

Is the Federal Accounting Standards Advisory Board Independent?

Can the Federal Accounting Standards Advisory Board Be More **Independent?**

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Is the Federal Accounting Standards Advisory Board (FASAB) Independent?

FASAB was created (as its name implies) as a federal advisory board. At its inception in 1990, federal employees dominated the board and three principal sponsors—the director of the U.S. Office of Management and Budget (OMB), the Comptroller General of the United States representing the U.S. Government Accountability Office (GAO) and the Secretary of the Treasury—initially retained the power to veto financial reporting policies recommended by the board. In part, this structure was designed to resolve constitutional issues concerning the prerogatives of the executive and legislative branches of the federal government. While public members could participate and potentially influence the outcomes via collegial, reasoned arguments, the federal government retained the final say over federal financial reporting requirements. One result of this structure was that (in at least one case), the board did not include certain solutions to an issue in a standard because it knew those solutions would lead to a veto of the standard by one of the principals. For example, OMB was openly opposed to explicitly disclosing and labeling a closed group dollar amount for Social Insurance. As a result, that option was not seriously considered as part of what became SFFAS 17. This sort of self-censorship was a natural result of the structure of the board and its processes. FASAB operated under this structure for over nine years.

In addition to the ability of the principal sponsoring federal agencies to veto policies at FASAB, the U.S. Department of Defense (DoD) was also able to exercise near-veto power with respect to a variety of issues relating to financial reporting for specialized defense situations. For example, for a number of years DoD repeatedly opposed depreciation of what the FASAB described as National Defense Property Plant and Equipment. As a result, FASAB did not produce a standard requiring depreciation for such items. Only when a new head of DoD with a stronger business orientation arrived did DoD change its view; and only then did FASAB produce a standard that required depreciation of many DoD weapons-related assets. This deference of the board to DoD seemed to be due to the fact that the DoD appeared to have many power-

ful allies in Congress who might be willing to provide financial reporting exemptions for DoD or bring into question the continuing role of FASAB in issuing financial reporting standards. Thus, federal members' interests clearly dominated FASAB proceedings through the late 1990s; by design, FASAB was not independent of the federal government financial report preparers.

In 1999, FASAB sought and received designation from the American Institute of Certified Public Accountants (AICPA) as the generally accepted accounting principles (GAAP) standards-setter for the federal government (Rule 203 status). One of the major concerns of the AICPA in reaching this endorsement was the real and perceived independence of FASAB. To try to accommodate those concerns, FASAB was eventually restructured to have a majority of public members, at six, and four federal members. Although veto power was retained by OMB and GAO, the AICPA indicated that if the veto power was ever used it would most likely rescind the FASAB's status as GAAP standards-setter. The AICPA also said that it would periodically review FASAB to see if GAAP status should be retained. The last review was in 2004; the next review is scheduled to begin in late 2009 and be completed by May 2010.

Although no explicit veto by a FASAB principal has occurred in the period since FASAB received Rule 203 status, other indications of impaired independence are evident. The federal government continues to dominate FASAB by threats of veto, selection of board members and budget control/oversight management. This domination constitutes a continuing threat to the independence of FASAB.

The most controversial federal financial reporting issue in the last 10 years has been Social Insurance. It has been considered and reconsidered by FASAB since at least the late 1990s. As part of this process, in May 2006 the board voted 6 to 4 to proceed with an Exposure Draft that included a provision that some part of Social Security beyond the 'due and payable' amount would be recognized on the federal balance sheet as a liability. All six public members of FASAB voted in favor; all four federal members voted against. This vote demonstrates a substantive policy split within the board. An important question related



to FASAB independence is how the principals responded to this split.

During the March 2006 board meeting, while discussing the apparent intention of a majority of FASAB members to propose accrual of some amount of Social Insurance liability on the balance sheet, the FASAB Treasury representative said that he "did not think the board could survive having it go the way it is." (See FASAB meeting minutes from March 2006.) The direct implication of this comment is that if one wanted the board to survive we ought "to take another look at the issue." This reconsideration was proposed even though the board had considered and reconsidered the topic for several years. We believe that this kind of comment impaired the independence of the board by suggesting that FASAB would cease to exist if the 'proper' solution was not reached.

In addition, while discussing the Social Insurance reporting issue directly with the board at the May 2006 FASAB meeting, the Comptroller General (CG) said that "the last thing in the world that I want is for a veto to be made on a standard...I hope it never happens, but feelings on this are pretty strong." The logical inference from this comment is that while the CG didn't really want to veto a Social Insurance standard, he would be willing to do so. While a veto is within the legal rights of the CG (and the OMB director), we believe that this kind of comment is a threat to the existence and independence of the board. A more subtle danger is that board members may be subject to self-censoring in anticipation of a potential veto or pressure by a principal to ensure that FASAB survives.

FASAB continued to deliberate the Social Insurance reporting issues after 2006. In the interim, one public board member retired after 10 years of service and, although no formal board member evaluation criteria or process existed, another public board member was not renewed after a single five-year term. This was the first time that a board member had not been renewed. In subsequent votes on Social Insurance reporting, the board deadlocked with votes of 5 to 5. While apparently no Social Insurance litmus test was applied in the new board member selection process, the fact that two demonstrably pro-Social Insurance liability votes were replaced (one apparently prematurely) certainly

gives the impression that the membership selection/retention process might have been used to avoid the possibility of FASAB passing a standard requiring accrual of a substantial Social Insurance liability. This outcome obviated the need for a 'smoking gun' veto that would have unambiguously indicated the board's lack of independence to the AICPA. This perception is exacerbated by the fact that both of the two new appointees had previously represented OMB on FASAB. While both of the new appointees are experienced and thoughtful, their views on federal financial reporting surely would have been shaped by their federal employment experience. Thus, the federal government's influence on FASAB extends well beyond its four official members. These appointments have caused some outside observers to question the independence of the board. For example, the CEO of the Institute for Truth in Accounting said at an April 2009 FASAB public hearing: "This seems like a form of jury tampering."

