

**Government Accountability Office**

**Federal Accounting Standards Advisory Board**

**Public Hearing**

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**P R O C E E D I N G S (8:33 a.m.)****Agenda Item: Welcome**

MR. ALLEN: Thank you very much for coming to help participate in the process of standard setting. This is going to be one of our exciting meetings because we get to hear from a lot of people. Usually we are discussing and arguing with each other. We have heard all of our arguments. This is a great opportunity to hear from you. We appreciate you participating.

I would ask that as you testify, that you limit your time that you make some comments to maybe not more than 10 minutes, so that would allow us the majority of that half hour for an interchange, so that we can ask some why's and maybe even some other questions, based on your background, that you didn't specifically identify in your paper. It is a learning process for us. We would appreciate that very much. Ms. Payne has a number of administrative matters to take care of.

MS. PAYNE: This is a public hearing, so it is somewhat different in terms of how we run it compared to being upstairs. One of the differences is the sound system. We do have microphones on the table, but there are fewer speakers in this room. I would ask you to be mindful of the audience, and I am probably the worst at this, but do try to project and make sure you are heard.

We have a transcriber. Normally for our meetings, we do have a transcriber, but that is not the official record of the meeting. The minutes are the official record. In this case because it is a public hearing, the transcript will serve as the official record. Therefore, it is very important that the transcriber be able to hear everything.

The microphones will pick up sidebar conversations, and the transcriber is hooked into the microphone system. I would ask you, if you do need to have a conversation, to please leave the table, so that you are away from the microphones.

We have some restrictions on food and drink. We may only have water in this room. In the kitchenette, for members and staff, we do have a coffee service. There are sodas in the refrigerator, and I think we are working on having bottled water brought in. Please feel free to, during the breaks, to go in there, but not to bring the food back in here. For our audience, water only, please.

I would ask members of the audience to turn off any electronic devices because again that will interfere with the transcriber and the ability to pick up the sound. For our board members and staff, those who normally join the board for lunch, we will be upstairs on the seventh floor in the same lunchroom that we are normally in. For

the audience, the cafeteria is on the H Street side of the building, which is down this way and down the hall to the back. There are also some nearby restaurants that are good. The Fairfield Inn has an Irish pub. There is a Burger King and a few other places. There is now a Corner Bakery one block up on H Street.

We will take a 45-minute lunch and I hope that will allow you adequate time to get back into the building. Also, those of you who are wearing the observer badges, that only allows you access to the first floor. I just wanted you to know that you don't have free reign of the building, so you will need to stay on the first floor. That is it for me.

MR. ALLEN: Let me ask the board members for their comments and questions that you would like to make before we start this hearing. If not, we welcome our first testifier to join us from the National Science Foundation, John Lynskey.

I would also say it is quite warm in this room, so feel comfortable to take your coat off or whatever makes you more comfortable, particularly if you are testifying.

**Agenda Item: John Lynskey - National Science Foundation**

MR. LYNSKEY: Good morning. I want to express my appreciation to the board members for the opportunity to

appear today to discuss the reporting entity exposure draft. I wanted to say a little about the National Science Foundation or NSF. NSF has a mission to advance, research and education in science and engineering across all fields and disciplines, and at all education levels.

NSF is an overarching source of federal support for fundamental research that enables and advances innovation across the fields of science, engineering and science (off mic). We accomplish this through a director and national science board, and a talented workforce dedicated to that mission.

I wanted to start. I basically have two items that I want to talk about, which was the related party definition and FFRDCs. I want to start with related party definition and requirements. The FASAB is proposing a definition of 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. NSF's opinion is that the definition of significant influence should be further clarified or expanded. For instance, the definition should make clear that presidentially-appointed or congressionally confirmed individuals that serve on agency boards, and also

have collegial or industry positions do not automatically create related party relationship between the agency and the university or the corporation.

The operation of the National Science Board is a good example. The National Science Board establishes the high-level science policies of NSF within the framework of the applicable national policy set forth by Congress and the president, along with the science and technology committees.

In this policy capacity, NSB acts strategically only, but does not influence daily operations or transactions. NSB members may be affiliated with institutions such as universities, where researchers are eligible to receive grants from NSF. However, the Federal Conflict of Interest rules prohibit them from participating in any way with those awards.

In addition, individual NSB members are not involved in the review approval or any proposed grants. They only are involved in about three to five grants a year, and those are the really big ones that have to go for their approval. They are really not involved in much on the day-to-day or operational standpoint.

The reference that significant influence lies in the power to participate in policy decisions may be interpreted, we think, too broadly in circumstances where

agencies are headed by individuals that also serve on collegial organizations. We think the designated related party relationship between an NSB member and NSF, or between an NSB member and their affiliated institution, would itself be misleading to the public. What we are getting at is to say that NSF is not related to MIT or the University of Maryland.

It would cause the public to question NSF's highly esteemed merit review process for making grants. It would also imply the existence of factors, such as the ability to cause the agency to enter into transactions or awards on different terms of conditions with those unavailable to related parties.

Treating the related parties and the not related parties differently in terms of entering into transactions. This is not the case with the National Science Board, so this is what we are concerned about. In regards to the sample scenarios, NSF suggests and presumes other agencies with boards or multi-member governing bodies would also benefit from a related party scenario.

Now, I am going to keep this moving, like Mr. Allen asked, and so I am going to turn to FFRDCs. On the proposed standard for FFRDCs, NSF thinks it is important to clarify the inclusion of FFRDCs in the definition of disclosure organizations and to clarify that inclusion.

Although NSF is a sponsoring agency, we have four FFRDCs.

By law, the National Science Foundation is prohibited from managing or operating those facilities. The exposure draft indicates that disclosure organizations are separately defined and presented in the general purpose federal financial report, in order to avoid obscuring information about more autonomous organizations while still providing accountability.

The NSF's prohibition or restriction from managing or operating these FFRDCs limits the level of influence and accountability the foundation has over the FFRDCs as it relates to the extent of this exposure draft. Therefore, we are suggesting that FASAB clarify the language that excludes FFRDCs for which the sponsoring agency is precluded by law from participating in the operation or management entity.

Just too kind of summarize concerning related parties, what NSF is suggesting or requesting is to clarify the definition for agencies with board of directors. Define significant influence in the context of board members where strategic actions do not affect transactions and do not automatically create a related party definition. Then, offer related party scenario involving agency board members. With respect to FFRDCs, add language in the definition of disclosure organizations that exclude FFRDCs

for the sponsoring agency cannot, by law, participate in the operation and management of the entity.

With that, I want to thank you for hearing NSF's concerns on the matter. I want to provide a special thanks to Melissa and Wendy who have been working with NSF all along on the related party issue for a while now. Thank you.

MR. ALLEN: Thank you. You did something I didn't do earlier and that was to introduce Ms. Loughan to testify. She is the project manager on this project. I wanted you to know, Melissa, if you need to ask questions, feel free to do that.

I have asked individual board members, so that we all sort of start off. I will turn time over to Bob and let him start off the questions. From there, we will just decide how many other questions board members may have.

MR. DACEY: With respect to the FFRDCs, there is obviously a wide range of practice out there. You spoke of the four that you have. Do you currently disclose in your financial statements any relationships with those FFRDCs?

MR. LYNSKEY: Yes, we do. We actually include this information in the current accounting policy section of NSF Financial Statement Notes.

MR. DACEY: What is the general nature of the information that you feel is appropriate to disclose for

that?

MR. LYNSKEY: We generally talk about these FFRDCs and we talk a little bit about them, related to contingent liabilities or any termination issues.

MR. DACEY: In terms of that, I guess one of the challenges in developing a standard is to make it applicable to all FFRDCs. I guess you had suggested that there be some structure about the role of the agency with respect to the FFRDCs. Do you think that would be applicable to all FFRDCs or are you that familiar with the other ones, besides the ones NSF has?

MR. LYNSKEY: One thing we actually did suggest in our comments is NSF is responsible for publishing the master list of FFRDCs by sponsoring federal agency. This is a good way to provide consistency. It shows the FFRDC and their sponsoring agency. If they have more than one, it shows the different sponsoring agencies.

I am familiar with quite a few of the others. We work with a lot other federal agencies. To me, the difference that we were talking about is that, for NSF, we do not have any staff at the FFRDCs. There are no government employees there. They basically make their decisions and have their own free will. Where, with some of the other FFRDCs, they are actually run and have federal employees there. Whether you are talking NASA or the

Department of Energy, it is a very different relationship than ours.

We have an issue where we are prohibited from doing that under the NSF Act and different laws. We think that there is quite a separation for us, where in other federal agencies; the relationship is a little bit closer.

MR. DACEY: As I recall, currently some FFRDCs are consolidated; some are not. Would that generally line up with the criteria you mentioned?

MR. LYNSKEY: The published list is pretty much just a published list. It doesn't get into who should be consolidated or not. It is a good reference point.

MR. DACEY: Right now, though, in practice, some are consolidated and some are not, depending upon the determinations made by the individual agencies, which may or may not be consistent. I don't know. Do you know these criteria you are suggesting, how that would correlate to ones that are currently consolidated or not?

MR. LYNSKEY: No, I am not sure exactly how that would play out in the other ones.

MR. ALLEN: As I read your response, initially I thought you were sort of saying for sure you are not a consolidation entity. I thought, well, maybe you are arguing for being a disclosure entity. Then, I think when I got through I thought, no, I think he is arguing that we

shouldn't be either one, neither a consolidation or a disclosure organization.

I guess following up on what Bob is saying, what is disclosed when you say disclosures? Do you talk about that generically or do you have information about the magnitude of the operations, the amount of federal financial assistance? Are there any financial disclosures for those entities?

MR. LYNSKEY: I would say that disclosure is more generic. We don't consider them a part of the federal government or part of NSF. The disclosures are more that we have these FFRDCs, and that we could have a contingent liability with them if certain transactions happened.

To get a little bit more specific on that, we don't have any legal requirement for post-employment retirement liabilities. I know that question was provided and we don't have any legal requirement for that.

What we do have is there are two types of terminations. There is a termination of an award. If UC Berkley is operating a facility for us. Then, we decide after the five-year period that we are going to assign it another university, there is a transition kind of termination there. The transition costs to go from one award to another, NSF does issue a supplemental award for. We are responsible for any of those transition costs for

that. If it happens to go over the end of a fiscal year, we have a liability.

The other kind of termination is if we decide to close a center or facility or FFRDCs, we at that point have a clause in all of our cooperative support agreements. That is a difference, too, for us is that these FFRDCs are run by these cooperative support agreements, which are very similar to grants. There is a clause in there that says if we terminate the facility, that we will go to Congress to seek termination costs on your behalf. There is no guarantee that we get that. Of course, it is a crap shoot. That is kind of what we put in. Those are some of the generalized disclosures that we put in our accounting policies.

MR. SHOWALTER: I wanted to ask the following question--What additional disclosures from the proposed standard do you see that you are currently not disclosing? I am trying to figure out how the standards are different than what you are currently doing, or you just don't like having a standard saying you have to do it?

MR. LYNSKEY: It is not really that. We actually only put forth some generic information. If the other things come to pass, we would put more information into them. On an annual basis, we may have just a couple of generic paragraphs. If all of a sudden, we had a

liability, we had to transition and a liability went over at year-end, we would be putting that in. Or if we had a termination where we were going to Congress asking for money, we might actually put that information in.

Absent from those events, it is fairly generic. We don't start putting in the amount of awards that we give to the FFRDCs and all sorts of specific information in our footnote.

MR. STEINBERG: I noticed that in your financial statements, you do have a note called awards to affiliated institutions, in which you describe how some of the board members may be affiliated with institutions that are eligible to receive awards. Then, you actually identify the amount of awards given to those institutions that are affiliated with board members.

Is it that you are concerned with the requirement for disclosure, or is it the concern with the term, related party?

MR. LYNSKEY: The National Science Board attorney would suggest that I indicate that we disclose that for transparency purposes. As an aside, we are getting a lot of pressure from our auditors, based on private sector standards which we don't think are applicable to us.

To get back to your question how it was, we feel that putting them as affiliated institutions is the correct

terminology. To disclose the transparency of awards with National Science Board members is good. When you use the related terminology, the definition and the implication of that is what is concerning, in that it is saying that the transactions are no longer arms' length. We don't have a problem disclosing the transactions. The implication that they are not arms' length, we have a very esteemed merit review process. Any sort of attacks on that merit review process, NSF takes very, very seriously. We fund the best science and education awards, period. We don't want anybody to think that there is any influence on that. That is basically one of the main reasons why I am here today.

MR. STEINBERG: Am I correct then in understanding that your concerns are with the term, related parties?

MR. LYNSKEY: Right, correct.

MR. GRANOF: If we added some language to paragraph 84C, would that solve the problem for you?

MR. LYNSKEY: Yes. I think that the two suggestions that we put in our response for either paragraph, I think would address our concerns.

MR. GRANOF: It is just a matter of adding a couple of words and dealing with the boards of directors?

MR. DACEY: In terms of the standard, I don't know that we require that you specifically label them

related parties, but that the information about them is disclosed. I guess I have not looked at the disclosures as Mr. Steinberg has, but I don't know if effectively we would meet the disclosure requirements currently, other than the terminology.

MR. LYNSKEY: I think we have talked to Ms. Loughan a little bit about that. We think we have disclosed quite a bit. We are being told that we are not meeting the private sector standard in our findings.

We think we are disclosing quite a bit and we think we are being very transparent. To us, it is key, like I said, not to use related party terminology. We think we are being very transparent.

I know one of the questions that was given to me before was, our National Science Board, even if it wasn't required to do it, they would still, report something in some manner related to the affiliate institutions, based on a couple of years of conversations that we have had about it.

MR. MC CALL: Mr. Granof mentioned paragraph 84. In your letter that you sent, you had commented that one suggestion was to include another sentence that would say including presidentially-appointed agency individuals. That is one of the alternatives. My question is I thought this might be appropriate for the National Science

Foundation. Do you agree that might not be appropriate for other agencies, that particular suggestion?

MR. LYNSKEY: I am not exactly sure how it would impact other agencies, to be truthful.

MR. DACEY: I am going to go to your letter as opposed to the comments you made. Hopefully you can answer a question. You had indicated in your comment that you had some concerns about one of the definition issues on consolidation entities that were financed through taxes and other non-exchanged revenue.

You had some concerns about whether or not you thought that should be an appropriate filter in deciding whether it is a disclosure or consolidation entity. I guess one of the questions I had is, as you read the document cold, do you view those as all being necessary or as four factors that you would consider in the predominance of information would be relevant?

I appreciate your point that not just simply because we provide general revenue, that it means that it is part of a federal entity or should be consolidated. I guess I also have some concerns about whether taking that out is a relative factor. I am trying to get a judgment, if you will, of whether you think it reads as if you are considering all four of those factors in trying to reach a composite judgment, not placing too much weight on any one

of the four.

MR. LYNSKEY: Your last statement was our concern. Our concern was that too much weight was being put on the financial factor versus all the other factors. It was making some of the other paragraphs be somewhat ambiguous. If the weight is evenly distributed or it is not an emphasis on the financial, that was pretty much what was concerning us. If the financial then overrides all the other factors, then we were seeing an issue with that.

MR. DACEY: Do you think some clarification could benefit the standard if it was made clear that it was consideration of the factors? Anyway, I think I understand your position. I appreciate that. Thank you.

MR. ALLEN: Questions you may have for us?

MR. LYNSKEY: No questions.

MR. ALLEN: Okay. Thank you very much.

MR. LYNSKEY: Thank you. I hope I put us ahead of schedule.

MR. ALLEN: Don't worry; you put us a few minutes ahead of schedule.

Agenda Item: Caryn Kauffman and Eileen Parlow  
Securities and Exchange Commission

MS. PARLOW: We are passing our informal written responses to staff questions.

MS. KAUFFMAN: I appreciate the opportunity to be

here today. I am going to submit some of my initial comments. We did receive, which I am appreciative of, some comments in advance of the hearing. I wanted to make sure we give ample time to responding to those questions. Thank you.

The views expressed today are those of the speakers and are not representative of the views of the SEC.

In today's discussion, we would like to focus on organizations that are currently included in the SEC's section of the *Budget of the United States Government: Analytical Perspectives, Supplemental Materials*, schedule titled, "Federal Programs by Agency and Account," known as "the Budget."

The organizations we mentioned in our response letter particularly are the Financial Accounting Standards Board (the FASB), the Securities Investor Protection Corporation SIPC and the Public Company Accounting Oversight Board (PCAOB). I am going to focus my discussions today primarily on FASB, as well as some additional clarifications that we are seeking in the interest of time, and as I mentioned, to make sure we get to your questions.

The staff believe that it is not the board's intent to establish a non-rebuttable presumption that

inclusion in the Budget always requires consolidation. The staff also believe that the proposed additional principles for inclusion would not require the consolidation of FASB, SIPC or PCAOB in the SEC or the government-wide financial statements. I will be glad to discuss our understanding of the inclusion principles with you today.

The staff also believe that the proposed disclosure requirements would not require the SEC to report financial data for these three organizations, in the SEC's financial statements or notes. At this hearing, we want to discuss our understanding of the proposed disclosure requirements with you. We also have suggested edits that the staff believe might clarify several of the disclosure requirements.

With respect to the Financial Accounting Standards Board, the FASB, the budget account titled "Standards-Setting Body," the staff believe that neither consolidation nor extensive disclosure would be appropriate for FASB.

Here is how the staff believes that each of the board's proposed three major principles would relate to FASB.

Principle one, "in the Budget."

The Budget Appendix for fiscal year 2014 includes the item, "Payment to Standard-Setting Body." The text of this

section states, the Sarbanes-Oxley Act of 2002 authorizes the Securities and Exchange Commission to designate a private entity as a standard-setting body. The private entity currently designated as the standard-setting body is the Financial Accounting Standards Board. Because the Budget clearly indicates that FASB is a private entity, the staff believes that FASB does not meet the board's intent in the budget principle.

Principle two, "majority ownership interest."

The staff believe that the FASB is not owned by the SEC or by the U.S. government. As noted by the response from the Financial Accounting Foundation: "...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 to no operating control."

Section 109 of the Sarbanes-Oxley Act states that: "[a]ccounting support fees and other receipts of ...such standard-setting body shall not be considered public monies of the United States." Staff believe that the FASB does not meet the criteria for majority ownership interest.

Principle three, "control with risk of loss or expectation of benefit."

Indicators that control does not exist include that:

- the SEC has no involvement in the FASB's daily operations, and
- the FASB is not funded by general tax revenues. It is funded by accounting support fees, investment income and sales of subscriptions and publications.

An indicator of control would be, as noted in the Financial Accounting Foundation letter, the intent of the funding provisions in the legislation was to strengthen FASB's independence by providing for mandatory accounting fees. Prior to 2002, FASB was funded by voluntary donations supplemented by sales, publications and subscriptions. The staff believe that the preponderance of control factors above indicate that FASB is not sufficiently controlled to be considered for inclusion as part of the U.S. government.

SEC staff comments for discussion on FASB disclosure requirements. The staff believe that the proposed objectives for disclosures listed in paragraph 72 of the exposure draft should be clarified as follows: Objective 72B should be clarified to indicate that the nature and magnitude of relevant activity and balances at the end of the period explicitly refer to

A, financial relationships or transactions between the disclosure organization and the federal reporting entity  
and/or

B, situations where they may be potential exposure to loss or gain by the federal government. The reason is that otherwise the objective 72B may be interpreted as requiring extensive reporting on the financial activities of non-federal organizations which would be confusing and/or misleading to financial statement readers.

With respect to example 73E, a discussion of the disclosure organization's key financial indicators and changes in key financial indicators also should be clarified to refer to relevant situations, for example, where the disclosure organization may potentially expose the federal government to future losses or gains. The reason is that in other situations, presenting information about key financial indicators of non-federal organizations would be confusing and/or misleading for financial statement readers. This comment also applies to subsequent events requirements in paragraph 76.

At this point, our comment letter goes through the same analysis with respect to the Securities Investor Protection Corporation and the PCAOB. I know you probably had an opportunity to review those comments. I would like to turn it over to Eileen Parlow, to take a few minutes to respond to certain other questions that we did receive from the board in advance, to make sure we give ample time to

that.

MS. PARLOW: These are in response to the additional questions that were in the briefing materials. Disclaimer: "we," in these responses, represent informal responses from Karen Kauffman and Eileen Parlow, and do not represent official views of the SEC.

The first staff question cites the SFAC 2 provisions, and these are the ones that I just gave out just now. Then the first question asks, "What are the key differences between the SFAC text and the proposed "in the Budget" language in the ED that led you to believe that SIPC would be treated differently under the proposal than it is under SFAC 2?"

Our response: the language in SFAC 2 says, "this does not mean however that an appropriation would, by itself, require..." That language implies that the conclusive criteria of "in the Budget" is only conclusive regarding federal entities and only potentially indicative for non-federal entities.

The term "appropriation" in SFAC 2 is a broad term that could also include situations where an appropriation functions as a pass-through for exchange revenues. For example, the appropriations listed in the Budget for SIPC, FASB and PCAOB consist of member assessments, fees and other user charges. The authority

for reporting these inflows as appropriations in the Budget is based on the fact that federal legislation makes the fees and other user charges mandatory.

However, the substance of these inflows is that they are exchange reviews. Paragraphs 3 and 292 of SFAS 7 state that regulatory user charges, although not wholly voluntary, do nevertheless meet the definition of exchange revenues. The proposed new exception language appears to limit exceptions to include only non-federal entities that receive federal assistance. Footnote 11 of the ED defines federal assistance in terms of the single audit.

This implies that, (a)A, "federal assistance" is required, and (b), "subject to the Single Audit Act," may also be required. Even if the Single Audit Act issue is resolved, there is an additional terminology issue. The revenues of the FASB, SIPC and PCAOB, although they are reported as appropriations in the Budget, do not represent federal assistance. No taxpayer-funded federal assistance is provided to FASB, SIPC or PCAOB.

The comment letter from the Financial Accounting Foundation, letter number five, footnote nine on page four, also mentions this: "-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 general purpose federal financial reports precisely because it does

not receive any form of federal financial assistance.”

Question number two, did you interpret non-federal organizations receiving financial assistance, and a related footnote in paragraph 22, to mean that an organization must report under the Single Audit Act provisions in order to qualify as one. The response is yes, because the definition of financial assistance is explicitly based upon the Single Audit Act. We believe that the ED language implies that this is a requirement.

However, we believe that there is an additional problem with the language in the exposure draft as explained in response number 1C above. The proposed new exception language appears to limit exceptions to include only non-federal entities that receive federal assistance.

MR. ALLEN: Ms. Parlow, I appreciate your very thoughtfully written response to each one of these. The staff drafted some questions for the board's consideration. You are provided a copy in case we ask that question. I also know that the board often writes many of their own questions.

If it is okay, what I would like to do is open up for the board to ask some questions. They may ask some of these same questions and we can have a discussion. Or they may have some other questions that we could focus on, knowing that you have carefully answered some of the

questions that the staff identified, if that is okay?

MS. PARLOW: Sure.

MR. GRANOF: The question I was going to ask was exactly what you have answered. I have to confess that your answer went so fast. There are a lot of sections that you cited here. Let me just ask you this. I don't understand why the FASB is in the Budget to begin with. It is a conduit agency, right? Why is it there and why not just eliminate it from the Budget?

MS. PARLOW: That is an excellent question. I mean the Financial Accounting Foundation said in their response letter "for reasons that the FAF does not understand, FASB is in the Budget." I totally agree with you. I don't know. It's funny; we don't understand either.

MR. REGER: I think all of our questions appear to be somewhat related to this. It seems an anomaly that these entities, which are created pursuant to federal authority or at least authorized, are therefore included in the financial statements, and the United States government should just go the way it is.

The question is, why are they there? Pursuing the logic of we want everything that is, in fact, a responsibility of the United States government to be there, it is only the authorization of these that appear to be

there.

Mine is two questions. One is what was the intent originally including them in the Budget process, and I am hoping one of you two know. Then, secondarily is, are the revenues that do come in, which are paid by the people who are basically regulated by these entities, collected pursuant to the federal statute, or would they pay the revenues regardless of the federal statute saying they had to?

MS. PARLOW: I am not sure. We would have to check actually with probably those organizations' general counsel. I am expecting, though, that the whole purpose of the legislation making, for example, the accounting fees mandatory for FASB were intended to make FASB's funding more secure. I think Congress believed that those accounting fees would not be paid, at least not as many of them, if they were not mandatory.

MR. DONG: The reason why it is included in the Budget is because it gives FASB the authority to collect the revenue.

MR. GRANOF: You need the in and out? You need both the revenues and the expenses included?

