suggests the concept of "consolidation entities" and "disclosure entities" is directly at odds with the Statement and Account Clause's "all public Money" requirement.

#20 Joseph H. Marren suggests 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.

#23 SEC CFO also believes, 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. They recommend the indicators be added to paragraph 46 (*staff notes this is paragraph related to Quasi-Governmental characteristics.)*

#24 DOL OIG does 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.

#27 GWSCPA FISC suggested there be a 5th attribute for consolidation entities "connected to the federal government in an other than temporary nature."

#28 Joyce Dillard requested that the Board address a Non-Profit Corporation acting as a Program Manager on a project partially funded by Federal funds? She also asked who determines the definition limited funding from general tax revenues and if Disclosure Entities are privately owned, what are the liability tests?

#36 Treasury CFO believes 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).

Staff notes there may be other suggestions and editorial remarks, but these were deemed most significant.

Public Hearing

Staff notes the following participants will be providing testimony at the public hearing and may be providing relevant testimony about the above issues specific to the distinction between consolidation entities and disclosure organizations and available to answer questions:

- John Lynskey, National Science Foundation #8
- Caryn Kauffman and Eileen W. Parlow, Securities and Exchange Commission #23
- Andrew Lewis,GWSCPA #27
- Joyce Dillard, Presenting as a Citizen, not on behalf of an organization #28
- Ed Mazur, AGA, Financial Management Standards Board #31
- James Gould and Amanda Nelson, KPMG #9
- Carole Banks, Treasury #36
- Joseph H. Marren #20

This testimony will provide additional insight and understanding of the issues and concerns surrounding the distinction between consolidation entities and disclosure organizations before deciding next steps.

QUESTION FOR THE BOARD: **DOES THE BOARD BELIEVE THE DISTINCTION BETWEEN CONSOLIDATION ENTITIES AND DISCLOSURE ORGANIZATIONS SHOULD BE RETAINED IN SUBSTANCE?**

Issue Area- Alternative View Regarding Receiverships, Conservatorships and Interventions (Question 12 in ED)

3 respondents agreed with the AV 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. (#27 GWSCPA, #30 Intelligence Community, #34 NRC CFO)

2 respondents agreed with the AV that the guidance for all interventions, regardless of type, should be presented in a single Statement of Federal Financial Accounting Standard. (#27 GWSCPA, #30 Intelligence Community)

#27 GWSCPA FISC agreed and believed information related to the federal government's role in intervention organizations should be disclosed separately from the financial information included for disclosure organizations in the notes to the financial statements of the GPFFRs. They suggested 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. They agreed with the AV 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.

#30 Intelligence Community agreed with the AV and believes 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. They don't believe the disclosure organization attributes align with receiverships, conservatorships and interventions due to

- the unique nature of their relationships with the federal government;
- the government's exposure to significant loss or benefit;
- the characteristics of receiverships, conservatorships and interventions in relation to those of a typical disclosure organization; and
- the high degree of influence by Congress and/or the President.

They believe the board should consider developing separate principles for receiverships, conservatorships and interventions. The intelligence community also believes a separate standard should be developed to capture and address all of the unique aspects related to interventions.

Although DOL #24 didn't support the AV, they did note it included a number of valid points; but believed those could be addressed by the standard establishing a minimum level of disaggregation and disclosure of information for such entities. They acknowledged the proposed standard allows latitude as to presentation for disclosure organizations and whether and how disclosure organizations should be aggregated or reported separately.

Although #31 AGA FMSB did not answer question 12 specifically, staff notes in the general comments they stated "…the views presented by Mr. Steinberg regarding the case of receivership, conservatorships and interventions are 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."

Public Hearing

Staff notes the following participants will be providing testimony at the public hearing and may be providing relevant testimony about the above issues specific to the alternative view and available to answer questions:

- Andrew Lewis,GWSCPA #27
- Ed Mazur, AGA, Financial Management Standards Board #31

This testimony will provide additional insight and understanding of the issues surrounding the alternative view before deciding next steps.

QUESTION FOR THE BOARD:

DOES THE BOARD BELIEVE THE ALTERNATIVE VIEW SHOULD BE CONSIDERED FURTHER?

Other Issues to be Developed at Next Meeting:

- **Disclosures about Disclosure Organizations**
- **Consolidating Organizations for which accountable without regard to funding source**
    - **Commingling of donor/restricted funds would be misleading**
    - **Contradictory to proposed standards**
- **FASB based information consolidated without conversion**
    - **Intra-governmental Requirement & Changes in Current Practice**
    - **Different accounting basis**
- **Related Party**
    - **Revisit examples etc- NSF & NSB issue- Advisory Boards,**
- **Central Bank**
- **Other Specific Organizations Addressed or Examples**
- **Other editorial issues and other substantive issues noted by respondents**

Members are asked to identify specific concerns not included in the above list. Because time is limited at the August meeting, please contact Melissa Loughan directly at loughanm@fasab.gov or 202-512-5976. A more developed list will be provided at the October 2013 meeting.