Another issue where the inordinate influence of central federal agencies was revealed involves a FASAB standard on fiduciary activities that was passed after several years of due process deliberations. Near the end of the sponsors' review period, OMB took a number of steps to request a last-minute meeting for FASAB to reconsider the content of the fiduciary standard. It also arranged for a change in the Memorandum of Understanding (MOU) so that the principals' review period would be doubled in length. These actions create the appearance that OMB was interested in reversing a majority position of the board even after the board's extensive due process deliberations had ended. Although these actions are within the technical rights of OMB, and differ from a threat to veto a standard, it does suggest that OMB was willing to take extraordinary steps (not available to public members) to overturn a majority position. We believe this disparity in power and prerogatives also constitutes a threat to FASAB's independence.

We believe the examples provided above reflect the impairment of FASAB's perceived and actual independence. Federal members have made it clear that they do not intend to yield sovereignty to FASAB and that they will act to prevent implementation of Standards and Concepts Statements that they fundamentally do not agree with. They have a number of methods

available to reach this end, short of actually vetoing a standard passed by the board. Domination of the FASAB process by federal members is incompatible with board independence. As a result, even though the individual public board members may be independent in spirit, the overall board is not independent.

Can the Federal Accounting Standards Advisory Board (FASAB) be More Independent?

Some might argue that because the federal government holds veto power over FASAB decisions (even if AICPA-constrained) it is impossible for FASAB to be truly independent. However, even if the federal government declines to relinquish sovereign power concerning the federal financial reporting standards, it may be possible to make FASAB more independent than it is now. The key would be to reduce the current domination of the board by the federal government, rather than relying on the continued forbearance of its federal members.

One step in this direction occurred in mid-2009. Although the Congressional Budget Office (CBO) has not had veto power over FASAB, it is a federal organization and has been a voting member of FASAB. Due to budgetary restrictions, it is giving up its seat on FASAB in October 2009. Assuming that the board size is reduced to nine and that another federal board member is not added as a replacement for CBO, this will leave a net of six public members and three federal members on the board. This change may make it easier for public members to assert their numerical majority if they happen to share a common position. At least one time in the past, a 6 to 4 vote, with public members in the majority, was not viewed as sufficiently strong a position to proceed with a Social Insurance Exposure Draft; a Preliminary Views document was substituted instead. Perhaps a 6 to 3 vote might be enough to proceed on difficult issues with a public versus federal member split.

FASAB is currently constituted to have direct representation of central federal agency points of view on the board. Another approach to making FASAB more independent could be to make the FASAB-federal government relationship more like the relationship

between the Financial Accounting Standards Board (FASB) and the Securities and Exchange Commission (SEC).¹ While the SEC clearly has the statutory authority to overrule FASB concerning financial reporting issues for publicly traded firms, and has, in fact, exercised that authority on occasion, it does not have FASB board members explicitly representing the SEC point of view. Also, although the SEC is an important participant in the FASB's processes, its influence is generally less direct than in the case of the federal influence on FASAB's processes. The knowledge of those with extensive federal financial reporting experience should always be an important part of the federal financial reporting concepts and standards process. However, reducing the federal members' percentage of votes on the board could increase independence by lessening the direct dominance of the process and outcomes by federal employee board members. This could be achieved, for example, by reducing the number of federal members to two, one from the executive branch (OMB or Treasury) and one from the legislative branch (GAO). This suggestion may be unpalatable to central federal agencies, but is less radical than having the executive and legislative branches give up veto power over FASAB outputs.

Another step that might help reduce federal dominance would be to reduce the role of the federal principals in the selection of the FASAB board members and chairman. Perhaps the Financial Accounting Foundation could play a central role in this process. This step would at least reduce some of the perceived lack of independence of FASAB. This could be a difficult step for the federal government in that it would be equivalent to giving up some sovereign control of federal financial reporting standards.

Although FASAB deals with important financial reporting issues for federal agencies and for the government as a whole, it has been unable to attract much participation in its due process from people other than federal employees or CPA firms that audit federal units. While these are important sources of information about the likely costs of implementation of standards and the potential usefulness of financial reports for internal users, too often the board is left without evidence from outsiders who might benefit from FASAB standard-based information. The board would be

well served by a major increase in its outreach programs so that nonfederal participants' points of view can be discovered and considered publicly. This would require a significant increase in funding from the federal sponsors, a difficult step in an era of tight budgets.

Conclusion

Unless changes are made to make FASAB more independent, the federal government should not continue to assert that FASAB is independent in the AICPA sense. If FASAB is not going to be a more independent body, perhaps it would be better to save the government some money and revert to federal government employees setting federal reporting standards as they see fit. Or, if nonfederal board members are to be retained as advisers, it would be appropriate to explicitly acknowledge that their role is strictly advisory, and that the board is not an independent standards-setter. This would be equivalent to reverting to FASAB's standing in its first 10 years of operation. ■

End Note

1. Note that some observers (e.g., Mosso, *CPA Journal*, July 2009, pp. 6-10) have questioned whether FASB is truly independent. Our point here is that FASAB is even less independent than FASB.

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