MR. REGER: There are other examples of that, though. I don't know if you know of any, and I am loath to bring one up. There are other examples where federal

agencies, in fact, collect revenue to run the agency as a result of regulatory environments.

The question always was, would people regulated actually voluntarily pay the fees were it not the federal statutes. I believe most of those have been tested in court. I don't think this has ever been tested in court.

MR. DONG: As I listen to this conversation, is the fix to, A, take it out of the budget, or is the fix for us to sharpen the language that we have in here that refers to that Budget exclusion principle?

MR. SHOWALTER: I think the latter point, basically this is funding coming from external sources. Really there is not an appropriation. It may go through the budget act, but it really is external money.

MR. GRANOF: Are there other examples of this? If there aren't, it is easier to fix the Budget perhaps.

MS. PARLOW: The strange part is the treatment of SIPC in the budget. SIPC has been around for 30 years. For a long time, they were not in the Budget. For another number of years, all that was in the budget was their line of credit, which they have never used and have no intentions really of using at least for the foreseeable future. Just the line of credit, not their inflows and outflows, just the line of credit.

Then, for a little while, that disappeared and

was replaced by just a couple of sentences about SIPC, just narrative. Then, SIPC does not know why, in 2011, suddenly its revenues and expenditures are in the Budget. It's funny, The only time I have seen an explanation of an "in or out" issue is when the Indian Tribal Trust Funds were taken out of the Budget because it was such a massive amount of money. There was actually an essay in *Analytical Perspectives* about why OMB took them out of the Budget.

I have never seen anything, and SIPC folks have never seen anything, about why they were put in the Budget in 2011. We don't know. They are not aware of any legislative changes that made that happen. It is pretty much a mystery to us.

MS. PAYNE: Could I interrupt for just a moment? I am getting word that folks in the back corner are not able to hear very well. If I could remind people to kind of focus toward the microphones and speak up. During the break, we are going to have to chairs for this side of the table, so observers in the backside can move closer. Thank you.

MR. STEINBERG: Speaking for myself, I can see where FASB is a non-federal organization receiving a federal payment. By not tying it to the Single Audit Act would get FASB out of the picture, so it would get it off the table. I can see that.

I could also see where SIPC, perhaps you could raise an argument that maybe it is a fiduciary fund, the same as Indian trust funds you mentioned. When you get to PCAOB, which has a regulatory authority in the same manner that the parent organization does, SEC, the regulatory authority, I am wondering whether your comments about not being intended, the payments, should not be a non-rebuttable presumption.

What we have in our document is that payments to a non-federal organization would get you out of the statements. If there are other things under either control or ownership that would bring you in, then you should be in. As I said, PCAOB's whole function is to regulate in the same manner as your function is to regulate. I wonder if you would respond to that.

MS. PARLOW: Well, PCAOB was intended to be independent. It has certain aspects of even being an intervention organization because it does what used to be a private sector function. That industry used to be self-regulating, and the AICPA used to have that kind of authority.

It was decided that that needs better or governmental intervention, I will put it that way. PCAOB was set up to take that over. That function has not been historically a governmental function. Now, whether that is

going to be permanent is anybody's guess.

MR. STEINBERG: I would dispute that statement. As a former partner in an accounting firm that has had more their wrist slapped by your organization, your organization has done one hell of a lot of regulation of the auditing profession. Maybe it required so much that the self-regulatory process was not enough. Rather, for whatever reasons, than the SEC do it itself, you all decided to set it up, or Congress did, with PCAOB. It is still doing to me, and the fact that your chairman appoints the members of the PCAOB, to me, that is a hell of a lot of control.

MR. GRANOF: By any criteria for manifestation of control, the SEC controls.

MR. REGER: It strikes me that we, as you know, had sort of robust discussion about not these particular organizations, but similar things when we were doing this. Crafting a solution here is going to be interesting. If either of you have any suggestions for a way to craft a solution that would not negatively impact, especially in both of your knowledges, other organizations that might obviously be in as a result of the criterion should be in, as opposed to what you believed these three shouldn't be in, I think if you could offer us some language, it would not necessarily help, but it would seriously clarify our perceptions of PCAOB and FASB and the others.

MS. KAUFFMAN: I think it is important also to think about, as we go through and think about solutions, to cost/-benefit. PCAOB is also an organization that currently does not follow federal accounting standards, the USSGL. It would be significant. Anything that we did that would then require them to start following the budgetary accounting would be a significant transition.

Not only that, they are a 12/31 year-end entity versus a 9/30. When you think about cost/-benefit and the use to a financial statement user, what level of disclosure, and I don't think that we are suggesting the disclosure at all is inappropriate. When you look at the level of disclosure warranted, and if we are getting down to a really detailed financial level, what is it really going to mean to a financial statement user? What is the cost that is going to be incurred? I think that is really what needs to be considered for an entity like the PCAOB.

MR. SMITH: I think the three examples you used is a great example of the complexity of what we are trying to do and why we need to lay a standard instead of a rule. I think when you look at PCAOB, it is an example. Ms. Parlow, you made the item of the government stepping in to regulate. That is what is perceived with the public, and I believe that is what it is.

I think to take a statement now to say, well, we

are going to opt out PCAOB because it is difficult or because it has a different year-end, or because of the complexity, then what we are going through now in saying instead of trying to comply and report to the government, what is the intent of the government for the reporting entity? We are letting other things that really shouldn't be driving. I think that some of the things that you mentioned are the practical issues of getting to disclosure and how we get there. We can have a practical approach, so that we don't put an undue burden on the government.

I think we still have to get back to the intent and say that the public, and I think the nature of what PCAOB is doing, as well as why it was created, was really to go and take a government function that was not comfortable when it was being done outside. I think that is different from FASB because I think FASB is an independent organization that was setting standards, and this just created a funding mechanism for that.

I think PCAOB is different. I think SIPC is clearly the one that is in the middle. I think SIPC, the only thing that you are really going to get to is this line of credit and what kind of obligation this line of credit could potentially tie back to the federal government because of the fact that withdrawing on that line of credit didn't have the ability to pay, that could potentially be

some exposure to the government. Maybe that is a risk item as opposed to something in the reporting entity.

I don't think that we can just kind of go through and say, purely because of how these organizations are funded that is going to automatically exempt them out, especially when we are applying a standard. While you could go through, and I think that this standard right now allows to review the various criteria to get to a decision that is judgment, if you would blanket go and provide that, I think that we would get to the end.

So many things would start coming out of the reporting entity that we would have a standard at the end that would say, is this really representative of the whole government, which is what we are trying to do with the standard.

MS. PARLOW: This is actually getting back to Mr. Reger's question. Early on in the original project plan for this project, there was a citation of a GASB rule that I briefly mentioned on page two in the first bullet in question four. I have got the whole citation here. I think it is outstanding, which would, I think, be something to consider. GASB requires that a legally separate tax-exempt organization should be reported as a component unit of a reporting entity if all of the following criteria are met:

(a) The economic resources received or held by the separate organization are entirely or almost entirely for the direct benefit of the primary government, its component units or its constituents.

The primary government or its component units is entitled to, or has the ability to otherwise access a majority of the economic resources received or held by the separate organization.

(b)

(c) The economic resources received or held by an individual organization that the specific primary government or its component units is entitled to, or has the ability to otherwise access, are significant to that primary government.

I think those considerations are something to think about. Those considerations would actually exempt PCAOB.

MR. REGER: The problem is it takes out way too much. Whether you like it or not, over time, the government has moved organizations off of taking in the money in the general fund appropriations and appropriating them into other kinds of revenue mechanisms and processes.

I am afraid that way too many organizations that we would all traditionally think about as part of the federal government would not qualify under that. These seem further out than that. I am struggling with the exact

criteria that would classify them further out. I think that is way too broad a brush.

MR. SHOWALTER: I think the intent of why this was put in was totally different than what you used it for.

MR. DACEY: One of your proposed solutions to the issue was to move "in the Budget" as part of an indicator of control, rather than separate criteria. What were some of your thoughts in wanting to move it there, and whether you think that is going to significantly change the current dynamic that we have, if you would move that to an indicator of control? Essentially, then you would be measuring the extent of control as opposed to simply "in the Budget."

MS. PARLOW: One reason is the sheer inconsistency of the "in the Budget, out of the Budget" of an organization like SIPC. If this had been a rule, (in the Budget, it is consolidated," for many years it [SIPC] would've been not in the financial statements at all. You can't really consolidate an unused line of credit. There would have been for 35 years nothing, and then suddenly, in 2011, SIPC would suddenly be consolidated. Then, going forward, who knows? If we were not really sure why they put it in the Budget, they could, in another year or two, take it out of the Budget again. It would be inconsistently in and out of the financial statements.

When you have a rule, and there is inconsistency, to me it is very problematic.

MR. DACEY: If it is in the Budget, it is consolidated, period, no question, no judgment, anything under the SFFAC 2. Is it not there? What I am trying to understand is, we have excluded certain entities under SFFAC-2. We say it may be on that page; it is not in the Budget, per se. We have struggled with coming up with some of that criteria to mirror that in language.

I was interested in your proposal, which would move it to an indicator of control as opposed to a strict adherence. You basically filter it there. I don't know if you think other organizations would be then excluded from the government-wide, or if you have thought about that, if you would move to more of a control-based criteria than simply "in the Budget."

MS. PARLOW: I think that it would make it more principle-based as opposed to rule-based. Really it reminds me very much of what we did with fiduciary funds. We said, don't just have a rule, such as, "if it is reported in a deposit fund, it must be fiduciary." No, no, no:

you have to, regardless of how something is reported to OMB or Treasury, regardless of what they are doing, that you need to take a look at the principles and

apply the principles to the organization. That is why I think that there shouldn't be a strict rule, "in the Budget = consolidated." I think that ["in the Budget"] should be an element. It can be an important element, but I think that it should be more principle-based and not rule-based.

MR. DACEY: Under what you would propose would be the ideal solution with the three entities you talked about, would those be reasonable disclosure organizations? Would you think those are related parties or totally off the table for any disclosure in your financial statement?

MS. PARLOW: I am speaking only for myself here, obviously. My impression is that they would be disclosure entities. That is the reason why we are also concerned about extensive reporting of financial data. We do not believe, for example, reporting actual numbers for the liabilities of an organization like SIPC might imply to some that those liabilities are backed by the full faith and credit of the federal government. They are not.

If SIPC borrowed that money, if it ever does use this line of credit and borrow from the treasury, it has to use its regular assessments, member assessments, to get that money to pay back Treasury.

MR. REGER: That is exactly the question because are their assessments then backed by federal authority? Therefore, they could raise those assessments to a level to

pay whatever the debt service would be.

MS. PARLOW: Yes, they have the authority, although I believe that they have to coordinate with, I am not sure whether it is Treasury or SEC or whomever they coordinate with.

MR. REGER: Does SEC approve their fee structure on an annual basis?

MS. PARLOW: It is different for different organizations. I would have to get back to you on that.

MR. REGER: All three issued their statements under FASB standards?

MS. PARLOW: Yes.

MR. REGER: Are there, to the best of your knowledge, material differences between anything in those statements? If they had to be included under ours, you would have to say what the differences were?

MS. PARLOW: Yes. The big difference is SIPC's very material, over one and a half billion dollars of Treasury securities. That is a problem. Those are valued according to FASB rules. They also value them as of December 31<sup>st</sup>. They do not buy Treasury securities the way a federal agency would. They don't have 'Fund Balance with Treasury.' They buy them on the open market like any other non-federal organization.

MR. SHOWALTER: If we were to fix the Budget

issue, where would you be on disclosure? The way you have worded this, it is kind for extensive disclosures. I wasn't really sure if you were finessing the words when you responded in your response here. That was a little bit to Mr. Reger's question to you. If these became disclosure organizations, what was your concern if they came to that?

As a follow-up to that, you were using SIPC as an example. There is another organization called FDIC that the public believes operates the same with the SIPC. The public thinks they do. Wouldn't you want to use this as an opportunity to explain that they don't, and you could use that through disclosure.

MS. PARLOW: As a matter of fact, it's funny because SIPC actually has a page on its website that says, "Why we are not the FDIC."

MR. SHOWALTER: I understand that, but the general public thinks they are very similar. What would be your objection be if there were disclosure laws?

MS. KAUFFMAN: I don't think we would object to disclosure regarding the extent of the nature of our relationship with these organizations. Maybe even going so far as to disclose any particular financial transactions we had with these organizations. I don't think that would be an issue.

I think it gets to when we used the word

"extensive," if we are actually talking about, rather than consolidations, going so far as to slap their financial information as an exhibit within the notes, that is where I think it will raise an extensive number of questions. Rather than just put in all the financial data, maybe just limiting it to what is the nature of our relationship with these organizations? Also, any particular financial transactions we may have with these organizations?

MR. SHOWALTER: You don't think you could have a discussion about whether that information is material or not? Do you have financial statements, any prior disclosure? Are you assuming you all are just going to use this as a checklist to make you show all that?

MS. PARLOW: Well, if you are going to talk about assets and liability, I mean, SIPC has one and a half billion in Treasury securities.

MR. SHOWALTER: You could talk about that, kind of consolidate. Financials, that is different than if you gave total assets.

MS. PARLOW: Even if we reported it in our notes and of course, with comments from (the Board member) representative for our auditor (GAO), maybe if we finessed it and said, "according to SIPC's financial statements as of last December 31<sup>st</sup>, here are their assets and liabilities." What would that mean?

MS. KAUFFMAN: Then you get into "subsequent events requirements." Again, at [SIPC's] 12/31 year end, we would be disclosing this as of 9/30. What would our obligations be with respect to that nine-month interim? I think there would be some auditor burden on that, as well as on us.

MR. DACEY: I appreciate your concern. Some of your concerns are that it would be misleading to include that information because it is not really relevant. They are not assets of the federal government and have access to. They are not liabilities of the federal government.

MR. REGER: In liquidation, if for some reason those organizations were to be liquidated, what happens to the assets?

MS. PARLOW: I don't believe that the federal government has access. We would have to get more involved with all four general counsels. I guess they would have to chat with each other. I do not believe that the SEC or the federal government have any claim on any residual assets of any of those organizations. That is my belief.

We did get an informal agreement with that from the SEC's Office of General Counsel. Of course, we would obviously have to discuss it with those organizations, as well. The tentative understanding is that the SEC and the federal government have no claim whatsoever on the

resources of any of those three organizations.

MR. DACEY: You had indicated in your response letter that you had some concerns about the clarity of "misleading to exclude." Do you have any specific language that you all considered or talked about that would be good to add to the discussion so that it was more clear?

MS. PARLOW: I guess the concern is that there seems to be a bit of a bias because, the "misleading to exclude" is actually in the government-wide section and has a whole subtitle devoted to it. Then, "misleading to include," for some reason, appears in the component section, which is confusing. The "misleading to include" does not appear on the decision tree, either. I know that is just an illustration. It is not authoritative, but still, the decision tree is also biased towards inclusion. That was a concern of ours.

MR. DACEY: I guess in reading the response, though, it suggested that we would perhaps benefit from having additional supporting principles or examples to support what we meant by misleading to exclude. That came across in a number of other letters, too, so I was just curious.

MS. PARLOW: Misleading to include, or, misleading to exclude?

MR. DACEY: It is include, as well. It is the

whole idea of what misleading means. A number of other comment letters have focused on that, as well, about the clarity of that. Bottom line is, I didn't know if you had any specific thoughts on what specific principles?

MS. PARLOW: Simply my thoughts about, I think, ownership is very important because if you are including something, if you are reporting assets, especially the financial data about assets and liabilities, that are not assets or liabilities of the federal government, I think that that is misleading.

On the other hand, you don't want to leave out assets and liabilities that would meet the definition of federal assets and liabilities. I think the FDIC comes to mind there in terms of "misleading to exclude" because the ownership is, I believe, different. I do believe that their assets are owned by the federal government.

MR. ALLEN: Thank you. I have got a series of questions for you, but I think maybe I will just send you a note and have you respond to them. Like many other board members, apparently these three all fit along a spectrum. One is easy to eliminate, one is a question and one, I don't know if you fixed "in the Budget" or anything else, you would still have the control factor there. I was going to talk about that. I appreciate your participating.

MS. KAUFFMAN: Thank you.

**Agenda Item: Andrew Lewis - GWSCPA**

MR. LEWIS: Good morning. I have a couple of comments that I wanted to share as we get started. It is my great pleasure to address the members and staff of the FASAB on behalf of more than 3300 members of the Greater Washington Society of CPAs. My name is Andrew Lewis, and it is my pleasure to serve as the chair of the Federal Issues and Standards Committee or FISC.

The FISC was formed to respond to requests for public comment on drafts issued by this esteemed body, along with exposure drafts from the GAO, OMB and other institutions that influence accounting, reporting and auditing within the federal government.

FISC is made up of a cross section of Greater Washington Society members from the federal preparer and auditing communities. It includes current and former senior federal employees, representatives from CPA firms and private organizations, recent graduates from local university accounting programs and retirees.

The FISC currently includes 27 members and our responses to the FASAB represented consensus of those members. Since 2009 alone, the FISC has been pleased to provide our views on all 23 of the exposure drafts and other documents released for comment by the FASAB. We hope that our responses have been well-received and that our

comments have assisted the FASAB and its staff in finalizing the important matters on its agenda.

In our letter to the FASAB, we provided our views on the reporting entity exposure draft on July 3<sup>rd</sup>. As conveyed in our letter, we support most of the elements of the exposure draft, but we also highlighted some areas that our members felt some additional attention and consideration was appropriate before the FASAB finalizes this critical accounting standard. I would like to take just a couple of moments to summarize just three of our key points, and then I would be happy to answer any questions and move onto the break.

We suggested that the FASAB consider allowing the preparer community with additional time or an alternative forum to consider the effects on component agencies' financial reports and the Financial Report of the United States Government. The final standard has the potential for some far-reaching consequences that may not be envisioned in deliberations during this limited comment period.

In our letter in July, we suggested that the FASAB consider an extended comment period for implementation challenges and/or allow the preparer community with additional time to consider whether the consequences of this exposure draft may result in

unattended legal or political challenges. This public hearing is a telling step that the FASAB is taking steps to expand its comment period and provide additional avenues for preparers to provide input on the standard.

One of the things that we observed is that the exposure draft could be interpreted to require entities not currently envisioned within today's view of the federal government reporting entity to be required as consolidation or disclosure entities. In our discussions among FISC members, we saw entities such as the government of the District of Columbia, potentially organizations like the U.S. Virgin Islands, Puerto Rico, Guam, American Samoa, several major universities that hold federal charters such as Gallaudet and Howard universities, could be entities that could be consolidated or disclosed in meeting the inclusion principles. The FISC suggested that additional time to consider the potential implications of this exposure draft in its final form would be worthwhile to prevent unattended reporting impacts when implementation is required.

Second, in our letter, we suggested that the exposure draft should further define the circumstances or framework in which the misleading to include or misleading to exclude situations would occur. More information from the FASAB 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.

Our emphasis is on the need for an objective basis of an opinion. Since there is limited definition or circumstances provided in the exposure draft in which the misleading to exclude or misleading to include situations would be appropriate.

Lastly, the FISC agreed with Mr. Steinberg's alternative view in that receiverships, conservatorships and interventions are often temporary in nature. Information related to the federal government's role in these organizations should be disclosed separately from the financial information included for other disclosure organizations in the financial statements.

We also suggested 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 these organizations, and not necessarily include key financial indicators as provided as an example in paragraph 73E.

We agreed with Mr. Steinberg that presenting condensed financial information for receiverships, conservatorships and interventions may give a false

impression to the users, the financial report of the U.S. government, of the federal government's size and financial position.

In closing the FISC recognizes that this exposure draft was no small effort, and took the collective effort to the taskforce members, FASAB staff, especially Melissa, and board members to consider and deliberate on these difficult topics. We want to express our thanks and appreciation to the board, the staff and the taskforce members for their efforts on this topic.

Thank you very much for allowing me the opportunity to share the views of the Greater Washington Society. I would be happy to take any questions.

MR. SHOWALTER: First, I want to thank the Greater Washington Society of CPAs because we can always count on your response. As you indicated earlier on, you do respond, so I want to thank you. We know these efforts, particularly volunteers, take a little while to get done. We really do appreciate your comments because they are always well thought out. Thank you for that.

I was particularly intrigued about your first comment about creating this forum. Can you add a little meat to those bones and give us some ideas of what you meant when you made that recommendation? Are you thinking about a pilot? What were you thinking when you made that

recommendation?

MR. LEWIS: Thank you. I think also trying to build the consensus of 27 members is also an interesting point. July was a different time than it is today, as far as the view of where we thought the board was headed. We thought the board was going to be moving rapidly through public comment and then through to deliberation and releasing a final standard.

Seeing that the board is now taking steps, such as this hearing, is one such way that we looked at, maybe providing a public hearing, a pilot. Other things that were brainstormed among our group could also be things such as, I guess, providing a survey more or less to all of the federal reporting entities.

Seeing that there has been a number of comments provided to the standard and to the exposure draft was also, I think, a very telling thing that we didn't have insight to when we wrote our letter in July. I am not sure what the final count of comments received, but we guess that you probably received more comments to this than you received in many other exposure drafts. We didn't have insight to that then, thinking that there may not have gotten necessarily the attention of the federal community when the exposure draft was released.

MR. SHOWALTER: Our experience shows by just

giving more people more time just puts off the decision. It doesn't get anything else done, so I was looking for whatever else you had. Thank you.

MR. REGER: One of the questions that we have had, and maybe Mr. Dacey and I share this more than the rest of the members is, if and when the standard goes in place, how best to socialize it, ensure that all the organizations and/or entities that may be affected by it, know about it and what the timing is to actually implement it.

You have noted about states and possessions and universities. KPMG at least, and I know you are not here on their behalf, is still the largest auditor of federal entities, I believe. How long do you think, given what you know now, is a reasonable period to anticipate we will have to do an educational exercise before we could really implement the standard?

MR. LEWIS: That is a great question, Mark, and I am here representing the Greater Washington Society. You will hear from KPMG later today. I think your question of timing also comes down to the priority placed by the three principles here at the table.

The priority that is placed by Treasury, OMB and GAO on socializing this, advertising the impact that it might have on the federal reporting entity. Mark

especially, your organization, Treasury, we thought in our discussions would have likely many of these organizations that aren't currently considered part of the reporting entity, and would fall to Treasury to provide and perhaps do research on, or provide that input back to the board on whether or not those organizations would be included or not included.

I don't really have an answer in terms of being able to tell you timing. I think it would come down to how much of a priority you place on this.

MR. REGER: Let me just clarify, especially since we are on the phone. Of course, we think it would be the individual agencies and CPA firms to interpret the standard and reach a conclusion. When we move from a list to a principle-based statement to determine whether somebody is included, we are all very concerned about the priority with which those interpretations occur.

MR. LEWIS: Perhaps some type of working group, maybe one through the CFO Council or other working groups might help to alleviate the attention agencies are placing on this. Certainly, agencies have a lot on their plate right now. This would be just one of the other things that they may not even be considering impacts of other organizations that might fall under the inclusion principles as they are written today.

MR. DONG: I just wanted to follow up on your response to Mr. Showalter's initial question because I am not sure I followed all of it. In terms of, in your opening statement, you talked about the need for a longer window of time and perhaps an alternative forum. Are you saying that that concern is less now than it was back in July because of what you have learned since then? Or is that a concern at all?

MR. LEWIS: I think that one element that may cause this to still be a concern is how significant of changes the board envisions between what was previously released and what would be the standard in its final form. If the inclusion principles are refined, if there are other significant changes that may bring more entities in or cause more entities to be excluded, or if such things that agencies might be counting on, such as the misleading to include and misleading to exclude principles that were removed, agencies may need some additional time to be able to consider that.

I am not sure exactly what may be the right course of action. I think it really depends upon how many changes are made.

MR. DACEY: I don't know if you are familiar. We had proposed and discussed as part of our implementation, which was a two-year process. It was felt, at least at the

time, that it would be important to coordinate all these efforts between both the individual agencies and their auditors, as well as the government-wide preparers and their auditor, and that was an important process that would take a significant amount of coordination and cooperation.

At the same time, there was a concern, I think, that we needed to have a finalized standard so it wasn't moving or potentially moving, and there could be an opportunity to go back and revisit the standard, if in fact in implementation we found problems. At least that was some of the discussions on the board.

To some extent, I am not really asking for your conclusion necessarily. To some extent, I think we had thought about a process of coming up with a standard, going through this rather extensive process, coordination between Treasury, OMB, GAO and all the agencies and their auditors to try to make sure we couldn't have an agency that is this consolidation entity. Then, at the government wide say no, it is not, or vice versa. I think to that extent, we are still, I think, trying to decide the best way. I am interested in your comments on that subject.

I guess raising to a different question, in the letter you had suggested that you would put qualifications, if you will, on the indicators of inclusion principles having to do with the government's interest other than

temporary in nature. Except you didn't do that with the budget. Maybe I will ask that question, why it is not all three. It seemed to be that you were moving down the road of suggesting that if it is other than temporary, it would simply be outside of the standard and not part of the standard. I didn't know if you could elaborate your thoughts on that a little bit more, and the reason why you are thinking about doing it as an inclusion.

MR. LEWIS: I think the goal of our comment was really, in our discussions, to try to simplify the classification of whether or not an entity meeting those principles would be disclosed or consolidated. Now, it wasn't trying to change the nature of the standard, just simplify that, right now, the standard speaks through several paragraphs, paragraphs 45 through 53.

Within those paragraphs, as they discuss financially independent or quasi-government organizations, receiverships, conservatorships and interventions, in each one of those sections, there are discussions of the permanency of the relationship. Our thought was just simply bringing forward the other than temporary into the exclusion principle. It might have been more straightforward to a reader in determining whether or not it was a disclosure or whether it was a consolidation entity.

We weren't trying to necessarily change the standard. We were just simply trying to bring together some of the language into the exclusion principles themselves.

MR. DACEY: Two other questions I had. Also in your response letter, you raised some concerns about the requirement in paragraph 66. It requires FASB-based organizations to disclose intergovernmental amounts according to the phase-out.

Technically that would apply, I guess, and you suggested that be part of the reporting package or closing package process. That relates to the 35 entities. I didn't know what your thoughts were in terms of that particular point, if you could elaborate a little more on your thoughts on that.

MR. LEWIS: Our conversation there was if the sole point of bringing those FASB organizations into the financial statements was in order to be able to gain access or gain insight into their intergovernmental reporting, then would using the general purpose financial statements or financial report be the right mechanism, or would there be another mechanism outside of the general purpose statements to be able to accomplish that objective?

That was the discussion that we had. That may be for both the FASB organizations, as well as potentially

even GASB organizations. We opened that discussion since the standard really focused more on FASB-based. There may be GASB-based organizations that may need to be included, as well.

MR. DACEY: The last question I had was you also had discussed the concept of misleading to exclude and misleading to include. Do you have any thoughts on what those characteristics would be that we might want to add to our standard? Did you have any discussion?

MR. LEWIS: I would be happy to go back to our members and see if we can identify or come up with any additional items. We were simply acknowledging in our response letter that, right now as written, the misleading to include and misleading to exclude was fairly wide open. We felt like that may lead to difficult conversations between the preparer community and the auditor community.

Without any objective lists or objective principles to guide that discussion, we predicted that maybe some of those more tenuous conversations may end up back here at this table. People may be then seeking input from the FASAB to mediate those conversations. Any additional things you can provide with misleading to include and misleading to exclude are contained in the final standard, then providing some additional guidance to those would be helpful.

MR. GRANOF: It seems to me that the purpose of a misleading to exclude is a catch-all because you can't think of others. That is why we put it in there because we can't identify specific items. Otherwise, they would be in the other.

MR. DONG: Are you suggesting that we illustrate it?

MR. SHOWALTER: Are you all concerned about exclude or include, if you want to order perspective? Are you really going to complain if a preparer wants to put something in, if you think the presentation has nothing misleading about it? Are you more concerned about them using the include to skirt around and not put something in?

MR. REGER: Before you answer that, ask Ms. Banks that same question in a couple of minutes, and you will get an answer.

MR. LEWIS: We didn't place any priority on one or the other. I think I have my own thoughts and maybe Carol might have some more comments about that a little bit later. I think that it depends upon which side of the coin you are on. The preparer side, I think they would take one particular side. The auditor may take another one. I think that there could just be some difficult conversations that may occur.

MR. MC CALL: I read your response and it was

excellent. I wanted to ask a question. In terms of combining and consolidating FASB and FASAB, you said you were in support of that. I wanted to get your thoughts on that because I think that is going to be discussed more today.

Then, I wanted to ask kind of a follow-up to that. Michael just mentioned, I believe it was, GASB. If it were that the Federal Reserve System were included, as a consolidation entity, how would you feel about combining all four types of financial statements?

MR. LEWIS: I think if an organization meets the requirements for the consolidation, then they should be included within the financial report. I think that there are some things that we highlighted in our response letter that the agencies may need some additional clarity on.

Some of the things that we talked about in our letter were perhaps some guidance on the conversion of how such a consolidation may take place. We also thought that perhaps some additional information may be worthwhile on whether or not the consolidation should be done on equity cost or acquisition consolidation method.

We highlighted a couple of different thoughts. As you take some of these different bases of accounting or these non-federal bases of accounting, and roll them up into the government wide, or even into the component, how

that is done, the agencies may have a number of questions about how to do that.

MR. STEINBERG: I was struck by the number of people that said we need more criteria for misleading to exclude. Then, I think back to when we met jointly with GASB. I had asked the GASB chairman specifically for examples of misleading to exclude because they have had that criteria for 25 years. He came up with one, after 25 years. I guess there is another one, which is the research foundation. They put that into a standard actually.

Having said that, going along with what people said before, that the misleading to exclude really is a catch-all, and that if we did have criteria, we would get it into the criteria. I guess my question is, do you think we can remove the controversy that may occur between auditors and preparers if we go into more elaboration and the basis for conclusion as to why we have put in misleading to exclude. The fact that it is going to be based upon judgment.

MR. LEWIS: Thinking more here in the seat about your question, as well as Scott's question, I think that really my concern is more of the misleading to include. It meets the inclusion principles, but then a preparer may say, well, but let's set this aside for I am not sure whatever reasons, maybe political reasons or other

regulatory concerns. They may say that even though it meets the inclusion principles, we want to set this aside from our reporting entity.

Those are the points that I think may become more controversial. I think misleading to exclude, perhaps we may be in the same position in a couple of years as a federal community, where there might only be one or two cases, maybe some unusual cases that may come along that it falls outside of the inclusion principles. Treasury or others feel that it would be misleading to exclude it, even though it falls outside those principles.

Right now, the inclusion principles we thought are written quite broadly. If you choose to narrow any of the inclusion principles, then people may find themselves having to lean more on misleading to exclude. That may become more important. As it is written right now, the inclusion principles are written, meeting only one of the three inclusion principles opens the door pretty wide for the reporting entity definition.

MR. ALLEN: Let me go back. Bob made the point early on of you talked about temporary and why you included that up front. Where, in essence, what we are saying up front is, are you included anyway? I don't think it would be appropriate to move that up. I think where we have it in the standard is the appropriate placement.

Nevertheless, let me ask, what is temporary? In other words, do we define that? In FASB literature, they have definitions of what they consider temporary or not temporary. At the FASAB level, we have things that have gone on what the railroad, 30 years. Is that temporary if something exists for that period of time?

How would we decide what "temporary" means? Where I am going with this is you talk about a limiting disclosures for those that are temporary. Do you think if we were going to do that we would have to define that, what temporary means?

MR. LEWIS: I think the term temporary does currently exist. I think I counted that it is listed in other parts of the existing exposure draft. The word temporary is already within the standard. I think it has been used in other standards, as well. That may be a broader question, which is should the board define the term temporary?

As we did some analysis and we looked at, let's talk about interventions, I think that may be one place in which there may be a temporary or an other than temporary relationship. As we looked back at over the past 30 or 40 years, there are some interventions that have occurred that have only been a couple of years long, such as some of the recent interventions that occurred due to the economic

events of the past four years.

There have been others. As we look back, there are some of the railroad interventions that occurred where the federal government was involved with the railroad industry for almost 20 years, such as your example there. Temporary probably would need some additional definition because I am not sure. I guess I can't necessarily answer that.

MR. ALLEN: You mentioned paragraph 72 and 73. If I can just read 73C, where intervention is a primary reason for the intervention, brief description of it, plan to monitor. That seems like that would be a very appropriate exposure. Yet, your recommendation is that we only talk about the risk factors.

If you look at paragraph 72, it has three things we are trying to talk about: the relationship of the organization, the relevant activity and then the future exposure. Again, your comment led me to believe that you thought we only ought to be talking about the future exposure.

I guess that is why I asked could we define that. The way the standard is structured, what we are saying is that temporary in nature helps us decide whether it is a consolidation or a disclosure entity. It does not affect the magnitude of the disclosures that we would have. Your

recommendation is that it should affect the magnitude of that. That was sort of why, I guess.

MR. LEWIS: I don't think that we were intending to try to say that some background description summary narrative wasn't appropriate. I certainly would think that in describing an intervention, there would be an expectation of a user to see some narrative to explain why the intervention occurred, such as what is highlighted there in 73C.

Our discussion was really focused more that the risk was more important. Then, later on in that same paragraph, another example is 73E. 73 E recommends that the disclosure organizations include a discussion of the disclosure organizations key financial indicators and changes in key financial indicators.

I am not sure if the term financial indicators was ever defined. Financial indicators could be interpreted by some in our discussions as being assets, liabilities, revenues and expenses perhaps. Would that then trigger some organizations choosing to include then, I think has been referenced today, condensed financial information of the disclosing entity.

MR. ALLEN: Again, every board member speaks only for themselves. In my mind, that was appropriate when you talk about a Fannie or Freddie, where you are saying some

understanding of that organization, how it is doing very much effects what our potential obligation may be, risk or loss or gain, I guess, either way we look at that.

Well, I appreciate that. Think about the temporary. It sounds like you have already thought about that. My comment, and I didn't mean it as a smart aleck comment, as I looked at your A12 response, I thought, so you don't want a 5 A and B, but if I have note five and note six talking about the reporting entity, and then note six was talking about the receiverships or other temporary things, you wouldn't really object to that.

It was kind of a smart aleck comment of you want the information; you are just talking about where you place the information, I guess. You don't want it as part of the reporting entity footnote. The next footnote would be fine.

MS. LOUGHAN: One final comment, paragraph 73, I just wanted to point out; that is examples of information.

MR. LEWIS: Sure, I agree; it is examples. To get back to Mr. Showalter's point, there may be instances in which people use this as a checklist. Some may expect them to see these being minimum examples for reporting. That is where we had some conversations again about 73E.

Some could interpret those key financial indicators when it is a financial institution or it is some

other type of company that the disclosure organization represents. Whether some people may interpret key financial indicators as condensed financial information.

Then, you may have say the case of the territories of the government of the District of Columbia. Then, you may have examples in which then you are placing. Again, this is taking it to an extreme, but these are some of the things that we discussed in our group, is it could take things like the government of the District of Columbia and expect condensed financial information for that entity.

Then, perhaps chartered universities, one could interpret this then as having condensed financial information. If they interpret it to be included and if they interpret 73E key financial indicators to be condensed financial information.

MR. SHOWALTER: That is no different than the conversation we just had with the SEC on disclosure. That is an issue that people are interpreting this as a floor, not a ceiling.

MS. PAYNE: Just a quick question about geography, since I have an auditor, I can ask at the end of the table. Often, when we are putting in an appendix that is illustrative, and we go to great lengths to label it is not authorities, meaning that it is not prescriptive like a boiler plate or a checklist. If all of the 73 paragraph

examples were instead in an appendix, do you think that mitigates against this checklist or does it have the same effect?

MR. REGER: You are just trying to mitigate against disputes between the auditor and the preparer.

MR. ALLEN: Seventy-two sets up those three areas. I guess if it is an appendix and it wasn't somewhere that was permanent, the first thing we are going to get is, what do you mean, by each of those three things. It is a Catch-22.

MR. LEWIS: I guess I have a couple of hats on here as I am sitting in front of you. My sense would be that maybe the board would want to consider not using terms such as examples. I am not sure I have a very good way to be able to respond to that on record.

I certainly would like to talk to you more about what might be appropriate in those circumstances. Perhaps placing more description within paragraph 73, more narrative to describe that these examples would need to be tailored to the facts and circumstances of the situation, the relevance and perhaps elements of materiality would be meaningful to the user on what would be appropriate for consideration.

I think as the board discussed and acknowledged here, there are a multitude of different interventions if

we stay on that. The ways that the government conducts interventions, the way the government holds control over quasi-government organizations, financially independent organizations.

This list is reflective of what may be appropriate in different circumstances and wouldn't be appropriate in all circumstances. Maybe even a statement such as that here in paragraph 73 may provide some more productive conversation between the preparer and auditor communities to recognize that this is not meant to be a checklist, but really is meant to be applied to facts and circumstances.

MR. STEINBERG: At one time, we were thinking of dividing the disclosure organizations into different types. Quasi financial, museums and those kind of organizations, would that help, do you think? In other words, if we had different kinds of disclosure organizations, the reason there are disclosure organizations is because some fall into one bucket, others fall into another bucket, others fall into another bucket. Then, we suggested the different kinds of disclosures that would be appropriate for each kind of bucket.

MR. LEWIS: Perhaps that maybe more meaningful. Again, that takes you into more precision than your standard setting. As it exists right now, it is a

principles-based standard. Perhaps then as OMB drafts the preparation guidance, they might then reflect on the different examples that may be appropriate as they craft them, what the footnote narrative may look like.

We saw that right now, the disclosure narrative is left pretty open-ended. It allows the preparers, whether it is at the component level or at the government-wide level, a certain amount of flexibility in the disclosure preparation.

OMB may be able to then provide that greater level of precision if the board chooses not to make that explicit statement that there has to be separate reporting in different footnotes, whether it be, as Tom had said, footnote five, footnote six, footnote seven or different types of disclosure entities.

MR. ALLEN: Thank you. We appreciate very much you being here. We would ask please be available if we do have further questions that we would like to ask you after the public hearing, that we could provide in writing to you. Thank you very much. Let's go ahead and take a break then. We are scheduled for a 15-minute break.

(Brief break)

MS. PAYNE: Welcome back, folks. I need to clarify a couple of things. Someone asked me on the break did I really mean the electronics have to be completely

turned off? What I really should have said was silence. You can have your Blackberry operating during the meeting, just quietly.

This next speaker is Joyce Dillard. Ms. Dillard is coming to us by phone from California. We have her patched in. Her voice will come out of the speakers in the ceiling. She will only hear folks who are speaking into the microphone.

With that, Ms. Dillard, we really appreciated getting your comment letter and your input. If you would like to make some opening remarks, please go ahead.

**Agenda Item: Joyce Dillard, Presenting as a Citizen**

**(This telephone quality was not sufficient for complete transcription. The (?) indicates inaudible words or phrases.**

MS. DILLARD: We are in the City of Los Angeles, specifically. We do not want to read the comments we sent but wish to relate how we are influenced by relationships of government entities in memorandums of understanding, public-private partnerships, joint powers agreements and other relationships created that are not disclosed on financial reports. CDFI Funds are an influence with the New Markets Tax Credit and the Community Development Entities allowed.

Influence from the President's Office is evident out here through Executive Orders and Councils. We have the Urban Waters Partnership and the LA River Pilot Programs. HUD hired consultants from Enterprise Community Partners, the non-profit end of the developers, to design the Consolidated Plan around MAP-21 funding combining housing and transportation as a sample for the rest of the country to use.

We find ourselves to be an experimental city for the country. The western part of the country hasn't really seen federal influence, except for aerospace industries and different things like that. Now, what we are seeing is influence of government relationships for our daily lives. We are kind of beginning to turn our attention there.

Most of us that are in this do it voluntarily. We are involved in writing comment letters in overseeing memorandums of understanding and influence in the environmental issues, the water issues, watershed especially out here at the L.A. River, that are coming from the EPA and the presidential office. What I heard so far in the testimony is people very steeped in the law. We are not steeped in the law. I am not steeped in the law and the others I work with are not steeped in the law like you are. I may not have the expertise that I have been

hearing.

What we are seeing is this influence is going into California State. I did some comments on public health and safety code out here because our state laws are really influenced. It has protected those appointees of the president and the congress people. Why it was done, we don't know. We found out about it when we went to research someone running for office and we couldn't get their address.

It ties into conflict of interest issues and all kinds of things. The banks important. Considerably the Fannie/Freddie Macs have been important for those disclosures and they have not been forthcoming yet. We felt it out here in the real estate bubble. In researching Fannie/Freddie Mac documents for the 1990s period, research after the fact you see it was happening.

In Los Angeles, we have a demographic issue. We are majority Latinos born here-and, in LA, we call them Chicanos. A lot of them are not immigrants and they are well-established now. They are our middle class. We need to bring disclosure more open enough to see that government works for them. Right now, they are not participatory. We have elected officials that get elected off very little votes and have influence, not only locally, but statewide. Generally, our congressmen have a lot of influence, but

really do not work with the people they represent.

As much disclosure and reviewing that we can do, the better. We run into problems like the National Estuary Program where the government actually is in business with a private non-profit, whether they know it or not. I think they may know it now. These just are problems for us.

I come from that end of it, not the functioning day-to-day of it, but it is really addressing issues and problems. Thank you.

MR. ALLEN: We are trying to adjust our sound system here to get it a little bit louder. We could hear if we listened carefully. We will probably be a little bit loud as we respond to you, in case you are having the same issue. When you respond, can you also move it up an octave or so, if that is okay.

We have a nine-member Board. I am going to turn the time over to Sam McCall. He is one of our newest board members to ask you the first question. Then, we will just have other board members as they have questions. You can ask us questions through this process, as well.

MR. MC CALL: Good morning, Joyce. Thank you for your comments you provided. Just to give you a little background, I have worked in state and local government for a little over 40 years. What we try to do at local government and state government is to connect with the

citizens and let them know what is going on, and hopefully engage them in the process.

Looking at your comments, the question I wanted to ask you was which federal finance reports have you reviewed and for what purpose? Do you have any suggestions on how to improve public awareness? What I am talking about here is how can a citizen look at the financial report of the federal government and then understand that? What are your thoughts on that? Also, if you are not aware, I hope you are aware, the federal government, or at least the Treasury, produces a citizen guide to the 2012 financial report. Are you aware of that? Do you think that is a good document to share with citizens?

MS. DILLARD: I looked at it. Most citizens don't understand the financial part, unfortunately. I have some background in it, so I can read it. No, I don't spend as much time on federal issues as I should. It is true it is beginning to turn that way, so it is going to be different responses in the future.

It is narratives that are important. What I find is that people understand the narrative graphs and charts. That kind of interpretation is minimal to what I have seen. You can put a chart in front of someone and they will get it very fast. I think in the future, some of these statements, they are more industry or people who can

understand them, need to be brought down more simply for the regular citizen to understand.

MR. ALLEN: Thank you. Are there other board members that have questions?

MR. SHOWALTER: I had a related question. When you do look at the reports, what particularly are you looking for? You mentioned you are looking for narratives and graphs and charts, but what topic? What type of information do you think is important?

MS. DILLARD: What we try to do is trace the revenues. We are on emergency out here. In fact it is what emergency do I have to do today? I do a lot of comment letters. I look at regulations now on federal and state level. City is done through their own ordinances. We are different out here. We are not really county-oriented; we are city oriented. We are a Spanish system, a ciudad, that moved on. We are a different breed of how we operate.

There are quite a few of us in Los Angeles in dealing with the problems. We are looking at tracing things now. We don't have luxury time to really look and analyze it. I spend a lot of time on the City of L.A. CAFRs and things like that, to trace revenue.

The revenue issue is big right now. We are not kind of looking at the balancing part of this. Everything

always balances. We are looking at how to trace sources. Like I said, we are not really steeped in the federal government like you. That is your business back there in Washington DC. But it is touching us in some ways because we don't see it directly. We see it operating through other entities, operating through memorandums of understanding, so the government is a place in the forefront.

It makes it harder because that memorandum of understanding is an entity to itself. I am not at a point where I can answer like some of the other speakers I have heard. They are well seasoned to it; we are not out here.

MR. REGER: Joyce, my name is Mark Reger. I am a board member, but a federal employee and work for the Treasury Department, so I am one of the three federal board members on the FASAB. The Treasury Department is the publisher of the federal government's annual financial statement and that citizens' guide that Mr. Mc Call was referring to a couple of minutes ago. We are constantly looking for ways to get financial information; I will say digestible financial information, into the hands of citizens and the hands of small business owners, that might help them.

A couple of big efforts underway related to the financial report and financial information. If I could

just for a second sort of bounce those off of you, and see if that is helpful or if there is any value. The federal government, for instance, does contract with people all over the country for various things.

There are big pushes to get that kind of detailed information on the web, so that somebody like yourself might be able to go out and look through where we are spending money or where we are contracting for work, or where we are interested in activities in Los Angeles and in your community. Do you think people would have an interest in those kind of anticipated contracts and/or who was getting money for doing things for the federal government?

MS. DILLARD: Definitely. The small business world is really being neglected out here. Yes, they are critical. In California, the state government makes it money on capital gains. The small business is the driver. No, they don't have the access. Like I said, we really don't have any representatives out here. They have their town halls sometimes the phone, you really don't have interaction with representatives. They may know your name if you are active, but most of them don't know your name. Anything that makes it easier to access information down the line.

I think the contracts are critical because out here in Los Angeles, they are pretty much hidden. That's

why my next projects are to work on conflict of interest and contracts accountability. That to me is critical to the growth of the country and the financial stability. The more that people can learn that, yes. I did look at your citizens' guide, but I don't think it is quite user friendly enough for the small business end. When I talk small, I don't mean 100 employees; I mean small. These are family-oriented businesses that we have.

Yes, I do think it would be very important. We are a driver for a lot of things. We are experimental for HUD, and how they are going to look at housing and transportation for the Consolidated Plan. We are in an experiment all the time. People are basically sitting on the outside of the experiment. Unfortunately, we have so many billionaires. They have a lot of influence, and that is what really drives a lot of the general issues and policies that happen here.

MR. ALLEN: Mr. Dong, can I have you also introduce yourself as Mr. Reger did? I think that is helpful.

MR. DONG: Joyce, it is Norman Dong. I am the interim controller at OMB. I am also one of the three federal board members. I just wanted to follow up on Mr. Reger's initial question regarding spending information.

We are working with Treasury on federal spending

transparency. Several years ago, we launched a website called USASpending.gov that provides all information on contracts, grants, financial assistance above \$25,000. As we think about how we improve federal spending transparency, I think it is important to have this type of dialogue with citizens and other potential users of this information, just to get a sense of how well we are doing in terms of putting this information out there, and whether it is helpful or what type of improvements we need to make.

I think part of the fundamental question for us is how much demand is there among citizens for this information? How well do citizens even know that it exists? As we talk about USASpending.gov, is that something that you and your colleagues currently utilize as you look to get information on federal spending? How well known is it out there in terms of the availability of this information?

MS. DILLARD: It is not. We look at grant support. Most of the people that are doing this work really are not earning a living right now, whether they are retired or have chosen just to deal with the problems out here. It is intense right now in Los Angeles. They don't know it exists.

I know that one of my associates had the SBA out here to do a seminar in Spanish. A lot of things have to

be a couple of languages or through groups that are affected. The non-profits out here really are a threat and really don't reach the people. We are looking at businesses wanting to leave Los Angeles because the government issues here and the taxation and other things that are coming down. They are about ready to accelerate the level.

I think that businesses may have used, at the federal level, contracting sites, at least left the area, maybe stayed in California in another area, but not here. It has really shrunk. That understanding of what federal contracts are, I think, has been seen in recent days not on the small business level.

MR. DONG: That is helpful for us as we think through how we enhance and improve this information. You are saying that there is a basic issue in terms of whether or not people know that this exists in the first place. We probably need to be doing more to not just put the information out there, but to market that information, and make the public know that it is available.

MS. DILLARD: Yes. We are seeing that federal programs creating density are at levels that are extreme. Through the HUD housing and transportation, things like that, you are going to drive more people out. We are seeing foreign investment buying homes here instead of

local investment. Middle class is whittling down. You are going to see it gone pretty soon the way that the design is now.

MR. ALLEN: Thank you. Mr. Smith, would you introduce yourself also?

MR. SMITH: This is Gray Smith, a board member, and I also practice public accounting. You had mentioned tracing the revenue and looking at the statements. In addition to the federal tax dollars that are being spent, when you look at a report related to financial statements for the federal government, what other type of entities or relationships do you believe are important to have in that report, so that you can understand those items, considering the complexity and how large the federal government is? What are some of the other type of entities that you would expect to see in that report?

MS. DILLARD: You need to address public-private partnerships, which I know you are doing. I was at a conference a few years ago on this issue with different ones across the country and one from Canada at USC. I have been at a couple of other events of a private group who won't let me attend anymore because it is a private group, where they are basically using our assets for their gain.

Those relationships are not easy to see and are never disclosed in anything I see. I don't see the

disclosure of the relationships out there. I know out here, we have tried to fight them off, but I believe BLM may have some policy on it. At a federal level, we haven't seen too much policy on the P3s. They are being pushed.

I just heard that the EPA program manager for the Clean Water Act push it last week. It is being pushed, but it is not being disclosed. Those are going to have to be addressed the liability of the government, the assets. Like I said, we have a lot of conflict of interest issues to address out here because it is just hidden from all. As you address the public-private partnership facet, we need larger discussions and probably more fact-finding.

MR. REGER: I have worked in local school systems, and state and local governments, and then on the federal side, too. Two things strike me when I am listening to you. One is all politics is local, so that the touch and feel, and the things that you see day-to-day are almost always delivered by your local government. I am assuming that is true in the city of Los Angeles, too.

The state government is sort of a level while providing some overarching umbrella over the state information. Fundamentally, what I am struggling with is what kinds of types of information can we, the federal government, provide to you, the citizens in California, that would be of value to you. I am going to offer you a

couple of suggestions and just kind of ask you to react to them.

One of the things might be, as we said a little while ago, who gets grant money, who is part that process, who is getting contracts. I think Mr. Dong talked about that. The next one would be, would it be of interest to you what state and local organizations are getting money? For instance, what grants for what purposes are going to the state? What portion of the federal expenditures are actually expended for things with local governments in California?

MS. DILLARD: I will answer that several ways. I am glad to see you have been in local government. LAUSD our school district here is a lost cause unfortunately. I have even walked away from it. It is such a hidden system; that is all identifiable.

Yes, we do need to know who gets grants and contracts. Things are local, but in California, the influence of the state government is from Los Angeles. Those who run the legislature up there are voted on down here. Like I said, very few people vote them in because of low turnout. They are usually from my area. I am right around downtown L.A. in those tracts that are poverty.

We don't see that state influence. In public safety and maybe in health issues, those grants comes down.

A lot of what happens here is the direct federal-local relationship. There have been relationships formed that aren't even non-profit. They are just loose relationships. Say the mayor, say the council president, and a non-profit form and they applied for a grant. They are not even a legal entity and they use the city seal. I don't even think it is legal, but the city clerk would never answer my question. It makes it look like a legal entity, but it is not. That is what we are seeing out here. How do you describe that entity? It is not formed as corporation. It is just formed by an agreement. It wasn't voted on by the council, which is our legislative entity locally. The mayor did it on his own. It is not this new mayor; it is the former mayor.

How do we account for that? Who knows, unless you search around the web and see it? Who knows there was even a grant applied, unless you found it on the grant website? It is difficult out there.

MR. ALLEN: Let me ask a question. I know several board members had questions about your comment about the Federal Reserve. You had indicated that it was too critical not to consolidate. I think they are one of the big entities, although we don't specifically name entities in this project. I think most board members would agree that we need very clear information about the Federal

Reserve, whether or not it is consolidated or whether it is extensive disclosures.

You had indicated a preference for consolidation. Do you want to provide some additional feedback on that? Do you feel like it is a need for information, or is it a specific need for consolidated information?

MS. DILLARD: It is a need for information. I think the input need is stronger than anyone knows. We have had several things that have happened out here. We had a riot that produced influence on the Community Reinvestment Act, which is the banking influence in my area before they can loan others. It gives control to non-profits and other groups. Now, with some of the banks going under, we have ownership coming in that is different than even I don't know. We had a speaker out here who did not even know there was a private owner of a bank that he had written about, but I had followed it on something I was watching.

I think that influence of banking from our area specifically here affects the rest of the country. That is what I see. Again, I don't know the rest of the country. I don't know about the markets in the other parts of the country or the Federal Reserve systems of different regions. I know it is a very regional system.

I think that banking influence is much stronger

here because of the Spanish land grant system where the federal government lacks jurisdiction over the land and we don't have the Indian federal land out here, at least as they are influenced in other areas. We have those that want to become federal. The western part is different in how they handle their water systems, how they handle their land systems. It is a little different out here. I think it has great influence, over the banking system, from what I have seen. And, there was someone that actually got convicted over some land issues out here. Like I said, I have seen influence from the '90s when I was doing the research. They used all the systems possible, tried everything possible to steal land from people, but they did get convicted. It took a lot of work and it took finding 200 properties, and then the state took over with a taskforce to convict. It took work personally to get it to that point. I don't think you are going to have that with everyone. That is why I think disclosure is so important. The easier to find or trace something, the better. Otherwise, you are taking someone's time and energy to do something that isn't always easy to execute.

I also want to bring up judges and the judicial system. Out here, the influence is huge. It is huge in the conflict of interest codes. They think about what the judges want. Yet, there is very little disclosure on the

judges. Even the salaries of our councilmen are based on the judges.

That seems to be an area that unless you are wealthy enough to get in the system and go to court, but it is an influential area. I hope you can address that, also.

MR. ALLEN: One more question from Mr. McCall, who started this discussion.

MR. MC CALL: I most recently worked in the city of Tallahassee for 13 years. We tried to reach out to citizens there through our financial statements, which were about 200 pages long, and our budgets, which were about 500 pages long. I think you can appreciate that citizens don't understand and don't have the time to look at them.

If we were to get citizens so they could understand what has been spent, what has been received, another question that we often don't see answered is what has been accomplished with the monies that have been provided? My question for you is, you talked about graphs and you talked about charts. Possibly if the federal government with its major federal agencies were to say these are the three things that we think are important decisions about this program and could provide not only financial information, but also information about what the program has provided and accomplished; do you think that would be helpful?

MS. DILLARD: Definitely. We have a void out here. Like I said, I was involved on a storm water permit that we have here. The local regional water board had jurisdiction. The EPA doesn't issue it; our local regional water board issues it. That is different than maybe some other states. There is an agreement with California and EPA.

The EPA was tossing out asset plan management. Well, asset plan management or infrastructure management, which we desperately need out here because everything is falling apart -- the roads, the sidewalks, you name it, it is. Billions and billions of dollars are expected from us, as taxpayers, when there is a parcel tax or whatever they are trying to do.

It was lost in local court. We had someone suing that already had lost; he didn't know that it is not a jurisdiction of the federal. The contracts are huge because there is money being given for things. We just can't see it, and we can't get our local government to account for it.

The financial statements are harder for people to address. I may be one of the few that actually gets them. We do have people very involved with the budget. We had something out here that was put in, when we had charter reform put in 2000 of neighborhood councils. We have a lot

of volunteer members that get elected onto their local neighborhood councils. It is just advisory; it doesn't throw the weight of a city council. They really look at the budget. They have budget advocates and they do a lot.

That is where we see local expertise coming out. It is not followed through at the operational end, and I think that is a definite missing aspect that adds to the accomplishment that operation is important as to how things function.

MR. ALLEN: Thank you very much. It is always valuable to hear from citizens, so we appreciate you participating with us. The next speaker, we just received notification that he wanted to participate by telephone. You have a copy of his written comments, Ed Mazur, representing the AGA. I am going to talk to him a little bit about how long we want to have him continue with his written comments that he provided.

MS. LOUGHAN: I think his remarks also includes responses to the questions we provided.

MR. ALLEN: Ed, this is Tom Allen. I am disappointed that you are not here.

**Agenda Item: Ed Mazur - AGA FMSB**

MR. MAZUR: I really appreciate your tolerance that I am not there. It saves me about 400 miles of slogging up 95. I appreciate it very much and hope that

you all forgive me and the courtesy in that regard.

MS. PAYNE: Mr. Mazur, this is Wendy. I apologize. I need to have you hold for just a moment while I try to reconnect our observer phone line. If we get disconnected, I will call you back.

(Phone call interruption)

MR. ALLEN: Mr. Mazur, what I was starting to say was that we did receive a copy of your testimony. We haven't had time to read it. I would like for you to make your opening comments, but maybe not go into the detailed responses to the staff questions. The staff wrote those questions, and the board, as you know, writes their own questions, as well. I think it is good to have your written response to those questions. Some of them may be reasked and we can have some discussion about it. I would like you to go through your opening comments. Then, we will just open it for up for the board members to ask whatever questions they want.

MR. MAZUR: That actually was my intention. In fact, I will be skipping a couple of the paragraphs in the beginning part of that. Then, I was just going to open it up for questions. I thought it might be helpful to at least be on record what the answers were to those inquiries. Is anyone missing today on the boards?

MR. ALLEN: No. We have all the board members

here.

MR. MAZUR: Including Mr. Dong? I have enjoyed getting to know him quite a bit the last couple of conferences I have attended, and basically everybody on the board is a familiar face. Some of you I have worked with, like Mr. Steinberg, for what seems like decades. Tell me when you want me to start.

MR. ALLEN: Go ahead and start.

MR. MAZUR: I will be formal here and read from some of my comments here. Chairman Allen and members of the board, my name is Edward J. Mazur. I am a member of the Financial Management Standards Board of the Association of Government Accountants. It is comprised of 25 members with accounting and auditing backgrounds in federal, state and local government, as well as academia and public accounting. By the way, they are just a great group to work with. It is my pleasure today to represent the board. Its chairman, Eric Berman, who is doing an outstanding job, I believe, in conveying portions of our comments regarding the reporting of the exposure draft in our letter of July 8<sup>th</sup>.

I won't be hitting all of the points in there. Those that I don't cover are still, we believe, important. I will just skip down to say that we like the principles-based approach. The federal government is probably the

largest, most complex, most diverse in terms of the activities involvement of any organization on the face of the earth. We believe that this approach of principle-based guidance will be practical and effective.

In clarifying the accountability of federal departments and agencies in the government as a whole, although not quantified at this moment, it can be anticipated that a large variety of diverse entities will be addressed under the reporting entity. You certainly worked hard in your appendix C to work everyone to those kinds of arrangements. We think that taking an approach, other than the one you took, would have been very impractical.

We think, therefore, that this principles-based approach will stand up over time. There will be changes in the federal government from time to time, and new entities coming in or new responsibilities, but we think the approach you are taking will stand up.

We particularly were supportive of the way in which you outlined the principles for determining what comes into the general purpose federal financial report and where it would end up, either consolidated or disclosed, or a related party disclosure. Despite this general concurrence with the principles for inclusion and classification, we did have some suggested changes that we

think would improve the clarity and application of the ultimate standard. I will be drawing some of these orally from our July 8<sup>th</sup> letter.

On page two, if you are following along, of my submitted testimony for this morning, regarding paragraphs 27, 28 and 40, we believe that certain items regarding the federal entity determination should be covered by a limited amount of rules due to the complexity of applying the principles. For example, paragraph 27 and 28 discuss issues of control, and the control can be indicated by the federal government's authority to determine and influence the policies governing activities.

We are concerned that these paragraphs might be interpreted by someone to require that financial information from certain states and localities should be included in the general purpose federal financial report. We do not believe that that is your intention, and therefore, recommend that a specific statement be made to this effect.

In part, we have raised that because of studies, including some that I have been part of the authorizing of. The average reliance by the 50 states on federal revenues is that 39 percent of their revenues come from the federal government. There are five states where the federal flows directly into the state's coffers or into their component

units exceed the 50 percent of their revenues, and 20 states where it exceeds 40 percent. There is quite reliance there and quite an influence on state functions and activities.

We think that this has to be clarified. From my personal perspective, you might even want to put a statement in, to the effect that if an entity is reported within the comprehensive annual report of the state, that it not get included in the general purpose federal financial reporting under any of your principles. That is just a thought.

Paragraph 40, this paragraph discusses the government structure, and for consolidated entities, the chain of command leads directly to elected officials. This could lead to questions regarding if the judicial and legislative branches are included. Paragraph A13 in your basis indicates that they are to be included. We recommend that the inclusion of the general purpose federal financial reports of the judicial and legislative branches report in compliance of the hierarchy established for federal agencies be presented in consolidated form, at least within the consolidated financial report of the federal government, and that this be stated directly in paragraph 40.

Regarding paragraph 25, 38 and 41, we think that

there is some terminology that you might want to give additional consideration to. In paragraph 25, you talk about the potential to be obligated. That means you have got to define the term, potential. Perhaps you can go back and use terms such as more likely than not or probable, rather than potential. They are a little more common in their usage.

In paragraph 38 and 41, you have got the terms 'consolidation entities' and 'disclosure organizations' to differentiate how information should be reported. We are not sure that these are necessarily, the second one, the best of terms. We would like to suggest that the term entity be incorporated in both instances as it defines an organization that has clear, separate existence from other entities.

We also encourage FASAB use a term other than disclosure. Disclosure is typically used in relationship to the establishment in the note that relates to information that appears on the face of the financial statements, though not in every case. We think that perhaps rather than bring that term in, maybe you could just say 'non-consolidated entity' rather than 'disclosure organization.'

Going down to the bottom of page three, we have a discussion in our letter of comment about how the

disclosure organization information should be presented. What we envisioned from your approach is that would be just a series of notes, if you would, maybe separated from the notes that are otherwise recorded, related or included to what is on the face of the financial statements.

We think that although it is essential to have this information about the disclosure organization separate from what is in there about the consolidation entities, the financial significance of the disclosure organizations could be made more clear if the basic financial statement information from the disclosure organizations is summarized and presented in a separate column or columns. It could be grouped by mission or what have you.

Then, with that basic information there, there still would be notes that would include additional information about why these organizations should be reflected or are reflected and their importance vis-a-vis the mission and operations of the federal government. We are worried that if this information just resides in a note, that it is going to be hard for people to grasp it in a ready a fashion as we think you would like them to grasp it.

Regarding the basis paragraph 89 and 93, we agree with the alternative view. That said, we think that when you are through with a risk assumed project, we envision

that ultimately there will be information about these other types of relationships that end up being disclosed or reported in some appropriate fashion in at least the consolidated report of the federal government. Otherwise, we think that that recommendation is something the full board ought to consider.

Regarding paragraph 87, the FMSB believes that related party information should reflect the impact of interdependency from the third-party perspective. We support the process of including related party disclosures that do not meet the tests imposed by the proposed principles, but could be considered as misleading if they are not to be included. The FASAB would require information on the risk of loss from the federal entities perspective, but no information on the risk of loss to the related parties should the federal support be removed. We believe that this information should be included in any related party discussion. From a federal perspective, the risk may be small and relatively immaterial. However, from the related party perspective, a relationship would likely be material.

That concludes formal comments, but we would also like to offer a couple of suggestions. They are not included specifically in our letter, but we want to offer them today. That is that once you have gone through your

further refinements to the standard, but perhaps before you issue the final one, you might consider conducting a survey of the 24 CFO agencies and the 11 other significant agencies, just to seek their best estimate or projection of the changes in reporting anticipated from the adoption of the standard to include estimates as to which entities not now reported will be added, either as consolidated entities, disclosure organizations or related parties.

Further, you might also consider asking three or four federal departments and agencies with differing missions to pilot test the adoption of the new reporting standard, just so that you have that full awareness of how this will all play out. With that, I will be delighted to try anyway, on behalf of our folks on the FMSB, to answer any questions that you might have.

MR. ALLEN: I will ask the board to identify themselves as they are asking the question.

MR. SMITH: This is board member Gray Smith. When you referred to the disclosure organizations consolidating condensed information are you suggesting then that the disclosure for all disclosure organizations would be exactly the same? If we just had a condensed balance sheet and statement of activities, that is sufficient? Or what information are you saying would meet the disclosure requirements for those?

MR. MAZUR: Well, appropriate to what decision you make elsewhere in the ED, we are certainly not suggesting creating any harmonious adoption of GAAP. In other words, however they report is how information might be presented. It would be summary level, so you would get the general size from an asset liability, and a revenue and expenditure perspective of these organizations.

The notion is again somewhat paralleling at least conceptually what benefit you get when you look at statements. You look at the discrete component units. If you had a column or a series of columns that would combine over into a single column, you would at least have an understanding of the general magnitude of the financial strength and operations of these entities that, under your principles, you feel are pretty important, and that the readers and the users of the statements need to know about.

Then, the other information that you are citing be included now under the disclosure concept you would still put into some form of further explanation in a note to this column or columns, if you will.

MR. SHOWALTER: Just reading all the other responses, GASB 34 came to mind when you were first reading this and I was reading it. A lot of people have actually commented on disclosures and they are concerned about bringing these amounts and even in the footnotes may give

the impression that the federal government has claim to these assets.

You would even exasperate that problem by combining it and putting it together. It will appear like a set of financial statements. With your federal background, I would be interested in your reaction to that. There was clearly a tone to a lot of the letters I read of people being concerned about the footnote disclosures. It seems like your recommendation would make that worse.

MR. MAZUR: Well, we hope not. That is certainly not our intention. The issue is you go through a series of steps and you have got some pretty fine examples of them in appendix C. When you decide to treat them as a disclosure organization, you have reached the conclusion, you being the preparer and their auditors, that there is a very important and significant relationship between the federal reporting entity and these disclosure organizations.

In your appendix C, you offer a series of different examples. Some of them relating to access to assets or the risk involved, and it is going to take a lot of energy on parts of people to sort of figure that out. In the end, to me the bottom line conclusion is that if it shows up as a disclosure organization, regardless of whether it is in the columns like we are talking about or just shoved into the notes, the preparer has got to be

reaching the conclusion that this is a significant relationship. It is a relationship that bears on the exercise of responsibility by the Congress and the administration for however this relationship was created in the many ways in which these relationships are created.

I think to know and have clear access to the overall financial size and power, if you will, of these organizations, to be able to see that readily and read further information about the nature of the relationship is consistent with reaching that decision, that it is a disclosure organization.

MR. SHOWALTER: Do you view this as similar to state and local government presentation where the disclosure organizations would be presented together in one column? Do you view this as a multi-column presentation when you talk about it? I think that may relate to what you are talking about.

MR. MAZUR: Well, I suspect that this one column could end up being a multi-column arrangement. It is difficult to say at this point. I mean, one of the reasons in my closing recommendation, I recommended maybe doing the survey. It is quite frankly hard to imagine agency by agency, exactly how the application of the standard will fight out. In some cases, you may only have one or two of these disclosure organizations. In other cases, you might

conceivably have more.

To have a layout summary financial statement information for each one of those, it is probably going to be clearer than if you tried to merge them into one column. If you look at the financial statements of state governments, you often see information set in after the basic statements that will have combining statements of non-major discrete component units for example. That is, I think, done in a lot of cases. That is sort of the image that I think we had in mind.

MR. ALLEN: Norm and then Michael, Sam and Bob.

MR. DONG: This is Norman Dong. I wanted to ask you to talk a little bit more about the issue of control that you identify on page two of your written testimony. You cite a potential concern that the standard as currently drafted could be interpreted to include states and localities in the GPFRR.

I wanted to focus on paragraph 27, but more specifically 28. As I look at paragraph 28 that examines the spectrum of control and provides an example of where there clearly is control, and then another example of the other end of the spectrum where there is not. I just wanted to get your thoughts in terms of the limitations of that discussion, and see how, even as you read that paragraph, you still have this concern about the potential

fear that state and localities could be captured in the GPFFR. It is acknowledging influence and it is saying influence doesn't necessary equate to control.

MR. MAZUR: I think what was in our mind was that the intergovernmental financial dependency between states and the federal government, particularly in certain program areas, transportation might be a good one, but certainly the whole Medicaid thing. These states and our organizational elements within these states are really bonded very close to one or more of the federal reporting entities. Such that I would state that it is impossible for the federal government to achieve its policies and operational objectives if it wasn't for the full participation and involvement on the part of the states.

The states receive funds with which to do this work. They receive guidance. I know your qualifying statements regarding the fact that regulations per se don't mean control and all of that. The partnership, if you will, the operational partnership is so full that we thought that some folks could construe, at least elements of the state could be picked off and included somehow in this concept. We think that if that happens or even threatens to happen, the states will go get excited about that. Maybe that really needs to be taken off the map. I don't think I am answering your questions per se, but what

we are trying to relate to here is that federal government and the states are really in close partnership.

MR. REGER: Ed, are you suggesting that maybe we ought to have something that specifically excludes the states? I think one of the other people has recommended something that specifically excludes organizations covered in state and local financials?

MR. MAZUR: Well, I think that is a safe road to take. If you make the statement that clear, then you won't have preparers and their auditors going through deliberations and angst, if you will. Where otherwise, following the principles you have laid out in some of the examples, they might say, well, you know, maybe the Department of Transportation in Wyoming --it is really is part of the federal operation here.

If you will just take it off, it will clarify it. It will take it off the table. Conversely, though, I will say that some of you feel, well, maybe there are some instances where that ought to be the case. Then you will have to take a different approach. I just think we thought that that shouldn't be left hanging out there and present itself as a question after the standard was issued. It is probably better to deal with it now.

MR. GRANOF: You suggest that in using the phrase in paragraph 25, potential to be obligated, that would

leave that to judgment. For sure, nobody knows what the word potential means. On the other hand, if we use more probable, if we use more likely than not, that is widely accepted as least 50 percent. Probable is often considered a much more rigorous test, as much as 80 percent.

If we went to 50 percent, more likely than not, isn't that sort of defeating the purpose of what we are after because that is a very rigorous test. Under that test, I doubt, for example, whether we look back five years ago, organizations or the potential obligation of organizations like Fannie Mae or Freddie Mac would have been disclosed.

MR. MAZUR: I guess the fair response is that we would like you to consider whether the word potential to be obligated is as clear as you want. Maybe to toss it back, will that then be left in the mind of the beholder? If it isn't using more likely than that or probable, are there other terms established in the literature and used with some regularity that might help determine that?

If you don't tighten it down a little bit, will you invite a possible inconsistency between and among the various federal reporting entities where one sort of sees potential. There is one way or the other. Or if you leave the word potential in there, to say more about it. If it is a low bar, try to describe why it is a low bar.

MR. GRANOF: In the GASB, and I am sure this was the case when you were there, as well, that we debate what percentage do we want. I think the last thing we want to get into is debating whether it should be 10 percent or 20 percent of whatever.

MR. ALLEN: We have got two people, Sam and Bob, who want to ask questions.

MR. MC CALL: In reading the response letter from the Financial Management Standards Board, there is one comment that just kind of stuck out to me. The comment was that the Financial Management Standards Board of AGA was puzzled, and I put quotes around that word, as to why the FASAB did not determine whether the Federal Reserve System was included. If so, should it be consolidated or disclosed.

MR. MAZUR: Sam, do you have that in front of you? What page were you on? Which one?

MR. MC CALL: It was a comment from the Financial Management Standards Board. It said that they were puzzled as to why FASAB didn't determine whether the Federal Reserve System was included. If so, should it be consolidated or disclosed. My question is, does the board have an opinion they could share with us, either pro or con, or an element to think of? Or do you think that our criteria for disclosure or consolidation are clear enough

that that decision can be made? I think our criteria are good for most entities, but this particular one is puzzling for us.

MR. MAZUR: I recall now what you are talking about. You do have specifically, and I can't quote the paragraph, proposed treatment for the central bank. It is that treatment, the minimum disclosures for the central banking system as much as would come into play if you otherwise applied the principles regarding consolidating entries.

That perhaps is what I recall maybe wasn't clear to us. It was, I think, pretty strong that there needs to be an incorporation of critical information about the central bank federal reserve, specifically in the consolidated report of the federal government. Well, that is probably the best I can do right now, Sam.

MR. ALLEN: I think there are several other people who have indicated, and I have got a couple of other questions. Maybe what we will do is just provide those in writing and ask you to respond to those after this hearing, if that is all right.

MR. MAZUR: We would be delighted to do that.

MR. ALLEN: Thank you very much and I hope the fishing is good.

MR. MAZUR: Thank you again for allowing us to

participate both by receiving and looking at our letters, and giving us the opportunity today. We appreciate your work, respect it greatly and wish you the best as you go forward on this and other projects.

MR. ALLEN: Please thank your committee. At an earlier testifier, we indicated we can always count on them and we can sure always count on you.

MR. MAZUR: I will pass that on, absolutely.

MR. ALLEN: Christina?

**Agenda Item: Christina Ho - Treasury BFS**

MS. HO: Thank you the opportunity to provide comments.

MR. ALLEN: We send a thank you when people join the AAPC committee. There is such an incredible amount of work that we don't get to interface with you. We do appreciate it. We read your documents and discuss them, but we don't get to thank you. I know that is not why you are here to testify today, but we want to thank you for your participation in that.

MS. HO: I am not sure since I just got here; I don't know the best way to approach this. I obviously have prepared remarks, and I know that I have a few more significant comments that I assume that the board would like to ask more questions. I just want to be brief about it.

MR. ALLEN: We have asked people to spend no more than 10 minutes with your opening comments, to provide the majority of the time for questions.

MS. HO: I would just focus on comments on questions that we have a little bit more concerns with and that we have raised. The first one is in regards to question number two. This is the one that we are commenting on concerns about consolidating entities and disclosure organizations.

With regard to the relevant factors for disclosure organizations, the criteria in paragraph 69C, whether the disclosure organization views itself as an extension of the federal government operationally independent of the congress and/or the president may influence the type and extent of information that is disclosed. This is the one where we struggle to understand how the disclosure organization's perception of its relationship is relevant here. This one, I would like to just highlight.

The next one is in regard to question five. This I would consider to be our most significant comment, assessing the consolidation entity reporting using FASAB and component entity reporting using FASB. I have concerns with the impact to the consolidation entities trial balance and financial statements, given the specific responsibility

I have in preparing the financial statements and collecting information from the agencies on a monthly basis.

We believe that the current exposure draft- that if they are FASB, they do not need to convert to FASAB--we have concern that this could create confusion and also differences within our systems. Component entities on FASB do not need to report things like SBR obligated balances, which are things that we currently require the federal entities to do. We would like to get a little bit more guidance on if the standard does not require the component entity that is on FASB to convert to FASAB, how we would address that.

The last area I want to highlight is question 12. We disagree with the alternate view that the proposed standard should not equate receivership, conservatorship and interventions with other disclosure organizations to avoid an inference that they are part of the federal government. One purpose of financial statement disclosure is to provide relevant information to assist reader in interpreting unique relationships between federal entities and non-federal entities, and how those relationships were formed and the extent to which they exist.

We also disagree with the alternate view that the guidance for all interventions, regardless of type, should be presented in a single statement of federal financial

accounting standard. I believe one standard, focusing on the reporting entity, is capable of addressing both the consolidating entities and the disclosure organization.

These are the three comments that I would like to highlight. I will, at this point, just let you ask me questions.

MR. STEINBERG: Several of the people did comment on the point about we should not require consolidation of FASAB entities into the consolidated statement. I was kind of surprised at that because we already seem to do it. Correct me if I am wrong. I guess we do it. Ginnie Mae, aren't they on FASB, and they get consolidated, and the Bureau of Engraving and Printing are on FASB.

A couple of them did talk about that they do the consolidation based upon the tie point. I think we, as a board, need to have a little bit better understanding of how this works and how you are able to do a consolidation of the entities that are on FASB and don't prepare budgetary statements. Could you elaborate on that?

MS. HO: My understanding, currently we have federal entities that also follow FASB standard because of the commercial dealing that they have and these Federal entities are required to follow FASAB. That is why we are able to know the linkage for those types of entities, the linkages between their budgetary and proprietary accounts.

Those are currently built into our system.

Several years ago, we started the tie point project to provide linkages between a budgetary account and the proprietary accounts. At this point, we have built that into our system, that some of you are familiar with, our new trial balance system, GTAS. It is built into our system, so that when we collect data from the reporting entities, that we will recognize the linkages between the budgetary account and the propriety account.

The main issue with not requiring the consolidating entity who currently are not federal entities, that they are only on FASB only and do not have to follow FASAB. Because they don't have budgetary accounting requirement, that we will not be able to see those linkages. If they submit information to us for consolidation purpose within our system, we would have difficulty trying to identify.

If we do not require them to follow FASAB, then we won't be able to see these linkages. We will have to know how to treat them. There could be potential differences that we would identify that we have to resolve.

MR. STEINBERG: Maybe I misunderstood then--what I was trying to find out is how do you get the information saved from Ginnie Mae, or the Bureau of Engraving and Printing, assuming that they don't prepare a Statement of

Budgetary Resources or the reconciliation between budget and propriety? That was the question I was asking.

Are you saying that you do want the FASB entities to convert to FASAB?

MS. HO: Yes.

MR. STEINBERG: Okay. Our stand is saying no.

MR. REGER: Let me chime in a little bit just to clarify. There are seven entities that currently follow under other accounting roles, not including the Federal Reserve. They are FCSIC, FDIC, TVA, USPS, NCUA and PBGC. I think all of those are following FASB's rules at this point. They provide Ms. Ho detailed information in the closing package process.

It is a huge effort on the accounting staff's point of view to try to reconcile those off because they don't get the corresponding information in the automated way that they get everything else. They literally have to deal with those entities as separate organization structures and reconcile things off. I believe she voiced putting forward the opinion that the consolidation, which is a huge task involving over 150 entities at this point, they are moving towards an automated way to do that based on trial balance and building off trail balances. There will likely be a closing package, but this complicates that.

MR. STEINBERG: If they do that, that would continue the practices we propose in our standard; am I correct? We would not require conversion by those entities in those financial statements.

MR. REGER: That is correct. The current standard does not require those entities to express themselves under our standards. It provides for them to report under any approved standards that are methodical.

MS. HO: The seven entities that follow FASB, they are following FASAB currently because they are federal entities.

MR. SHOWALTER: What I am hearing Ms. Ho say, which is really challenging our three inclusion principles. What she said, what I interpreted was, as long as it has got a budget and it comes in, you are okay with it. Let's say we get something in the control or ownership that doesn't have a budget. That is what I am listening to and saying that is a problem because it doesn't have a budget.

MR. REGER: It is both a budgetary reconciliation and a reporting problem. Let's deal with them backwards. On the reporting problem, if they are reporting assets of inventory or something, and they are valuing that in a different methodology, all we are acknowledging is that there is a difference between the methodologies. They tell us that there is a difference in the methodologies, and we

report that in the footnote.

For budgetary purposes, these organizations are covered by budgetary rules. They are providing budgetary information to reconcile that off.

MR. SHOWALTER: My point is, under our criteria, it is capable to include entities that don't have a budget.

MR. REGER: It is possible we should pick up one of these that do not have any budget.

MR. SHOWALTER: What I am hearing is that is more of a major problem than even the other budget.

MR. REGER: It will mean we need a methodology to deal with that budgetary process, or eliminate that somehow in the consolidation.

MR. DACEY: Just a clarification point. What do we currently do with, like I said, the FDIC is a big consolidation in terms of budget information. Under GTAS, I guess they are supposed to have all the budgetary accounts. Do they keep budgetary accounts at FDIC? Or do they somehow kind of fit them into the budgetary account structure so you have budgetary information?

MS. HO: It sounds like I am misunderstanding. My understanding is that these federal entities that also do FASB currently are maintaining their trial balance in accordance with FASAB. That is how we can collect because we will be collecting information in GTAS from these

federal entities.

MR. DACEY: I think some of those federal entities are, in fact, not converting today when they are submitting the information. I am not sure how that is being accomplished. We can chat after this meeting, but I think that is just a question we need to look at.

MR. SHOWALTER: We will probably have the auditors up for some of those.

MR. GRANOF: Aside from the budgetary information, what are the major differences between FASB and FASB information? We are talking about lots, and it is a major issue.

MS. HO: I can't cite for you the specifics. I think the main thing is the budgetary. For example, the FASB required the budgetary, in terms of the SBR and things like that. That is not currently a requirement in the FASB. I think is the main one that we are concerned about.

MR. ALLEN: We had an earlier testifier talk about significant asset that was value different. A major asset, a billion and a half dollars it was valued, the FASB method of valuing versus what FASAB does. There can be differences.

MR. REGER: I think that one was a billion and a half. Again on the consolidated, the billion and a half is immaterial. It may be material to a reporting

organization.

MR. DACEY: There are some differences in accounting bases for, let's say, the federal debt helped buy some of these entities that they buy on the market, recorded fair value versus Treasury recording.

MR. REGER: What asset was that?

MR. DACEY: There are some accounting bases differences, which ought to be quantified as something that would take some extra effort to quantify.

MR. REGER: That and elimination. One of our big challenges is intra governmental eliminations. I think Ms. Ho actually mentions that in her testimony is allowing organizations who are combining into the consolidated world to report under any different basis causes interesting elimination problems in both directions. It is a problem we haven't solved now and we have, so we will have to continue to work on a solution regardless of what the standard says.

MR. ALLEN: Ms. Ho, that was my question that I had written to you as I recognize the problem. You have identified it in a technical way that I don't understand all of those. I was looking for a specific recommendation. In other words, as we write the standard, what would your specific recommendation be, knowing that the board has already consciously said that if you are following FASB

standards, you can continue to do that.

Now, we could revisit that decision. Is that your specific recommendation or do you have some specific recommendation that these organizations that meet this criteria, whether it is consolidation or disclosure, also report some other additional information that would help you in your process? I was just struggling for what your specific recommendation was.

MS. HO: I think we are definitely not recommending that you get all FASB or things like that. We would need additional information in order, as part of the reporting, for us to make sure that we know how to treat some of the differences.

MR. ALLEN: After this meeting, we can correspond with you to look for wording that you would propose or something like that.

MR. REGER: I am pretty sure that the last time she appeared before the board, in fact, her and Carole Banks, as I recall you guys were together, recommended that any closing package information would have to provide the different information from the organizations, so that they weren't stressed, or it is impossible to consolidate a loan. That they would have the data they needed to reconcile.

MS. HO: As we implement the GTAS in collecting

this information on a monthly basis, if we could have consolidated entities that are considered reporting entities, we would have to collect those type of information from these entities, as well. Just like all the other reporting entities currently. We would need additional information so we could address if there are submitting one account that is propriety and doesn't have a corresponding budgetary account, what do we do?

Mechanically, I think we need to know how to treat those.

MR. ALLEN: We need wording for you because we can't have wording like closing package or whatever in the standards.

MR. SMITH: Wouldn't we want to put that in the standards? That just becomes something that the preparer would need to figure out what they need to do to comply. We would just say that you can keep FASB standards. Then, the preparer can figure out what they need to do to get there.

MR. REGER: We would have to amend our TFM.

MS. HO: I think if you just say that you can keep staying with FASB standards without specifying any additional requirements, it could create problems for us to ask for that information in the future. If they said that they are following the FASB standard and they don't have anything else, I don't know what incentive they would have

to provide that additional information to us.

MR. ALLEN: That is what I was looking for was just some generic wording that, in addition, they may be required to provide other information to consolidate or something like that.

MR. REGER: I can't put my fingers on it, but I think that is in there that they have to provide whatever information Treasury needs for consolidation.

MS. PAYNE: There is a proposed disclosure requirement regarding consolidation, but it is that the standalone financial statements of a FASB preparer disclose the intragovernmental amounts under FASAB. The letters that we got in response from all of the FASB preparers was they did not want that disclosure in their financial report.

I am hearing that you would have to have more of that information in the disclosure to meet what Ms. Ho is saying she would need.

MS. HO: I think this problem is not going to be so much of a problem for the disclosure organization. It is mainly if it is a consolidation entity.

MR. ALLEN: Other questions that we may have?

MR. STEINBERG: You had said you didn't agree with the alternative views because you thought the financial statement should have disclosures for all the

risks and the liabilities. I believe that is what you said, which I agree with you even though I wrote the alternative view.

The question I would ask is, are you suggesting that the interventions and receiverships, and all these other temporary arrangements, are part of the entity regardless of whether they are temporary or not?

MS. HO: I think at least for disclosure, I mean, I was more familiar with FASB. I know that under the FASB requirement that if you think about the GSE when they have to consolidate all the loans that they guarantee on their book, I look at them kind of under a similar light. It is really to help the reader to identify all of the risks and all of the contingencies that the entity is subject to. That is kind of how I was thinking about it.

MR. ALLEN: Any other questions? If not, we want to thank you very much. We appreciate you being here. We are glad you made it. All right. Let's break for lunch, and we will see everyone at 1:00.

(Recess for lunch)

## A f t e r n o o n S e s s I o n

MR. ALLEN: Well, we're on Dan's time, so we better get going.

**Agenda Item: Dan Murrin - Ernst & Young**

MR. MURRIN: I appreciate the chance to be here. I had participated earlier in some of the drafting of the remarks that came from the Greater Washington Society of CPSSs. There is not a weighty tome coming from us on particular points within the standard itself. I understand there is going to be more of that sort of element of conversation later in the day. I did pass around a couple of remarks beforehand. I would handle them in any direction that you'd like or we can take them one at a time.

I think the one that probably has the most robust conversation around it really is the idea of using the fullness of time and the chance to recognize that there probably is a little bit of time here to apply the standard or the proposed standard, and try to develop in effect-- here's really how this would work, and understand how it would work before it actually goes effective. I am concerned that if there are 300 entities, there probably are a fair number of people like the SEC and like PCAOB and FASB that if they really focused on what the language is, they might have a desire to comment and might have a point of view on whether they should or should not be included.

Doing some sort of a dry run of this top-down directed, as opposed to bottom-up, would be a good way of figuring out what the real practical implications are of what you're proposing. I would pause there because I think that's probably the largest comment that I would have.

MR. ALLEN: Do you have from your experience with agencies and other organizations-- I know we've struggled with that concept and the magnitude. We talked earlier about how long it should be. Obviously, there's a leadership role the sponsors are going to need to play in that, but do you have concerns there may be 300 organizations out there? I think some of us, and many don't have as much experience as you do, in the federal environment don't envision that kind of magnitude of organizations.

MR. MURRIN: An example would be the FFRDCs. We don't have 40 FFRDCs weighing in on this topic. There may not even be awareness of many of those entities of the potential for this to have ramifications for them. To the extent that they haven't already, been included in the entity and haven't been subjected to FASAB standards. The standard setting process probably has not policed them up the way we might otherwise be policing up, entities that are already in the entity. That would just be one example of a concern. PCAOB and FASB had not occurred to me, but

then obviously they pop up. There are a lot of other entities that are in the budget.

MR. REGER: So Mr. Murrin, are there things that you could suggest that we do to socialize this further to make sure that we've raised the attention of anybody who might be subject to it?

MR. MURRIN: I am more inclined after the six years or so to just prepare the Excel spreadsheet and identify all the entities that you think bottom-up, top-down have anything in this, whether they go in a consolidation line, whether they go in a disclosure line, whether they go in a related party line, and just have the central support agencies effectively say here's what we think is the right answer and here's what is going to change, and then figure out whether the standard creates an anomalous result that you would not want, or it costs money because it's not clear why it makes sense to do a lot of things that cost a lot of money, because I haven't heard a really compelling argument for any substantive change in the reporting entity.

MR. REGER: Mr. Murrin, just because I'll beat this one to death because I'm the one that's got to do it, we have expressed some concern about short of getting the auditors concerned about this enough to have the conversation with the customers, the clients, and short of-

- the SEC was very proactive in looking at their situations to determine who might at least be subject to it that if somebody's not there right now, no one's going to self-identify.

MR. MURRIN: That is really why I think it's up to the Central Support Agency unfortunately, to say, OMB, Treasury, what do you want them to be? To the extent that you're actually also controlling what's in the budget, there's a charming circularity about having one of the criteria be something that is within the control of at least one of the entities that decides what's in there or not. We can sort of run away from that, or we can just run toward it and figure out, well, this is your entity. Figure out where you want it to go.

If you have an answer that is repugnant to the audience, then we should bring it back up again and give everybody a chance under the standard setting process to say, no, that entity really belongs in, and it's really material, but otherwise this is kind of an inside pool-- this is a lot of instruction manual for something that maybe you could just come up with the answer for.

MR. ALLEN: You used the word "material", and also you mentioned related parties. Does it bother you in this standard if we take a different direction in defining related parties and other standard setting organizations?

In other words, it's about control as opposed to arm's length transactions a little bit more. One of the written comments was that we come up with a different name for-- maybe they're still testifying, and I don't mean to get into that, but that's a term of use that's already out there and already established. If we have it mean something a little bit different in the federal environment, that would cause a concern.

Then I guess the primary question I had is you, working with the preparer, determines materiality. On one hand, I'm afraid there could be many related party transactions. On the other hand, the magnitude and size of the federal government as well as the individual departments, it seems would make almost all of those not material. How would you deal with materiality as it comes to some of these issues of the organizations, whether they be related parties, whether they be disclosure organizations? Is there any thought you've given to that? I know the forms apply internally, and it's quantitative and qualitative, but you still apply some-- at least you used to, I haven't followed it recently-- some percentage or some dollar amount or something like that, that I think would screen out many of these relationships.

MR. MURRIN: We've all sort of over the 20 years mutually invested in putting the oranges in the crate the

way the oranges are in the crate now. To the extent that we want to pick up one of those individual oranges, there almost needs to be, to my mind, a compelling reason to even bother to do that. If we are going to pick up one of those individual oranges and say there might be other things that should be in there, we're going to have to do that on not just the first tier entity, the US government. We're going to have to do it on the second tier entity, the departments. We're going to have to do it on any of the subsidiary OpDivs that get separate financial statements. You're down to at least three tiers.

Eventually your materiality is going to be driven by what that little orange looks like. Is it an orange that when you open it up like a Russian doll, it's got smaller and smaller things in it, and to what end? It's difficult to see to what end as we get into these smaller and smaller entities. We are really improving the utility of financial information for anybody, whether it's that fourth tier entity, the third, second-- clearly not for the first tier entity, because it's probably only one or two of these decisions that are not subject to any of this conversation that have already been made, to not consolidate some of those entities.

MR. SHOWALTER: My question is related to the materiality question. When you talk about materiality, you

have to know how big the pie is to determine whether it is. Do you have any concern where the standard is currently worded that you would be able to determine what the population is enough to be able to make a decision about whether-- there's always a saying that you don't know what's not there. Are you concerned with the standard setting, or the preparers not knowing what the total population is to be able to make that decision? The crate of oranges is what it is. You've lived with it for 20 years. This standard has the possibility of changing that crate. Are you concerned about that?

MR. MURRIN: Well yes and no. I can't envision a world in which we would implement this standard without eventually producing the Excel spreadsheet that says here are all the entities, and here's what they line up with, and here's the first tier, the second tier, the third tier, and if there is some fifth tier entity that is extraordinarily small but it still does apply, then we then know. My guess is that fifth tier entity doesn't even know we're talking about this and doesn't know there's going to be any demand for them for FASAB based information, hopefully FASB based information. Imagine a scenario in which they're forced to convert from FASB to FASAB on top of being surprised, and welcome to the party. As long as that Excel spreadsheet is produced, I don't think we would

get trapped in a situation in which a materiality problem would occur. I would think the Central Support Agency is going to have to really do that.

MR. ALLEN: First, we went through this single audit. We were doing a statewide single audit, and two or three years down the stream they'd say, holy cow, is that really federal funds? I didn't know that. You realize it is, and you add it to them. It sometimes takes years, and this is one of those projects that may be several years before you even have an Excel spreadsheet people feel comfortable with. I didn't think you had to have it to start with. That's my concern.

MR. MURRIN: I would disagree with that. I would think that if you're going to focus on-- we had folks from the SEC in the discussion. Internal control over financial reporting, somebody, whether it's GAO or the individual four firms, should be demanding an internal control over a financial reporting process that obviates the need to ever talk about what we're talking about right now. You should not be able to implement this standard without somebody doing that comprehensive review across all the entities. Otherwise, what insures that gets no answer. That does not sound like an environment in which you should be getting clean opinions.

MR. REGER: It seems to me we are in the

circumstance currently where we have a list. My colleague next door publishes a list of whose subject to form and content and issues that list once a year, all those people have to give us financial statements. There are some broad criteria. I think it was \$8 billion or something like that, that are the underlying criteria.

We went away from the list to get to a principle-based standard so that there was discussion between the individual organizations and their auditors to surface anybody or identify people who might come and go that should be part of the entity. I don't think at a central level we're going to have any way of knowing that except at that surface up through the grassroots effort of the individual agencies. There's a question in there somewhere.

MR. DACEY: It is a matter of timing. I think it's going to require a significant coordinated effort at both the individual agency and government-wide levels to come up with consistent decision making and conclusions. As I said earlier, you can't have different decisions. One side's consolidate route, kind of needs to have that same conclusion or we have a problem.

I guess the concern I would have in trying to do this, or the thought I had, what we are talking about it is that there would be a period of time, and we had suggested a two-year time table as I recall, to identify any issues

that may need to be addressed and resolved based upon a final standard, if you will, and then tweak that.

To some extent, you could do some of that looking-- and I guess we have to a certain extent-- thought about it running the standard about what we know to be the case. There are all those little things that we've learned.

I guess it's just a question of balancing the equities and the resources required to do this on less than a final standard. That's the balance. I think we need to see and figure out what the best balance is. If there are incremental ways that we could get input from others that might be affected, that would be great, and I would be open to that. I'm not sure how we inspire those that may not have looked at it to look at it. I think we had a fairly strong distribution in certain areas, Ms. Payne, as I recall.

MS. PAYNE: We did, and I would commend Ms. Loughan for doing such a great job on outreach. It has been speculated, not by anyone at the table, but that one reason we didn't hear from what we might call tier three or tier four organizations, was that to respond might be to suggest that we have some authority over them. So they chose to remain silent and not participate. Just as a standard setting body, we confront that anomaly.

MR. MURRIN: I sit quiet because there still

haven't been any questions. Excellent soliloquies, however. I would just comment again that in terms of an organized way to do this from the bottom-up, top-down, eventually we need a list that takes everything that's in the budget, that takes at the margin, these questions about these entities like the District of Columbia and others that receive significant financial assistance.

I'm all for a principles-based standard. To the extent that you can use words that are more in keeping with saying some of the things you already have about misleading to exclude, and introduce more "such as's" as opposed to compelling you to say that if a particular group of things would drive an answer, that these are illustrations of things you might consider so by the time we all sit down, the three agencies that really are responsible for doing this and getting them audited would be able to have a standard that they could point to to say, that those four words led me to do what I did, notwithstanding that these other paragraphs might initially get you to do this. If you do all that, I would assume it would all work out fine.

MR. MCCALL: Mr. Murrin, I kind of look at this as the auditor in the entity that would make the determination as to how they would fit in the reporting model in terms of disclosure and those kinds of things. We had a comment from another person in one of their letters that said, you know

the standards do not appear to assist agencies in determining substantial control. The control resides in more than one federal agency.

Do you have a concern that you might have an entity that you're auditing and they are reporting disclosure on something, and then another federal agency has disclosure on that same entity, so there's duplication?

MR. MURRIN: I could imagine that might come up, but my concern comes back from that to really do I really want 300 entities to spend the money to even answer these questions because we have a different way, potentially, to get 95 percent of the way there, and then maybe for some subset of those entities we do need to engage them and we do need to engage their auditors on whether there's a meeting of the minds, on whether they are a fourth tier entity that fits in or not.

Is it really in the country's best interests and in the preparer's best interests, even in the auditor's best interests to have all of these people engaged in these conversations to what end? They're immaterial entities that didn't fit in the orange. I haven't heard any conversation here about how those individual oranges are somehow the wrong oranges. There's just a quest to potentially see if we should change the orange. Any discussion of adding additional oranges from this standard setting process has

not changed really, so to what end?

MR. ALLEN: You mentioned this misleading to include or exclude, doesn't really matter-- maybe this is too direct of a question. I was going to ask has that ever had application to you in your professional career. I'm coming from a point that that's so limited. I'm going to end with a question as should we even put it in there? It's sort of the caveat that you put in a standard, but in this case it's caused so much concern from people responding. Do you see any harm in just taking it out? That's the question at the end? If you want to say whether you've been involved or not with situations where you've had to use that professional judgment but in the end, would anything be missing if we just took it out?

MR. MURRIN: My experience is more by analogy. By analogy it is useful to have language that is supportive of, by the way, this all needs to make sense in the end.

MR. ALLEN: That is why it is there, but when people start asking to give us the criteria and how we define it. My experience is you can't ever do that.

MR. MURRIN: I think that is a safety valve for a top-down conversation in the end that says here's where everybody falls. Having a sentence or two that seems to contradict the answer for that one, but if you were going to write the instruction manual over again five years from

now, you would have changed those words a little bit in order to make it more clear that you could do what you decided to do so that the standard can live on and not have to be ever amended. You really want to stop issuing standards and then frequently amending them, which is one of the reasons why I'd fuzz it up a little more and not make it a stop and go, and make it be a standard that can just live as is.

MR. SHOWALTER: Your question is actually the question I was going to ask, except I do want to bifurcate "include" and "exclude". Are you more concerned about misleading to include than exclude? It's perceived as including is the way to work around the standard.

MR. MURRIN: Equally concerned, just on a principles-based standard.

MR. SHOWALTER: I am asking is how some of the responses people were more concerned about the include than exclude because you did all the work and at the end, it's misleading to include it so I'm just going to throw out all the work I just did. I'm just concerned how the auditor would respond.

MR. MURRIN: Again that is why we're having this conversation as though the U.S. government we're not just a giant corporation that is a consolidated entity with a central support agency that is responsible for all of this

and that ought to make these decisions. We shouldn't be having this conversation at the third tier entity. It should be a decision that's been made across this whole entity.

MR. DACEY: Mr. Murrin, you have a number of points that talked about reporting under FASB and conversion or not in dealing with the budgetary treatment if you do include one of these entities. I didn't know if you could elaborate anymore on your thoughts in that area. I know that your firm has had experience with a couple of entities that are FASB based and some of the issues there.

MR. MURRIN: Well, I am a big supporter of continuing a process that says that an entity that has prepared financial statements on a FASB basis for "x" number of years should be able to continue to do so unless there is a compelling reason with the formation of FASAB to have changed that and that there are lots of models around that refer to different bases of accounting in consolidation. That is not different really, here.

To the extent that it does complicate the consolidation process, I think that needs to be acknowledged and that is something that everybody needs to be aware of, but the difference between taking an entity that has a history and a procured accounting system and a process to prepare FASB standards, users that are used to

FASB standards, and then suddenly having to socialize to them a completely different process and different development of their financial statements would seem to need something particularly compelling to get that to happen.

As it relates to the comment about the footnotes, I would second any thoughts that outside of the general purpose financial statements is really where any of those intergovernmental types of items might be. It's hard for me to construct a discussion of putting in the FASB-based footnote a FASAB-based number and having somebody even understand who is getting that set of financial statements who might not even know that FASAB existed, what this whole intergovernmental thing is all about. That would seem to be the right direction. Moving away from that is something I would encourage the Board to do and to revisit. That footnote disclosure is really a sub-optimal answer.

The third is around the budgetary reporting. A lot of these entities, to me at least, it's not necessarily representationally faithful to say that they have obligations. We are converting them for purposes, solely for purposes. In some cases, of preparing the consolidated financial statements as though they did budgetary accounting, had obligations, and did all those things, but they really are not.

For the U.S. government as a whole, it doesn't matter. It's immaterial. But if you had to look at the individual entities and then say we want you to use budgetary accounting, when they do not have to use budgetary accounting in running their own organization, that would seem to be an odd position for FASAB who actually are prohibited from doing things around budgetary accounting in the first place, to be weighing in on. I would move away from that.

MR. STEINBERG: I want to build on that because it may not effect this standard directly, but it may affect some other stuff. You said they should not change unless there's a compelling reason to change, which I guess you would say is a positive way of looking at it. There are some entities out there that have been on FASB GAAP because FASAB didn't exist, and yet they are no different than other federal agencies. At some point they would have to change even the FASB GAAP. If FASB standards change, like if we go to IASB, or they have to put in a new system.

I guess the question is if you reverse that, if you said, organizations on FASB GAAP should be on FASAB GAAP unless there's a compelling reason not to change. Do you follow what I'm saying? You guys audit TVA. We read their letter. It was very excellent in explaining why they're on FASB GAAP. I would say there's no compelling

reason for them to change. In fact, it's compelling that they don't change, but there are other organizations, as I said, that are on FASB GAAP only because they started to produce financial statements prior to the existence of FASAB, and yet there is no other reason that I can see that they should be on FASB GAAP. Since they are part of the federal government by all of these criteria that we talk about, would you say that unless there's a compelling reason not to change that we should require them to change?

MR. MURRIN: I came to a compelling reason to change primarily from a cost-benefit standpoint. Could I construct an argument that said for some future change in their accounting system that it might be more optimal for them to move toward FASAB? Perhaps they could make that argument, but otherwise the bias would be toward-- there really is no-- why would we incur any dollars for these relatively immaterial entities.

MR. STEINBERG: I agree. That would be a reason not to change if there are dollars, but I think you answered my question.

MR. ALLEN: Mr. Granof has the last question, thank you.

MR. GRANOF: Your comments have been very valuable to us, but they dealt with fairly narrow issues, like the fifth tier entities. When this statement is issued, the

criticism that the Board is going to get is not going to have to do with those entities. It's going to have to do with the big elephant in the room, like the Federal Reserve or other intervention entities perhaps, like Fannie Mae, Freddie Mac, and the like.

Has Ernst & Young discussed the impact on those entities? Do you have any feeling as to whether we're heading in the right direction with respect to those entities? First of all, is the statement clear, your opinion as to how those entities will be accounted for, and secondly, if it is, do you agree with the way those entities will be accounted for?

MR. MURRIN: We did not have separate substantive discussions within the firm on how any entity might or might not apply to the individual standards. We did participate with the Greater Washington Society's letter on their process of pulling it together. I would acknowledge that it would be important to be prepared to discuss how those kinds of entities fit within the model. I know that you've had extensive conversations around each one of those. To a great extent what this project is bringing is a lot of process in the sunshine around that answer. Whether you like the answer or not, at least it's an answer that has been done over the course of six to eight years really, in the sunshine. I don't have any particular individual

point of view on those. I'd be happy to study them.

MR. ALLEN: I assume if we do have other questions we can provide you those?

MR. MURRIN: I would be pleased to. I did not get a chance to comment on the last point.

MR. ALLEN: I do have a question, and I'll send that to you. Thank you. The afternoon must be the accounting firms, at least starting off. Amanda, James, thank you for coming. You're probably getting an idea of some of the questions you're going to get, whether or not they're in your paper or not. Everything's in your paper.

**Agenda Item: James Gould and Amanda Nelson -**

**KPMG**

MS. NELSON: Good afternoon, I am Amanda Nelson. I'm a partner in KPMG's national office. I oversee our public sector accounting. With me today is James Gould, who is a rotational senior manager in our national office and out of the federal practice. Although our national office is in New York, we actually reside here in DC, embedded in our governmental practice here, which is fairly large and we thank you for the opportunity to participate in today's hearings.

In our letter, we clearly had quite a number of comments, but I thought one of the things that might be useful for you to understand the effort we went into in

terms of preparing for this. Because we have a large practice here, we did gather about 20 senior managers and partners in the federal practice, as well as entities that aren't exactly federal but might be the kinds of entities that would get pulled in. We got them together, gave them the draft, and then said, okay, how do you think you would apply this? Who do you think you might be pulling in, and do you believe that in meeting this that your entities might be pulled in, kind of from both sides?

To one of your earlier points, we also asked them to go back to their clients and say, okay, this is out there. This is real. We really think you need to participate in this process to try to, again, I think he called it socialization, outreach, etc. We tried to push our clients, because a lot of them, think you will respond on our behalf. We didn't want to respond on everyone's behalf. We want people to respond on their own behalf. We did have a lot of those conversations.

Actually, our letter was really from the point of view of the words on the page. I know we could sit here and listen to the discussion about intentions, but what we really went from was do we actually know how to apply what is on the page? I know some things in there get very detailed about how we think this should be here, this works, this wasn't clear, we would suggest alternative

wording. The intent was not to change what you wanted to be in or out. If that really was the result of what we ended up with, then we may not have understood what the words on the page were trying to get to.

Being a national office person, one of the things we deal with day over day is what the standard says. Having a history of looking at standards that were written five or six years ago where memories have faded, we're back again to what's on the page. That was the approach we took. We appreciate lots of effort went in on the Board's point of view for what you put on the page, but we thought the most value we could bring to the table was trying to assist in the way we actually read and might be able to assist clients in understanding, as well as what standard we would be holding our clients to.

We didn't actually intend to highlight anything in our letter as our prepared remarks. We thought we would make ourselves available for your answers.

MR. ALLEN: That is great because you made lots of points in your letter, quite a few concerns, and Mark wants to talk to you. Go ahead, Mr. Reger.

MR. REGER: Ms Nelson, realizing that Ms. Banks is next, as a result of your reviews, and I know your letter talked about a significant implementation effort by probing people. What were your findings? When your partners got

together and your customers did their reviews, can you share a little bit? Do you think there are a significant number of entities at the surface, or do you think that in changing the principles to a principles-based approach we really have captured basically the same audience?

MS. NELSON: We did not have anybody come back and say we found six more entities, but we also didn't ask our partners to go out and go through the standard with their clients and say, "how did you implement this?" I don't think that anybody went through that level of analysis.

What we wanted them to say was do you know where you'd look? Do you know how you'd make those determinations? We did have some feedback, which is in our letter, about making sure that people understand the population. Using off of Mr. Murrin's what's in that bucket that contains those oranges? I didn't follow your analogy exactly there, Dan, but where are the boundaries of how far you had to look, in appreciating materiality at the government-wide is huge.

Again, to paraphrase Mr. Murrin's a little bit, some of the feedback was when materiality gets smaller at the third, fourth tier entities, how did that come across? I probably should highlight it was the component-reporting entities that we focused our attention because that's the entities that we're going to be dealing with. These

standards are a little more from what's in the government-wide, but how would ABC, a department, agency, whatever, figure out how to apply it? Did I answer your question or do you want me to rephrase it?

MR. REGER: To pull this to something that I'll ask Ms. Banks in a minute, too, on a specific basis we have been discussing the implementation of the general fund, which is what many of us consider the missing element in our current model. Just working around what exactly is a working definition of that. Here we have a document this thick that tries to identify the organizations that are part of the federal government.

I'm just trying to get some response back from KPMG because you've probably fought it more than anybody else in the federal government, of the depth and breadth of effort that you think will go through this process. I'll try one more time. In your reviews just educating people in this regard, acknowledging that people didn't come back and say, oh, I've got six more entities. Do you see it as a huge increase in audit effort amongst your customers and your partners to spend time on this once it implements or do you think it's definitional and it might not be that intrusive?

MS. NELSON: Once the implementation gets done year over year, I don't see it as a huge effort. I

certainly would expect a reevaluation, as you would anywhere, have the circumstances change to whether you still meet the criteria. It's not done once and then you totally forget, but it certainly is what are you doing differently? One of the questions we have in our document is the budget. Year after year, how much does that change? The timing, or what budget are we talking about? Is that a fixed point in time? Some of these things won't be every year, but there will be a substantial initial implementation.

MR. ALLEN: Let me ask, much of your response focuses on the control principle. We define control in an interesting way. We point out we appoint board members, and its control with, and say it has to be both control and with the potential for loss or risk or benefit. How do you see that in the environment of the federal government, and even the-- this is actually a question I was going to ask the SEC earlier. In other words, when you see-- it's easy to find control, you appoint the majority of the board. You have to approve the budget, but how do you as an auditor look at this and say it's now effective?

You do all of that, but it's only effective because there is this identifiable potential risk or potential benefit? Or do you just stop when you say, well, you appoint the board, do this, and do this, and we can't

really define well risk or reward, so we won't worry about that.

I'm struggling with how this is going to be applied where we clearly in the standards say you have to have both control and the risk or benefit. How would you apply that?

MS. NELSON: I guess I wasn't troubled by having both elements in there. We've had other situations where it is a, "why do you control it?" Often you're controlling it for one of those reasons because you're either backstopping it or getting the benefit from it. I don't see them as being evaluated together. That doesn't really bother me.

MR. ALLEN: So you would evaluate them together? You wouldn't say "I applied the authority of the board--" I'm curious that we laid out so we're going to just assume that you're in without thinking about the other side of it.

MS. NELSON: I thought it was both.

MR. ALLEN: And it is both.

MR. GOULD: I think our thought to that was looking at the indicators of control, if you have control then it's connected to the fact that you have the risk and/or rewards associated with it. It wasn't that you could think that you have controls but then wouldn't be thinking about those or wouldn't have those (i.e. Risk and Rewards).

MR. DACEY: Just a question, I've seen where you

have discussed and recommended that we perhaps move majority ownership interest to a presumptive indicator of control. We had other letters that suggested we take in the budget and make it a part of control. I didn't know what your thoughts were in that regard, what your rationale was. There seems to be some desire by some people to limit it down to control. Is that a key definition or do you have any thoughts on that matter as to why you would move that to control?

MS. NELSON: We didn't see them as distinguishable. Really, as we said, it was a simplification of trying to say, okay, if there are only two principles then that's two decisions that I have to make and not three. Well, it wasn't. We just looked at it as I have the majority ownership. Now granted since we looked at it as why would you own something without risks or rewards or benefits, it fit into the control bucket. It wasn't anything more than simplification.

MR. STEINBERG: I noticed you are one of many that said that the standards should require the control be other than temporary. Several people said that. I wondered if you could speak to that and why you said that.

MS. NELSON: We came to that because there was the other side already in the document that talked about temporary. If you are trying to implement this and one side

says, temporary, you do this, it looks like then the other than temporary would be the other side. Again, it was if "temporary" is this, then "other than temporary" might-- it wasn't you should do something about "other than temporary". If the Board's belief is that there's some middle ground between "temporary" and "other than temporary" it wasn't clear to us.

MS. PAYNE: Can I ask a follow up? I wasn't really clear on the way you would sequence and how the other than temporary would effect. If it's "other than temporary", is it a consolidation entity? If it's "temporary", then it's a disclosure organization? It's not that you would exclude them entirely if they were temporary relationships?

MR. GOULD: We weren't trying to attach it to the principles because the temporary or not permanent was first introduced when it was talking about disclosures, after you were already finished with the principles. Our thought was to introduce the other side of it as it relates to a consolidated organization. It wasn't necessarily touching the principles.

MR. ALLEN: Since we've side tracked it, let me just ask a question in terms of whether you define temporary -- in the environment that you're in, you've got the railroads - what if 20 years from now the same

relationships between Fannie and Freddie exist, is it still temporary? FASB, which has dealt with temporary, defines it very clearly. This is what it means, not more than a year. It's a definable term, but we don't live in that environment here.

MS. NELSON: From an evaluation point of view it would certainly be helpful to have something, even if it's not a bright line in terms of our evaluation for management and the auditor, but to my point earlier that it's not a once and forget it. If I decide that it's temporary this year, coming on five, six years, do I still think it's temporary? If I made that determination, do I get to keep it forever? I think that's an annual preparation type of evaluation. The simple answer is, being auditors, we always would like something clear.

MR. ALLEN: Scott, I think your point and then Michael.

MR. SHOWALTER: In your comments you actually talked about "to include", if somebody would be misinformed to be included. I've always asked the questions about misleading "to exclude" and "to include". It seems like you've gone forward to be okay with the "to exclude" if something would not be clear about excluding it. You said we should not have the "to include". I'm assuming that's because you think it's a backdoor way around the principle.

MS. NELSON: Absolutely. We believe this misleading to include kind of gets to the end-- and I also envision, do you actually spend the time to do the evaluation when you get to the point of can I jump to, it would be misleading to include it anyway? I do believe it's a way around the whole presentation.

MR. GRANOF: I remember a comment you made, although I can't find it right now, that if an organization meets the disclosure qualifications for two different entities it would be confusing. Is that right?

MS. NELSON: We were thinking of control as more of an exclusive concept. Either you control or you don't control. You can both influence, but I was thinking control, if I said no, you couldn't override it, that would be control. That was where we were going.

At the component entities, if James' component entity disclosed it because he kind of controlled it, and I kind of controlled it and disclosure as such, but then is that a separate evaluation for the government as a whole that if we both semi-control it, then the government as a whole then really controls it? It just seemed to us that it was an exclusive concept, that's all.

MR. GRANOF: Do you have a problem with two organizations disclosing the same entity?

MS. NELSON: Whether they'd actually disclose the

same thing would take some coordination. We could have some interesting alternative disclosures on the same entity, but I'm not terribly troubled that two entities—I'm not sure I'd call it control, but if two people want to have a relationship--

MR. GRANOF: You are not troubled with that, that's what I was getting at.

MS. NELSON: No.

MR. SMITH: As supposed to a bright line, at what point do you believe it becomes misleading because of the standpoint that's saying this relationship has been long enough that as a user of the financial statements really should be evaluating that as if they own it. It's not necessarily a year, but where is that? Because as Tom said, FASB has a reason, but it works for FASB. But when we're looking at temporary in this content, it's more of what is the point that a user of the financial statements need to understand that relationship.

I'm not sure that it's necessarily a year, especially given some of the interventions at this point. At some point you would say this relationship would be long enough that it carries a level of risk that it should be in the disclosure. I just want to know what your thoughts would be on what that length of time will be.

MS. NELSON: I don't think we have a real position

on what that timeline would be. My biggest concern is that it get re-evaluated over time and not be a temporary forever.

MR. SMITH: Just a follow-up of that, would you be comfortable with the users of the financial statements making that determination, understanding that different users could get different periods of time so that you could have inconsistency in the application of the standard?

MS. NELSON: Users or preparers?

MR. SMITH: I meant preparers.

MS. NELSON: I think it would be a management preparation in terms of management would prepare a paper or an explanation as to why they believe it is what it is. I don't see a way to really get it without you all putting something down, I don't think there is a way to get it consistent. We as auditors couldn't say one entity here, one entity here, they both have to be three years or something. I don't think that could work.

MR. STEINBERG: Could you see a transition from temporary to other than temporary being based upon some act like an enactment of legislation that does something that causes the organization to come under some more control or ownership?

MS. NELSON: It sounds like one way to do it. You may need more than one way to be able to make that

transition.

MR. GOULD: I think looking at the indicators of control, when they do their periodic reevaluation it could be that combined with multiple things.

MR. MCCALL: You had indicated that you didn't look so much at the government-wide because you deal with a component level entity. If you have a component level entity, and the decision is made on whether they're a consolidated entity or a disclosure entity, do you see that being picked up in that exact setting and moved up government wide, and all the related notes that go with it?

MS. NELSON: You certainly have a different materiality level government wide, but even within the different component entities, we're going to have that same decision.

MR. MCCALL: I think what I'm asking is if something is a consolidated entity government wide, could you they be a disclosure organization at the component level?

MS. NELSON: If we have different people making the evaluation on the same entity on a principles-based standard, there's certainly a possibility we may not come—here's preparer one and I'm preparer two, we may not come to the same answer. Assuming they all have the same facts, that's the other—when we have evaluation of the government

wide versus the component entity, do they all have the same information to make that determination.

MR. MCCALL: I think some of our letters—correct me if I'm wrong—but I think some said why do we have the discussion with component entities? Do you remember some of the responses we got?

MR. ALLEN: I think we had talked about the need to plan equally, and although consistently all the way through. I think your letter was one that did that and said you first are talking about these principles, and you ought to start talking about the principles of the government-wide as well as the component units all the way through or something like that.

MS. NELSON: In some ways—because what we are asking them to do with the components is step into the shoes of the government-wide. What do you think would be the decisions made at the government-wide as opposed to what do you have, what control and things do you have at your component level entity? That was what we were trying to say. Am I making the determination based upon the knowledge I have versus assuming what somebody else would have up at the government-wide. That was where we were trying to get them equally balanced.

MR. REGER: So I don't know if you remember, but in paragraphs 72 and 73 we keep referring to, and a couple

of the audit firms earlier, that 72 was sort of our criteria for significant disclosure and 73 were examples of the type of disclosure you would then do. Earlier we heard somebody say you would read this as if it was a laundry list. I've heard you twice say the first thing we do is go back and read the standard because interpretations change over time. We go back and read the standard. I'm really interested in reading your interpretation of this draft standard. If this were adopted like it is, how would you interpret 73? I think you were here for the earlier discussion.

MS. NELSON: We were here for the earlier discussions. Actually our letter does suggest some different language to try and—if you really mean these as examples, how to align that so it would be not viewed as prescriptive.

MR. REGER: I'm going one step beyond that. In your view of what we are trying to accomplish, should we do that with 73? I know you offered language that said it fits your intent, but I'm sort of coming back part of the discussion earlier, which it seemed to lean that people said no, 72 is what you're trying to accomplish. 73 are just the examples.

MR. GOULD: I think our comment letter said we thought that 72 was what you were intending, and 73 was

trying to provide examples, but for ease of read and application of it, having some sort of merge of those two together—like 72A, this is an intended required element. The following are ways you could accomplish that. Then B is--

MS. NELSON: We tried to go back to 73 and say, okay, do all of these align with 72 so that we could see if — what would give us more of an idea that these were examples of what you meant in 72, but if there were extra things in 73, it would kind of seem that you meant all of 73 if there were extras. To somebody's point earlier, making sure that 73, or whatever 73 becomes, is from the point of view of the reporting entity as opposed to trying to pull in thoughts of somebody that's not management—having the reporting entity management rep to the feelings or views of somebody else would probably be a challenge.

MR. SHOWALTER: Even if you incorporated, would then you put those required into your workpaper 514? I'm putting it in their terms.

MS. NELSON: Workpaper 514 is our disclosure checklist.

MR. SHOWALTER: Would you incorporate those into your disclosure checklist?

MS. NELSON: I would put 72 in the disclosure checklist.

MR. SHOWALTER: Even if we combined—I'm just taking your recommendation. If we flipped 73 up into 72 and said these are examples of that, what would be in your disclosure checklist, the three items in 72? Your recommendation is to combine 73 and 72.

MS. NELSON: You'd take 72A and if you follow an outline format, whichever ones we said between A and J relate, we had thought aligned with A, we would have whatever the next roman numeral is below A and have those three be whatever the examples are of those.

MR. SHOWALTER: So all you have done is make them part of your checklist?

MR. GOULD: Using the words, "that could be accomplished through the following", so 72A in our 5-14 would be the required--

MS. NELSON: The relationship and organization would be the words that would be in there.

MR. SHOWALTER: I just want make sure we solve the problem and don't move it.

MS. NELSON: We're still wanting some example language.

MR. ALLEN: Thank you very much. We appreciate that. I hope if we have other questions we can submit them to you in writing for your response. Well, I guess we are at a break here. They gave me no agenda, so Ms. Banks, you

get a break before your testimony I guess.

MS. PAYNE: There was an error in the agenda that went out with the printed materials. We had two things at 2:00-2:30, Ms. Banks and a break, so I took the executive step to put the break a little earlier since after lunch you usually need a break a little earlier. We did notify Carol that it was 2:30 even if you didn't get word. Sorry.

(Break)

MR. ALLEN: Welcome, you've already been introduced by Mr. Reger, so I will go ahead and turn the time over to you.

MR. REGER: Carole Banks is the chief accounting officer for the Department of Treasury and the compiler of the Treasury financial statements, which are still one of the more complex sets of statements to go into the general purpose statements. Also she has been an incredible advocate for consolidated accounting, for helping policy address accounting issues. Carole, it's always nice to see you.

**Agenda Item: Carole Banks - Department of  
Treasury**

MS. BANKS: Thank you to the Board for inviting me to speak. I only thought I would lift up just a couple of

comments to you and then just turn it over to you for questions. My first comment just focus on the catch-all "misleading to exclude" inclusion principle. I also just want to comment on one area of the disclosure requirement under the FRS, paragraph 77. By the way, I hope all of you did receive my bio and some prepared remarks there. Hopefully you have that.

Let's start. I unfortunately haven't had the privilege of being here in the morning, so if I am redundant, tell me. The ED states that if you do not meet the three inclusion criteria, then you turn to paragraph 35 and 36, which says that if it's too misleading to exclude then consider inclusion by consolidation or disclosure, which most likely, in 99 percent of all cases, will be inclusion by disclosure. My only point is simply this. The same misleading to exclude phrase is used in paragraph 78 in defining a material related party. There is not a really clear distinction between an entity that is included as a disclosure entity, because it meets the misleading to exclude inclusion principle versus an entity that is included because it is a material related party. For a reporting entity trying to assess if an organization that does not meet any of the budget, ownership, or control criteria, (we call it the BOC criteria) then which way do I go? Do I using the guidance containing numerous paragraphs

on disclosure entities, or do I just use the related party guidance which is minimal.

MR. ALLEN: That isn't clear to you the way it is written?

MS. BANKS: Not extremely. As a matter of fact, the way I look at it is this, and I could be the only one out there with this view. I think if you're not in the budget, nor is there any ownership or control, then I think the entity should be labeled as an affiliate which falls in line with the traditional GAPP definition of what a related party is. That's my view of it.

Therefore, I would ask the Board to consider slightly modifying this by, taking out paragraphs 35 and 36, and state that if an entity doesn't meet one of the three criteria, then next consider whether or not the entity should be disclosed as a material related party.

Honestly, this is a principle-based standard. If the affiliate relationship is huge you might even suggest reporting entities to turn to contain of the disclosure guidance for disclosure entities in addition to the guidance for related parties. It doesn't have to be limited to the related party guidelines.

This approach I think would cover just about any organization and any entity without having to single out any specific entity (i.e. the Fed). It would make the

guidance a little more clearer, more simplified and avoids differentiating from GAAP on the definition of a related party. We've done a great job mirroring, to some degree, many of the GAAP principles. I think we ought to continue to do so.

MR. DONG: Are you saying by having paragraphs 35 and 36 that's actually creating a bias to include?

MS. BANKS: I'm just saying that paragraphs 35 and 36 are not clearly distinguished from the material related party paragraphs. If you looked at the last page of my remarks I actually drew a diagram. It illustrates after you've gone through the three criteria and the answer is "no", to consider disclosure as a material for related party. Once again, it's a principle-based standard, so if the affiliation is really significant, the Board may even point the reporting entity to consider certain additional disclosures included in 72 and 73. That's one issue.

The other issue I would like to bring up is related to the Federal Reserve System, paragraph 77. Although the Department generally concurs with the guidelines that the Board sets forth, you may recall Greg Evans from the FRB and I came to you about a year ago give you our views on how we think the Federal Reserve system should be incorporated or disclosed in our Treasury financial statements.

Together, Greg and I spent a considerable amount of time creating a model disclosure that would be incorporated into our financial statements. We actually presented that model disclosure to you. The model disclosure is very much in line with the disclosure requirements that are proposed in paragraph 77. There is one exception. We actually took that model disclosure, and we included it in our 2012 financial statements, which became subject to audit scrutiny. By and large, KPMG was fine with it.

In fact, we think it enhanced our disclosures because we were able to put everything regarding FRB within one disclosure. It was actually great. KPMG did have some issues and strongly recommended that we delete some of the detailed information around FRB. Most of that was in the removal of the detailed descriptions of how the FRS monetary policy is executed. We attempted to elaborate on this discussion in the model draft. KPMG concern was mostly around how they would audit this. If we had insisted on keeping the detailed discussion in our disclosure, a lot more audit effort may have been involved. To do so might have required us to increase our audit fees to KPMG. Of course, given the budget arena we're in, we readily succumbed and modified our disclosure by deleting this language.

The disclosure, as you see in the 2012 audit financial statements does have a brief description of monetary policy, and generally how it is executed, but it is very high level. We'd like to keep it that way. This is my second concern with the exposure draft. I would like to respectfully request that the Board consider modifying paragraph 77C, which currently states that requires disclosure of significant financial actions and changes in those actions undertaken by the central banking system to achieve monetary and fiscal policy objectives. I think that such a disclosure requirement would be too complex for us to articulate clearly and in concise manner within our disclosures. This could be pretty burdensome.

Is the benefit to be derived from this additional disclosure going to outweigh the cost of getting the information, the cost of having that information audited and approved by our auditors? I don't think it really is worth it. You do have in paragraph 77F a reference that says you have to indicate a reference of where readers can find the FRB annual financial report. We think we should just continue with a very general, brief description of what monetary policy is, very generically, and then reference where they can find this discussion in the FRB annual report. I think that would be a more practical solution to implementing the standard with regards to this

particular area. That's about it.

MR. DONG: Ms. Banks, thanks for sharing your thoughts on the standard. I wanted to come back to the discussion that you had on the central bank. I wasn't quite following your written comments in terms of paragraph 77 because you start by talking about how it's valuable to have the substance that we covered in paragraph 77, but in the subsequent paragraph you talked about how we're violating the principle-based standard.

MS. BANKS: I thought I would stick that one in. Paragraph 72 and 73 are disclosure guidelines that should be considered for reporting disclosure entities. They're examples of what reporting entities should consider for disclosure. To me, that's principles-based. You're leaving it up to the entity to discern what would be the best disclosure for the entity being disclosed. That's not how I read 77. I think 77 rules-based requirement. Like I said, I'm not at all opposed to most of it. I would just like to tweak it a little bit. If you want to make it more principles-based, write it on the same style as paragraphs 72 and 73 as though they are examples of disclosures for an entity to consider in disclosing its relationship with the FRS.

MR. DONG: So you'd say focus your efforts on the discussion of what it means to be a related party as

opposed to focus your efforts on calling out the Federal Reserve specifically?

MS. BANKS: I don't think you even have to call out the Federal Reserve separately within the standard. The way the proposed standard is currently written, I'm not quite certain I believe that the FRS is a disclosure entity. I think I would conclude just a material related party, a big related party in accordance with the exposure draft. If you follow recommendations I made to you earlier on disclosure guidelines for related parties and by modifying the flow chart, I think we would get to the same type of disclosures for the FRS. On the other hand, I'm also very happy to comply with the disclosures under the very specific guidelines of paragraph 77. It meets exactly what we had anticipated and recommended last year to you.

MR. DONG: With the exception of 77C.

MS. BANKS: With the exception of just that tweak on 77C. I do believe that there should be some general, high level description of monetary policy. I just don't think it should be too in depth as currently required by 77c on how the policy is executed and changes to the policy.

MR. STEINBERG: I have two questions. The first one has to do with the push-back you discussed. When we were discussing the disclosure to the Federal Reserve, and

in particular 77C, we were thinking of these as desired disclosures for the financial report of the federal government, the consolidated report. Is it possible that KPMG's pushback was because they felt this disclosure while appropriate for the government-wide report was not necessary for Treasury?

MS. BANKS: I am going to echo something that I heard said. Because KPMG focuses on component reporting entities, I will say that I think it was because that KPMG was looking at it only from our Treasury perspective and not necessarily from a government-wide perspective.

MR. STEINBERG: So you are agreeing with what I'm saying. It was appropriate for the government-wide but not for Treasury.

MS. BANKS: It could be.

MR. STEINBERG: But we're writing this document—as I said, we're thinking about these as disclosures and necessary because we think what the Federal Reserve does effects the government and the nation as a whole, and not just Treasury. The second question I had is there's a new entity that came into existence since we started working on this thing, and I think a lot of people have a lot of high hope for this entity, the Consumer Financial Protection Board. How do you envision that being picked up?

MS. BANKS: I think we stood them up as a separate

entity. I'm not very familiar with how CFPB — where it falls on the budget ladder and who it reports to or should it go directly up to the FR as a consolidated FPA? I'm not quite sure I know the structure around that yet. I can't answer that question.

MR. STEINBERG: If I remember correctly, it is a unit of the Federal Reserve System, but it comes under — are there some other — Mark, you may know this.

MS. BANKS: It is a separate federal entity, right?

MR. STEINBERG: Who is its parent, so to speak?

MR. REGER: Well, currently it's the Federal Reserve board, and they attain the revenue through the Federal Reserve. We're checking now--

MS. BANKS: Is it or is, it not? I can look that up and come back to you on that.

MR. GRANOF: It seems to me you are so articulate and charming in expressing your view that it's easy to be accepting of what you say.

MS. BANKS: Thank you.

(Laughter)

MR. GRANOF: But, changing 77C is not merely a tweak, it seems to me. I think it's a very fundamental issue that we have discussed. I appreciate your point of view. It's been expressed around this table previously.

Here is my question related to that, if you say this information will be difficult to obtain, first of all, that's what the Federal Reserve does. That's the heart of what the Federal Reserve does, and if you read the 300 page report of the Fed, it's spelled out there. Why is it so hard to get that information? Auditing is another issue. We can discuss that later, but why is it hard for you or KPMG to get that information?

MS. BANKS: I don't think it is hard to go on their website and look at the information and even possibly cut and paste it. It's just that it will be difficult getting underlining information that will serve as audit evidence to substantiate the statements being made in our financial statements. KPMG would look to us to get it in a format and to provide documentation that will substantiate all that the information included in our disclosure on the FRS..

MR. GRANOF: So now we are into cost-benefit question. That's a tough one because in my view at least, the benefits are huge. I don't have a clue as to cost.

MS. BANKS: I better realize now that these disclosures should be considered not only from Treasury's perspective but also from a government-wide perspective. Maybe the government-wide report may meet the 77c disclosure requirement more fully GAO can adequately audit

the information. It may be more mostly for KPMG to audit in Treasury's agency report.

Maybe there's some compromise there, and that's something we would probably just have to work out between ourselves, and the government-wide reporting team. I think generally most disclosures should be funneling up through an agency into the FR if possible. Maybe this is one of those that we may have to compromise on if we find that we can't get KPMG to look and opine on that note without a significant audit bill that is attached to it.

MR. GRANOF: You can imagine my fear is that you'll just have a paragraph of boilerplate, which would be repeated from year to year, which doesn't capture what the Fed has done in that previous year.

MS. BANKS: So maybe there is some compromise we can look at.

MR. REGER: Ms. Banks, I am going to try and lead these guys down a path which they are not going to like. If for instance the Federal Reserve were a separate reporting entity, and I realize you have not endorsed that concept despite my colleague trying to get you to say those words, wouldn't there still be significant disclosure in Treasury's financial statements because you are the agency with the most significant relationship among the reporting entities currently that is the Federal Reserve.

MS. BANKS: Yes, I think that's true. Prior to last year, when we put our model disclosure in there, we did have a fair amount of disclosure around the FRS. It was just placed in various different portions of the document. The exercise we undertook last year by creating a model disclosure enabled us not only to elaborate on our relationship with the FRS, but also allowed us to put our FRS disclosures all in one place within the report. Because most of the FRS relationship is working through BFS, and since BFS is part of Treasury, then we feel it is important to have that information, those disclosures, within our report.

MR. REGER: One more follow-on, which is of all the organizations, and there's a whole area of organizations the Treasury combines for its financial reporting purposes, when you look at the disclosure requirements in 77, do you report out those same sort of things for all the other organizations, and specifically 77C, where they talk about, well, certainly not monetary policy, but other major economic policy discussions?

MS. BANKS: No, we don't.

MR. DACEY: I just want to clarify, it's more of a cost matter than a relevance issue because there's evidence that would have to be obtained, and it could be at a significant cost to obtain that evidence for certain

information. That was my main point, but I think that's been answered.

MS. BANKS: Can I ask the question? I understand the relevance my only point is that if I can point someone to a document, which is the FRS' or FRB's financial statements, that will have a much more elaborate and comprehensive discussion around monetary policy, will we not be achieving the same result?

MR. DACEY: Different members around this table may have different viewpoints.

MS. BANKS: Then let's not open that up.

MR. ALLEN: Let me go back to the first of your responses if I can, where you were talking about the basic inclusion principles. In other words, what we're trying to say here is that if these three principles - then we're going to later decide whether your consolidated or disclosed, but if you meet those -. I was surprised by the answer that you gave. It's on page two of your written response, where you wrote in, is other than temporary. It seemed like to me if we followed it through our standard, if we take out everything that's temporary, it falls right out of the standard. That seems inconsistent. While Hal might like that, that seems inconsistent with your later discussion that says it should be in this standards. There was an inconsistency there that I struggled with.

MS. BANKS: I can appreciate that. As a matter of fact I will say to you that when we first began discussing how to comment on the ED, we thought it was important. It was probably one of the points we focused on first. Obviously, we don't want to consolidate entities like the GSEs or entities that we've taken temporary ownership or control for intervention purposes. Our management intent is never to own it, and therefore we shouldn't be consolidating it. I think we just wanted to make that very clear.

Now, the ED later on gets very specific around how to deal with entities that are in conservatorship, receivership, intervention, and you're very clear they should be disclosure entities. I think we are fine with the exposure draft on this. I am perfectly fine with how it is characterized in there. I think, again, in the very beginning as we were looking at the inclusion principles we just thought that we wanted to make it very clear we didn't want to consolidate those organizations that are temporarily held, where ownership is temporary in nature or control is temporary in nature. I do think the ED addresses it overall later on in the document.

MR. ALLEN: Other questions? If not, thank you very much. We appreciate it, and we know where you work so we can ask you more questions.

MS. BANKS: Thank you.

MR. ALLEN: We've got Ms. Terzak, yes. I think your organization has been taken in vain a couple of times during the discussion.

**Agenda Item: Donna Terzak - Tennessee Valley**

**Authority**

MS. TERZAK: I am really excited to be here. I've been working on various aspects of this project for a long time. I met with Ms. Payne way back when at OMB, when we started doing financial reporting for the federal government. It's just been an ongoing evolution to where we are now. I guess this is the culmination of it. I'm here to represent the Tennessee Valley Authority. When I look around this room and see all the people here, this is a huge footprint up here and TVA is such a little thing. To the people of the Tennessee Valley we are a footprint, and so it's very important that I get our message out and hope that you understand where we're coming from with some of our remarks.

I'm going to go ahead and read some of my prepared remarks and do some abbreviated parts of this, because I do get into quite a bit of detail just because I'm excited about my agency. I also think it's pertinent that you understand where we're coming from and why we've reached some of the conclusions we did.

The Tennessee Valley Authority is a corporate agency an instrumentality of the United States Government. It was created in 1933, by legislation enacted by the Act of Congress called the TVA Act. Today TVA operates the nation's largest public power system. It supplies power in most of Tennessee and a seven state area. In 2012 our revenues generated electricity sales for \$11.1 billion. This accounted for virtually all of TVA's revenues. A question earlier what our capacity was. We have a 33,000 megawatt capacity of electricity from various sources.

Initially all of TVA's operations were funded by federal appropriations. Direct appropriations for the TVA power program ended in 1959. Appropriations for TVA's stewardship, economic development, and multi-purpose activities ended in 1999. The fact is we are receiving no federal money. In fact, we are repaying part of the power appropriations back at \$20 million a year plus interest.

Since 1999, TVA has funded all of its operations almost entirely through the sales of electricity and power system finances. TVA's power system financing consists primarily of the sale of debt securities and secondarily of alternative forms of financing, such as lease arrangements. Most of TVA power bonds are listed and traded on the bond market of the New York Stock Exchange. Some global bonds are listed on various foreign exchanges. We have been

getting audited financial statements since 1939 on a FASB basis.

The Consolidated Appropriation Act of 2005 amended section 37 of the Securities Exchange Act of 1934 to require TVA to file annual reports, quarterly reports, and current reports with the SEC. The mission of the SEC is to protect investors, and it does this by requiring public companies and TVA to disclose meaningful financial, and other information to the public by following US generally accepted accounting principles, which is US GAAP or FASB. This provides a common pool of knowledge for all investors to use to judge for themselves whether to buy, sell, or hold a particular security through the steady stream of timely, comprehensive, and accurate information.

As an SEC filer, TVA is required to comply with the Sarbanes Oxley Act of 2002. This requires management to annually certify to the effectiveness of its financial reporting control. In addition to management certification, TVA also elects to obtain an opinion from an external audit firm regarding its internal control environment.

TVA is very encouraged that the FASAB that would recognize that reporting should allow the users of financial statements to identify the various activities undertaken by the federal government in order to achieve the missions and objectives of the government's diverse

programs. We do concur with the three inclusion principles proposed by the FASAB, that organizations need to be included in the government statements.

Having determined who should be included as far as TVA is concerned, and I know there are a lot of other opinions out here as to other agencies, but this is us, the next consideration may be whether a one-size fits all reporting model is appropriate to best convey the results of the government's financial objectives of budgetary integrity, operating performance, stewardship, and adequacy of systems and controls. Depending on the type of activity, focus may be on how effectively tax-payer's money is being used to fund projects and programs to benefit the general public.

In other instances focus may be on how successful an individual organization is characterized by exchange relationships, such as rate payers, are in meeting directives to be self-sufficient and not rely on taxpayer money to achieve their missions. Because of the different means to achieve objectives, different reporting models are needed to measure and report on the effectiveness of the various activities to meet organization's missions and objectives.

TVA believes the proposal by the FASAB to distinguish between types of organizations in the

government-wide financial statement so it may better convey the financial condition of organizations as well as communicate the effectiveness of these organizations in achieving financial objectives to users of the report. The distinction between consolidating and disclosing organizations will allow for organizations to report according to their business models, and more appropriately portray actual results and financial conditions of organizations in the federal government in its entirety to meet the needs and users of the statements.

As discussed earlier, organizations such as TVA with business type activities frequently operate in an environment that differs to a certain extent from the environment in which government-type activities operate, requiring business type organizations to confer FASB-based financial statements to FASAB-based would result in an organization having two sets of financial statements with different format and content including different accounts, balances, footnotes, and disclosures, as well as different financial positions and results of operations. This would further confuse the users of TVA's financial statements and others including potential investors, existing bond holders, analysts and bond rating agencies, the media, ratepayers, the general public, and other stakeholders.

I want to emphasize the word "media" because a

lot of what you see in the paper can effect what a person's standing is in the financial community, and one misstatement can really affect our bond ratings.

Additionally, requiring TVA to submit FASAB-based financial statements would be inefficient and would increase TVA's financial and accounting costs as well as audit costs. Since TVA is self-funded and receives no appropriations, these added costs would ultimately be passed on to ratepayers in the form of higher electricity costs, which may be contrary to the TVA Act, which states that rates are to be as low as are feasible to produce gross revenues sufficient to provide funds for operations, maintenance, and administration of its power system among other requirements.

Given the current financial climate whereby federal organizations are being asked to make program cuts and work more efficiently and effectively, and the requirements of the TVA Act, this conversion requirement may seem contrary to directives. TVA can appreciate the challenge faced by US Treasury in creating the government-wide financial report including the issues of eliminating intergovernmental transactions in the consolidation process, however TVA does not believe that requiring business-like organizations to convert FASB-based statements to FASAB-based would eliminate the issue.

TVA believes that consolidation is achievable to produce government-wide statements without conversion through the closing package instructions. In support of the closing package requirements related to intergovernmental activity noted above, the US Treasury revised its intergovernmental transaction procedures for 2013. The purpose of the new procedures is to assist organizations in adequately accounting for and eliminating intergovernmental activity and balances between federal agencies by establishing business rules and processes to properly record, report, and reconcile the balances.

Consolidation of organizations' financial statements into the government-wide financial statements should be achieved by following US Treasury guidance rather than an accounting standard. This will allow both government-wide and business-like organizations to follow appropriate accounting standards to meet the needs of users of their financial statements.

In conclusion, we'd like to state that one, TVA concurs with the inclusion principles as proposed by the FASAB for organizations to be included in the government wide financial statement. TVA concurs with FASAB's proposal that it is appropriate to differentiate between organizations, those that will be consolidating organizations and those that will be disclosing

organizations. TVA concurs with FASAB that it does not support a requirement that organizations with FASB-based financial statements convert to FASAB-based statements for the purposes of consolidating the government wide financial statement.

TVA is not one of the 24 CFO Act agencies. We realize we are not a material entity in the federal government, but we are committed to producing financial statements which appropriately represent our financial condition and results of operations.

MR. ALLEN: Thank you very much. I appreciate that.

MR. REGER: I get to ask the first couple of questions. They're really going to be straightforward, and they're right in a row. TVA, the bonds that you say will support TVA, are full faith and credited to the United States government or revenue bonds based on TVA?

MS. TERZAK: The TVA act states that they are not backed by the federal government. The bonds issued by the TVA Act shall not be obligations of nor show payment of the principle, therefore, in interest their own be guaranteed by the United States. That's section 15DB of the TVA Act.

MR. REGER: When is the TVA's fiscal year end?

MS. TERZAK: September 30th.

MR. REGER: Right now you maintain your records

under FASB standards, but I think you've clearly stated, and since we've had the discussion around the table all day, you do report to us annually. You do provide the elimination entries, and you do provide the translation to FASB for the material transactions.

MS. TERZAK: What we do is we take our trial balance and assign the USGL numbers to it and do a crosswalk on an Excel spreadsheet.

MR. REGER: I just want to point to the members who were asked earlier could that be done, TVA is a very big organization. Last question in this series, in the way you read the proposed standard, what would TVA be? Are they consolidated, are they disclosure?

MS. TERZAK: We would be disclosure because of our business model. It makes more sense for the rate payers to know how we are operating as a business because it is their money, versus a taxpayer, which is total federal government money.

MR. ALLEN: Mr. Dacey , did you have any questions?

MR. DACEY: Just an elaboration on that, it's been somewhat clarified by Mr. Reger's questions. You do provide currently information to Treasury to eliminate intragovernmental-- So you do give adjustments for the intragovernmental accounts that would be necessary?

MS. TERZAK: We do the GFRS, like any other agency, and then during that process the eliminations occur, because we have to identify which specific agencies we do business with. We do work with them on a quarterly basis to do this new project that you undertook, which I grant is really good because it's focusing a lot on what we need to focus on.

MR. DACEY: Where necessary, accounts are adjusted so we can match up with the other. Or does Treasury know what adjusting entries they need to make to then match up and eliminate the intra-governmental amount?

MR. REGER: They provide all the documentation for all of those adjusting entries. Works very well.

MR. DACEY: Just a clarification, in the letter it suggested you were talking about presenting a second set of financial statements with intragovernmental accounts. I think our intention was simply to indicate the intergovernmental accounts that were different in the footnote, but you still think that might be confusing?

MS. TERZAK: To get to the footnote, you're going to have to do the accounting.

MR. DACEY: You would have to do it for Treasury anyway, so it's a question of --

MS. TERZAK: If you follow the FASAB standards, some of the standards differ from FASB. For us, that was

one of the questions I was asked to prepare. The listing would be, first of all we have a lot of differences in actuarial assumptions. What we follow for FASB is not for FASAB, and one big one is asset retirement obligations. There are some unintended consequences even though it may not affect our relationship with other federal agencies, the way we're accounting for some things could affect our bottom-line of our financials.

MR. DACEY: I'm only referring to the intergovernmental accounts, in which you have another party similar in the federal government to try to match those up so they can be eliminated.

MS. TERZAK: So we are doing that on a quarterly basis now and then through the GFRS package and then filing GTAS.

MR. DACEY: So your concern was that putting filing information in the note would be confusing to the readers, if it would be put in the notes in addition to the closing statement.

MS. TERZAK: The thing is that I said something about perception in the media. It's like why are two sets of financial statements out there? Which one is really correct? Which one is TVA trying to hide? Why are there two sets of books under the table? Again, that has a big effect on us in the market.

MR. SHOWALTER: We're not really suggesting two sets of statements. I understand that you have to create the set of statements to be able to get the adjustments. What we were talking about was reconciling items being in a footnotes, not a separate set of statements.

MS. TERZAK: But if they're in our financial statements, which are audited, it's going to have to be looked at.

MR. SHOWALTER: Just to confirm what Mr. Dacey said, how do you think your bond holders feel about having some strange looking information to them in the footnotes that they're not used to seeing? I think that's relevant.

MS. TERZAK: I spoke to one investor relations person, who said if an analyst is worth their salt, they're all going to start digging. Then it comes down to the question of which assumptions are more correct because as we know in accounting you can have different assumptions and both be correct. It's going to be which one is more correct. Do you follow the ones that are out that the general public is following, which, us being the only SEC filing from the federal government, puts us in the spotlight, versus FASAB?

MR. STEINBERG: I want to build on that too, because we've had several letters and testifiers interpret this that we were requiring the FASB reporters to convert

to FASAB. I'm looking at the sentence in paragraph 66, and it's pretty clear. It does say consolidation entries should consolidate component reporting entity or subcomponent financial statements consolidation entity prepared in accordance with FASAB 34 without conversion for any differences in accounting policies among the organizations. We're saying without conversion.

It does go on to say, nonetheless if they publish financial reports, they should disclose the intragovernmental amounts, and that I see as a footnote disclosure in which you describe that we follow FASB, but since we're an entity of the federal government and they have this thing called FASAB, the amounts that we report is owed to and owed from other entities are slightly different. I suspect in the amounts the differences are not going to be that different anyway.

I guess the question is if there are so many misinterpretations of this, do you have any suggestions for how we could clarify and say more clearly what people do not have to do?

MS. TERZAK: Well I guess I'm going back to the point if we put anything in the FASB statements for our auditors to opine on, they're going to have to go back and look through FASAB methodology. One example would be the Department of Labor. That would be an expense on our books.

They use different actuarial assumptions than we do. To get the FASAB number on that it would be another actuarial study, another opinion. Again, that's extra cost and not very efficient.

MR. STEINBERG: I don't think we are asking you to disclose the expense.

MS. TERZAK: Well, that's a related party, its liability and expense.

MR. STEINBERG: Right now they're getting it through the closing package.

PARTICIPANT: Who audits TVA, the closing packets?

(Simultaneous comments)

MS. TERZAK: Special purpose audit opinion from E&Y. They audit our crosswalk and make sure we have everything correct.

MR. REGER: So we collect the closing package audit report from all 35 significant entities and rely on that as the accuracy of the numbers that we combine.

MR. STEINBERG: Is the closing package audited?

MR. REGER: Yes. That is what I'm saying, for each of the 35 following.

MR. GRANOF: I am confused about something. Did I hear you say a moment ago that you would interpret this as - under the statement that TVA would now be a disclosure

organization, and yet all the discussion in the last few minutes has been on consolidation entity? What am I missing?

MR. REGER: No elimination. This stuff would be eliminating entries. She still has to give us the eliminating entries.

MR. ALLEN: For intragovernmental but not the other information for consolidation like they are now.

MR. REGER: They are currently a consolidation entity.

MS. TERZAK: We are in the budget.

MR. GRANOF: You are in the budget? So as far as the intragovernmental transactions, what sort of transactions are there?

MS. TERZAK: We sell electricity to DOD.

MR. GRANOF: Just the sale of power?

MS. TERZAK: No, in the Department of Labor we have workman's compensation.

MR. REGER: I don't know all it is but there are numerous transactions.

MR. GRANOF: I have to think about this, how the eliminations work. Let me ask you another question. You say that the bonds are not guaranteed by the federal government, and I don't know if you can answer this or not, but do you have a sense of whether the market thinks that

they are guaranteed? That is, compared to other comparable-- well, there are no comparable power companies-- but other power companies with the same rating, do you have a lower interest rate?

MS. TERZAK: I do believe we do. As far as how it affects Treasury bonds and things like that, our ratings are closely aligned to that by the analysts, the rating agencies, but they don't go one for one. There are some that will grade us a little higher at times.

MR. GRANOF: Presumably because they think maybe the government is with them.

MS. TERZAK: Then again, there are some ratings where TVA was higher than the federal government.

MR. DONG: I want to make sure I'm following all of the nuances of the discussion. Right now we're not proposing a conversion, but we're all arguing the hypothetical "if we were, this would be the impact", what we're not proposing.

MS. TERZAK: Except for the fact of putting that footnote.

MR. REGER: That was in our statements, not in yours.

MS. TERZAK: But "related parties", so as far as FASB, we have to disclose related party transactions.

MR. DONG: What is the change?

MS. TERZAK: If we have to go to FASAB --

MR. ALLEN: We were just building the defenses, don't make us change. We agree with-- don't change from what you've proposed.

MS. TERZAK: If we have to convert to FASAB again, some of the actuarial assumptions are different.

MR. STEINBERG: Now I am confused. You disclose the intragovernmental amounts in the footnotes using FASB or FASAB?

MS. TERZAK: FASB. That's what's on our statement.

MR. REGER: It eliminates them from hers with FASB. It gives us the numbers under FASAB, and we have to the corresponding eliminations in FASAB.

MR. STEINBERG: Our proposal says here they should disclose intergovernmental amounts mentioned in the courts with FASAB, which is different than what they're doing now.

MR. DACEY: No. There's no -- it would be different.

MR. REGER: You are not getting notes for her statements because she's doing them under FASB.

MR. ALLEN: Ms. Loughan, this is a good thing to bring up at our next meeting to make sure that we are clear about some of these things.

MS. LOUGHAN: You were accurate. I am agreeing with Hal.

(Laughter)

MR. ALLEN: Any other questions? We really appreciate you being here, and obviously you can see you've raised some interesting issues for us to focus on.

MS. TERZAK: Again, if there's anything else, please let me know. I did bring souvenirs.

MR. ALLEN: Thank you. Joseph is last and in wanting to make sure that the Board stayed awake has a presentation for us.

We welcome you. I did want to point out to the other Board members that contrary to what I said this morning where we ask everyone to limit their comments to no more than ten minutes, we were approached at the beginning of this process and asked for a two hour period of time, which we've corresponded back that we did not have. We needed to limit that to 30 minutes, but we were willing to have most of that 30 minutes be for his presentation. The presentation will be most of the 30 minutes. I would encourage if you can to end so that we can engage in this back and forth conversation if there's time to do that.

**Agenda Item: Joseph H. Marren - Presenting as a Citizen**

MR. MARREN: Absolutely. My name is Joe Marren. The views expressed today are my own and do not reflect the views of my partners at Kstone Partners or the firm. Before

I begin I also want to acknowledge Robin Blumenthal, Senior Editor at Barron's magazine, for her recent article describing accounting by the federal government and this public hearing. I believe that government corruption with respect to federal financial reporting will be a major news story in the near future, and I applaud Robin for being out front. In my remarks I will answer all of the questions posed to me by FASAB in the August 20th briefing materials. In addition, I should have a few minutes left over to answer some questions.

My remarks will focus on both the proposal and the larger picture of how FASAB pronouncements result in fraudulent reporting. I will also briefly describe why FASAB is an unconstitutional entity.

Our political leaders have subverted the democratic process to protect their self-interests. The Legislative and Executive branches have controlled financial reporting and thereby public opinion to minimize their accountability for spending. Current financial reporting, as well as the proposed rule, violate numerous private rights protected by our constitution. Also, in 2012, the Supreme Court decided the Obamacare case based on "financial facts" that are simply untrue.

The framework for my remarks was initially created for the Representation Without Accountability

conference held at Fordham Law School in 2012. Participants included David Walker, David Mosso, Professors Brian Fitzpatrick of Vanderbilt, Professor Sean Griffith of Fordham, and me. All presentations and a video of the conference are available at the Fordham website.

Just as fear and greed are the primary motivators on Wall Street, they heavily influence actions of our political leaders. To date, there have been no downside implications for the Legislative and Executive branches for fraudulent financial reporting. Politicians have spent enormous sums in an effort to endear themselves to their constituents. Fear of severe negative career consequences needs to be introduced into our leaders political calculus. Applying the rule of law will restore accountability.

Let's begin our analysis of the rule of law by focusing on our Constitution. All reporting must comply with the Statement and Account clause. It provides that "a regular Statement and Account of the receipts and expenditures of all public Money shall be published from time to time." The federal government is falsely reporting total receipts, total expenditures, and the resulting deficit. These three figures are not subject to the plenary power of Congress.

It is critical to note that there is no government report that complies with the Statement and

Account clause. The Combined Statement of Receipts, Outlays, and Balances is the official Statement and Account published by the United States government. It is cash-based. It is not known or used by the public, including the media, not central to any discussion of the nation's finances, and is not viewed as a major publication by any recent Congress or Administration. Because no report complies, several private rights protected by our Constitution have been violated, and most importantly, our democracy is completely dysfunctional.

The rights violated include the right to vote, freedom of speech, the right to political accountability, equal protection, due process, and the right to financial information. I have included one of the leading relevant Supreme Court cases next to each right violated. In all cases, there are multiple relevant cases. I have written extensively about these violations in articles published in Jurist, a web-based legal research site for the University of Pittsburgh's School of Law. I will briefly touch on a few of these.

"The Framers of our Constitution deemed fiscal information essential if the electorate was to exercise any control over its representatives and meet their new responsibilities as citizens of the republic." US v. Richardson is the only case related to the Statement and

Account clause to have reached the Supreme Court. It was not decided on the merits, but disposed of with respect to standing to bring the lawsuit. The lower court judge and Justice Douglas took the same view of the meaning of the Statement and Account clause.

Article II, section three requires the President "from time to time to give the 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 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 for the public as well as coordinate branches of government. It should be apparent to all that the Statement and Account is political speech that is critical to the functioning of our democracy.

FASAB's proposed rule is designed to influence voter's choices. "The Constitution confers upon voters, not Congress, the power to choose Members of the House of Representatives, and it is a very dangerous business for Congress to use election laws to influence voter's choices." The fact that Congress is using laws governing federal financial reporting to influence voter's choices

doesn't make it any less dangerous.

When you couple enormous off-balance sheet entities funded with public money and massive mandatory spending with inadequate financial reporting, accountability disappears altogether. Given this mess of financial reporting, voters have no idea what the level of expenditures are, and they cannot end the responsible representatives packing because they retired years ago. Their current representative stance is that their hands are tied and they cannot be held accountable for mandatory spending.

"Secrecy has, of course, some constitutional sanction. Article I, section five, clause three provides that each house shall keep a Journal of its Proceedings, and from time to time publish the same, except in such Parts as may in their Judgment require Secrecy. But the difference was great when it came to an accounting of public money."

I want to be very clear on this. I am not advocating either policy option of raising taxes or cutting spending. No attempt is made to assign blame for the current state of the nation's finances to any politician or any political party. The authority to suppress financial information related to national security matters is not being questioned. No commentary is made or intended about

the validity or need for any government program.

Quoting Mark Twain "It ain't what you don't know that gets you in trouble, it's what you know for sure that just ain't so. Let's talk about what "just ain't so", the President's Budget.

When you add up total outlays over the last decade, it comes to \$29.4 trillion. When you add up total revenues, they come to \$22.3 trillion, so the long division of outlays over revenues yields \$1.32. Under budget accounting, we're spending \$1.32 for every dollar of revenue we've taken in over the last decade. Please note that the GDP figure for 2012 was \$15.8 trillion, and that's before the BEA's recently announced adjustments.

Why are we here today talking about rules governing accrual accounting? It's because the government instituted accrual accounting because cash accounting is so bad. "The OMB and the Congressional appropriations' Committees have been unwilling to change the accounting basis of the federal budget to the accrual basis. The accounting underlying the President's Budget obfuscates federal fiscal accountability. It understates the headline numbers that dominate congressional and public discussion and for perceptions of the government's financial health.

That false picture nurtures financial profligacy. Cash basis accounting in the president's budget is the

spearhead of reckless fiscal policy.”

These comments were made by the former chairman of FASAB, David Mosso, at the conference at Fordham Law. I want to note here that I have tremendous respect for David Mosso and for FASAB’s Executive Director Wendy Payne.

Let’s take a moment to look at reported results using accrual accounting. All we’re doing on the schedule is adding to the budget deficit amounts, accrued expenses for federal and veteran’s benefits that are payable in the future. As a result, it increases the overall cost to \$1.42.

The Financial Report’s Balance Sheet indicates that the Liability at the end of last year was about the size of the nation’s GDP. Please note that the total assets were \$2.7 trillion, total liabilities almost \$19 trillion, and the Net Position a little more than a negative \$16 trillion.

In addition to these statements, the SOSI is a required statement in the Financial Report. The best way to think about SOSI is as the credit card that nobody wants to talk about. The schedule is basically the SOSI report, with the exception that I’ve added in Medicaid Somehow under FASAB rules Medicaid doesn’t qualify as a major social insurance program for financial reporting purposes even though when it finally revealed what the net present value

of the cost was, it was in the \$24 trillion range.

It is critical to note that SOSI does not interrelate with the other statements in the accrual based Financial Report. The only expense that is recorded in the financials is essentially cash outlays. This is called the "Due and Payable" approach. Everyone who has a credit card knows that the amount you spent in any given year is the amount you paid the credit card company, plus or minus the increase or decrease in your year-end balance. Please focus your attention on the bottom line of this schedule. You'll see these figures a little later. The government has also indicated that the SOSI amounts that are reported are substantially understated. I agree.

Now, I'll turn to how FASAB is an unconstitutional entity. FASAB was created because OMB claimed a constitutional issue. Chuck Bowsher, after his accounting reforms proposal was crushed in the mid-1980s, was unwilling to sue the Executive branch, and Congress was unwilling to use its power of the purse to stop the executive branch from poaching its responsibilities. So Bowsher decided to cut a deal. The deal that he cut, unfortunately, violates the separation of powers requirement in the Constitution. There are at least two court cases that I believe if this matter were litigated, a court would find that assertion to be true. I'd also tell you that for the 50 years that OMB has

been claiming a constitutional issue, if they really thought they had a proper legal position, they would have requested an opinion from the Office of Legal Counsel. They haven't done that, and they haven't done that for a reason.

Finally, there's a reasonable probability that the Supreme Court would rule that the 1921 Act's delegation of authority to the Comptroller General to make up accounting principles for agencies violates the requirement for passage of laws by Congress and presentment to the President.

FASAB's rules are also unconstitutional. Financial statements need to consolidate all entities that are funded with "public Money". That includes the Federal Reserve, Fannie Mae, and Freddie Mac. The full cost of the nation's social insurance programs also need to be included in those financials.

There are no exceptions for entities or programs funded with "public Money" that our politicians want to avoid accountability for by excluding them, putting them off balance sheet, or describing them only in footnotes. The standards promulgated by FASAB do not comply with the Constitution, and they also violate the anti-fraud provisions of the securities laws.

There is absolutely no discussion explaining how its principles comply with the "all public Money"

requirement. Furthermore, no matter how much AICPA GAAP compliant" lipstick FASAB puts on its accounting principles they still violate the United States Constitution.

How can I possibly allege that FASAB's accounting principles violate the anti-fraud provisions? Recently the Supreme Court reaffirmed the tests underlying the anti-fraud provisions in *Matrixx Initiative v. Siracusano*. Justice Sotomayor wrote the court's opinion in a 9-0 decision. In my estimation the anti-fraud provisions are inherent in the statement and account clause.

A government "of the people, by the people, and for the people" with an explicit provision in its constitution requiring the publication of a Statement and Account of the Receipts and Expenditures of all public Money does not need an anti-fraud amendment to that constitution requiring the federal government to publish truthful numbers. To a certain extent, Congress recognized the importance of the anti-fraud provisions by making the issuance of municipal securities subject to them.

Let's take a look at the municipal securities markets. The municipal securities market is very diverse, with close to 44,000 state and local issuers and with a total face amount of \$3.7 trillion. The Government Accounting Standards Board (GASB) establishes GAAP, which are used by many state and local governments.

The SEC lacks authority to prescribe standards in the municipal securities market. The securities laws were enacted with broad exemptions from municipal securities from all provisions, except for the anti-fraud provisions. Generally these prohibit fraudulent or deceptive practices by issuers including making any untrue statement of a material fact or omitting to state material fact necessary in order to make statements made not misleading.

Government pension funding obligations are front page news. Detroit's bankruptcy has focused the nation on the importance of this issue. Underfunding for state and other municipal government pension benefits may exceed \$4 trillion. Congress has focused on this issue and introduced legislation clearly intended to put pressure on states to clean up their pension issues so they do not end up on Congress' doorstep. In 2011, legislation entitled "Public Employee Pension Transparency Act" was introduced in Congress. The legislation would require states to report their pension finances and provide an express ban on federal bailouts.

The SEC formed a specialized group within its division of enforcement to focus on public pension accounting and disclosure violations. The SEC has brought actions against two states. Let's take a look at them.

In 2010, the SEC found that the state of New

Jersey violated the anti-fraud provisions in connection with the sale of over \$26 billion in bonds from 2001 through 2007. The state made material misrepresentations and omissions that created the fiscal illusion that its pension plans were being adequately funded and masked the fact that New Jersey was unable to contribute to the plans without raising taxes or cutting other services or otherwise impacting the budget.

As of June 30, 2009, the two largest pension plans had an unfunded actuarial accrued liability of \$27 billion. The SEC found that the information regarding the state's underfunding of the pension plans and their financial health was important to investors in evaluating New Jersey's overall financial condition and future financial prospects.

In 2013, the SEC found that in connection with multiple bond offerings, raising over \$2.2 billion from 2005-2009, the state of Illinois misled bond investors about the adequacy of the statutory plan to fund its pension obligations, and the risks created by the state's underfunding of its pension systems. As of 2011, Illinois' pension systems were underfunded by \$83 billion. In April 2012, the state acknowledged that unsustainable 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.

The SEC determined that reasonable investors would have considered information regarding the underfunding of Illinois' pensions, the risk 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 future financial prospects.

After reviewing these two cases, I can say with certainty that FASAB has hit the trifecta. The proposed Reporting Entity exposure draft violates the anti-fraud provisions. Disclosure by state and federal governments regarding Medicaid violates the anti-fraud provisions finally, federal financial disclosure related to social security and Medicare violate the anti-fraud provisions.

Let's start with the Reporting Entity. The Federal Reserve, Fannie Mae, and Freddie Mac have total assets of \$3.3, \$3.2, and \$2.0 trillion. They are material to the 9/30/2012 balance sheet with total assets of \$2.7 trillion. Reasonable investors in government securities, and for that matter voters, would view the availability of consolidated information as significantly altering the total mix of information available regarding the nation's

financial prospects.

Let's take a look at Medicaid. No state or the District of Columbia records the full costs of its share of Medicaid costs in its income statement or balance sheet. Between 2005 and 2008, federal contributions averaged 57 percent and state contributions averaged 43 percent. Based on the \$26.1 trillion federal government obligation recorded in the 2012 Financial Report, the 50 states and the District of Columbia aggregate net present value obligation for Medicaid is \$19.7 trillion. Both the \$26.1 and the \$19.7 trillion figures are significantly understated. The details are in the memo I submitted.

Omitting the disclosure of material facts clearly violates the anti-fraud provisions as a matter of law. All states and the District of Columbia have inadequate financial disclosure regarding an aggregate Medicaid obligation that at approximately \$20 trillion is over five times the size of the \$3.7 trillion municipal securities market or the \$4 trillion pension underfunding issue.

The top 12 states account for two-thirds of Medicaid spending, and therefore in all likelihood, they will account for two-thirds of the present value cost of the future obligation. I have done some rough estimates. The state of New York's obligation exceeds \$3 trillion. California's is about \$2.5 trillion. Texas and Pennsylvania

have an obligation exceeding \$1 trillion. The total again is \$19.7 trillion.

Let's take a look at reporting by the federal government on the Medicaid issue. In the Required Supplementary Information, in the back of the 250 page 2010 Financial Report was a \$24.2 trillion net present value cost for the Feds for Medicaid. Under the Supreme Court's "buried facts" doctrine associated with the anti-fraud provisions, this practice is a clear violation. Prior to 2010, the federal government had never published in any financial statement any estimate of the net present value cost of Medicaid. CBO presented long term Medicaid projections for the first time in November 2007. The Medicaid program has existed since the 1960s.

Finally, let's take a look at Medicare and Social Security. The net present value cost of Medicare and Social Security has been reported in the SOSI for many years. The total adjusted cost for both as reported in the earlier slide was \$48.5 trillion. However, SOSI does not interrelate with the other financial statements. Reasonable investors in government securities, and for that matter voters, would clearly consider interrelated information as significantly altering the total mix of information available regarding the nation's future financial prospects.

What happens to the government's Statement of Net Cost when you add in all the costs associated with our social insurance obligations? Adding all social insurance costs the Feds spent almost four dollars for every dollar of revenue taken in over the last decade. Just to be clear: over the last decade using understated, incomplete estimates of federal government spending, they've spent over \$88 trillion when it has taken in a little more than \$22 trillion.

Turning to the Balance Sheet, when you add the present value of all social insurance obligations to the Balance Sheet, our total net obligation rises to \$91 trillion. This is almost six times the size of our GDP.

In the exposure draft, FASAB thought it appropriate to ask numerous questions. I thought I might use this approach as well. What do you think the electorate's reaction will be if they learn that the government's financials are fraudulent? Have responsible federal officials committed a "high crime or misdemeanor" under our Constitution by publishing fraudulent financials? What do you think Congress' reaction will be if the electorate holds them accountable? Who are they going to throw under the bus? Are all those that aided and abetted in fraudulent financial reporting likely to be afforded immunity from criminal/civil litigation? Have the litigants

and their lawyers in last year's Obamacare case on the Medicaid issue committed a fraud on the U.S. Supreme Court? What type of budget and debt ceiling compromise can be reached this fall if the Congress and the President continue to use fraudulent figures?

Quoting James Madison, "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." We have reached the stage where federal financial reporting is both a farce and a tragedy. FASAB is an unconstitutional political creation that is incapable of making correct decisions regarding proper accounting for the Feds. The Supreme Court is our only hope for returning the government's financial reporting to the requirements called for in our constitution. Once all parties must deal with the truth, the hard political choices will be made to put our finances in order. In closing, my hope is that you view my remarks as being in keeping with the Jesuit tradition of searching for the truth in the world even if that truth is not what you'd like to find. Thank you for the opportunity, and I'd be happy to answer questions.

MR. GRANOF: All of the information that you've presented is in the public domain.

MR. MARREN: It is right out of the Financial Report of the United States government.

MR. GRANOF: Exactly, it's all in the public domain. The empirical evidence, the academic evidence is overwhelming. That when information is available in the public domain, users of financial statements incorporate it into their decisions. The question is this, why don't you believe-- or to put it another way, what decisions do you think will be affected if indeed the government were to consolidate all of this in one financial statement? The related question is what studies have you relied upon to indicate that this notion of the public incorporating all available information is inappropriate?

MR. MARREN: I guess I have several reactions. What jumps to mind is a circumstance where someone in the private sector has published fraudulent financials and is in front of the SEC. What I would tell you is you don't get to ask that question in front of the SEC. The only question is are the financials right or not. That's number one.

The next reaction that I have is related to the Constitution. The bottom line is that unless the feds put financial reports together that are consistent with the requirements of the Constitution, it is violating all of those rights that I enumerated. If we get to a point where the Supreme Court determines that federal financial reporting is fraudulent and is violating those rights, the government is going to have to put out correct financial

statements.

MR. GRANOF: Let me make one comment, and that is to say that the reason that is not consolidated, and the reason we don't consolidate social security and social insurance, is not because we're unaware of it. It's because a group of accounting experts believe that constitutes the most appropriate financial reporting.

MR. MARREN: I don't disagree with your statement whatsoever. Unfortunately, I think it is in direct contravention to the Constitution of the United States. The Constitution of the United States is crystal clear. If it's funded with all public Money, it has to be in the financial statements.

MR. GRANOF: It is in the financial statements. The Constitution does not use the word "balance sheet".

MR. MARREN: Hence, that is why I made the point this will get resolved ultimately at the Supreme Court. In terms of the financial reporting requirements FASAB is slicing the apple so many ways and so many times that I think a court of law will come to a different conclusion than you do.

MR. GRANOF: They would overrule accounting experts?

MR. MARREN: Yes, because it does not comply with the Constitution.

MR. ALLEN: Let me ask another question. Obviously I'm not going to defend what we've done or not done. Obviously we wouldn't be here if we didn't think we were contributing to the information. That's why most people serve on this board, all people serve on the board. You in the written comments made some comments about the American Institute of Certified Public Accountants, or the AICPA, which is the organization that decides whether we can set generally accepted accounting principles.

I think that's consistent with Mike saying if they looked at it, they looked at the process, and they've made that determination we are sufficiently independent to set those standards. You pointed out part of the challenge of them arriving at that point, and you actually quoted the then chairman of the AICPA when that was granted and made a comment that, and I paraphrase because I can't remember exactly the quote, but the paraphrase was that we acknowledge there are potentially some challenges to independence based on this structure. Nevertheless we grant GAAP authority because we believe that is in the best public interest to get this information out.

Whether it's out in the right form by having a separate statement of social insurance versus including it in the balance sheet are issues that this board has debated for probably over half of its existence. We've had at least

three major projects and other discussions about how to best account for and treat. As you well know, the opinions around this table vary in how best to treat that information. I guess I would ask you, would you disagree-- you're very critical of the AICPA, and it seemed like what they were doing was being open. Yet, they were saying in the broader public interest for information, we grant that GAAP authority. I'm curious as to somebody who believes in broad, public information, why you would then attack them in that process?

MR. MARREN: I guess I have multiple reactions to your questions. First of all, I indicated in the list of questions that those that aided and abetted in the publication of fraudulent financial statements might have a concern about criminal or civil liability. I think that's on the table. I suspect. I don't know. I'm not going to give anybody legal advice, but if in fact the Supreme Court of the United States determines that the federal government is publishing fraudulent financial statements, I suspect it's not in the AICPA's interest to have backed the group that helped promulgate standards that created fraudulent financial statements.

MR. ALLEN: If they don't reach that conclusion--

MR. MARREN: If they don't reach that conclusion, then we just have terrible accounting. One of the things

that I think-- we all have very smart people here. You can disagree with almost every point that I've made. This is a financial train wreck. For people in the government that are just used to having things go on and on, it will. In the private sector, things actually go bankrupt. There is a bad ending to things, and we are clearly headed there.

MR. ALLEN: I guess one of the things that this board supported though didn't do-- this actually comes from the Treasury Department itself-- is their attempt to try and broadly try and get that message out to all citizens. This is a specific guide to citizens of the United States. It's a guide that you can go online and any of the sponsor agencies probably and find that-- it makes a very clear statement here within this that we are not on a sustainable path.

Our projections of obligations far exceed our projections of revenue and we need to make some changes. The fact that Congress maybe hasn't acted on that is not, I don't believe, the responsibility of the agencies themselves who published this information or of our board who tries to get that information, financial information, out.

MR. MARREN: I would agree with the concept that it is Congress' responsibility to publish an accurate Statement and Account. That is clearly defined in the

Constitution. It's not necessarily your job or anyone else's job. Congress has got to get that done. They're not getting it done.

MR. ALLEN: That seems to me the focus of-- go ahead and take it to the Supreme Court. That'd be great, but it's--

MR. MARREN: I'm not leading the charge on it. I'm not filing a lawsuit--

MR. ALLEN: That ought to be the focus, which would be Congress with the responsibility or not, not these other parties, such as us, who tries within the confines that we have to get this information out.

MR. MARREN: There's one other comment that I want to make. I was thinking ever since we had a little chat earlier today and it relates to FASAB. I have seven children. Several of them are here. My wife's here. I've had the good fortune to teach a little bit at different institutions. I know we've got a number of academics on-board here as well. One of the things that is absolutely true is if you take a test and the test is 20 percent multiple choice and 80 percent allocated to essays and you get all of the multiple choice test questions correct and you get all the essay questions wrong, you failed.

What I would tell you is that from my perspective, FASAB is focusing on getting the 20 percent

right that they can get right, and they're getting all the big issues wrong, every single one of them. If you don't start addressing the big problems, you're never going to get anywhere.

MR. ALLEN: I appreciate that, and I appreciate you coming to testify. I enjoyed the read, though it was long. It provided some good historic information for me. Thank you. We appreciate it, and we will adjourn the public hearing.

(Whereupon, the meeting adjourned at 4:02 p.m.)