

National Association of State Auditors, Comptrollers and Treasurers

EXECUTIVE COMMITTEE OFFICERS

President
VERN L. LARSON
State Treasurer
South Dakota

First Vice President THOMAS H. McTAVISH Auditor General Michigan

Second Vice President GLEN B. GAINER, III State Auditor West Virginia

Secretary NANCY K. KOPP State Treasurer Maryland

Treasurer
BARBARA J. HINTON
Legislative Post Auditor
Kansas

EXECUTIVE DIRECTOR

R. KINNEY POYNTER Lexington, Kentucky

CONTACT INFORMATION

Headquarters Office 449 Lewis Hargett Circle Suite 290 Lexington, KY 40503-3590 (859) 276-1147 Fax (859) 278-0507

Washington Office 444 N. Capitol Street, NW Suite 234 Washington, DC 20001 (202) 624-5451 Fax (202) 624-5473

www.nasact.org

32

LETTER OF COMMENT NO.

Teresa S. Polley Chief Operating Officer Financial Accounting Foundation 401 Merritt 7 Norwalk, CT 06856-5116

Dear Ms. Polley:

February 8, 2008

On behalf of the National Association of State Auditors, Comptrollers, and Treasurers (NASACT), I am pleased to provide you with our comments on the report entitled *Proposed Changes to Oversight, Structure, and Operations of the FAF, FASB, and GASB*, which was prepared by the Financial Accounting Foundation's (FAF) Special Governance Committee. We agree that operations of the FAF, and both of the standards-setting boards under its jurisdiction, the Financial Accounting Standards Board (FASB) and the Governmental Accounting Standards Board (GASB), should be reviewed periodically.

We believe this is an appropriate time for a review given the momentum toward acceptance of international accounting standards. However, it is in many ways difficult to address some of the proposed changes contained in the report without a clearer understanding of FASB's role in the future. For example, if international accounting principles are established by the International Accounting Standards Board (IASB) and adopted by public companies in the United States, what impact will this have on the role of the FASB? Whether the FASB essentially goes out of business entirely, serves in an advisory capacity to the IASB, or serves in a much reduced capacity from its present day form, we believe it is safe to assume that substantial change is on the way. The real question is not "if," but "when."

For this reason, it is difficult to respond with any certainty to some issues raised in the report pertaining to the size and composition of the FAF. For example, if the FASB's future role is reduced to establishing accounting principles for only privately held companies or not-for-profit corporations, is it reasonable that such a disproportionately small number of representatives from government, only three, should serve on the FAF? Should the FASB's role be greatly diminished in the future due to IASB's increased role in the convergence of international accounting principles, we believe that the FAF should have considerably more representation from state and local government. Carried to an extreme, GASB might ultimately be the only standard-setting body under the FAF. If this were to happen, more dramatic changes to the FAF governance model would need to occur than those addressed in the report.

With this level of uncertainty surrounding international convergence, and its impact on the FASB in mind, we address the specific proposals that impact the GASB.

Nomination and Election of Government Trustees

FAF proposes to expand the breadth of individuals and organizations that are invited to submit nominations for the FAF Board of Trustees, with the understanding that final authority for all appointments rests solely with the Board of Trustees.

We disagree with this proposal, specifically as it relates to the selection of the three government trustees. First, regarding the number of organizations that are invited to submit nominations, the current process for nominating government trustees allows for potential trustees to be nominated by nine major government organizations representative of both the state and local levels of government and the executive and legislative branches of government. We believe this process adequately covers the landscape. If the intent of this proposal is to address needs of citizen user groups, we believe these needs are more appropriately addressed through the "user" seat which already exists on the GASB.

Second, we disagree that the final authority for all appointments should rest solely with the Board of Trustees. The process for appointing government trustees was one of the essential elements of the agreement that created the GASB in 1984. The 1984 "structural agreement" was carefully crafted to ensure that state and local governments are adequately represented on the FAF. The ability for NASACT and the Government Finance Officers Association (GFOA), after consultation with the "Big Seven" public interest groups, to serve as "electors" of the government trustees, was a key component of the agreement then, and it remains critical today. State and local governments must be adequately represented on the Board, and this process provides a mechanism that the state and local government organizations believe is fair and reasonable.

Further, NASACT expressed its strong objection to the FAF in March 2007 (letter to Bob DeSantis, FAF, March 30, 2007) pertaining to any involvement by the U.S. Securities and Exchange Commission in the appointment or reappointment of government trustees. Given that states are recognized as sovereign units of government, the SEC should not be in a position to directly, or indirectly, select the government trustees that oversee the operations of the GASB.

SEC involvement is implicit in the proposal, whereby final authority for future appointments to the Board of Trustees would rest solely with the Board of Trustees, a body of which all but three members are currently vetted by the SEC per a procedural change occurring in March 2007.

As you know, the FAF has requested that the nine government organizations renegotiate the 1984 structural agreement. NASACT and GFOA are currently working with the FAF on this renegotiation. Until that effort has come to completion, NASACT believes that the current process of appointing the government trustees of the FAF should remain in place. We look forward to continuing the renegotiation process.

Trustee Terms of Service

The FAF proposes to change the term of service for trustees from two three-year terms to one five-year term. We can support this proposed change. However, we further recommend a requirement be added to stagger the terms of the trustees to control the number of new members in a given year. In establishing the appropriate manner in which to stagger the terms, the Board of Trustees should also consider the expertise of the members to ensure that there is sufficient continuity from year to year in the various areas of expertise. For example, we recommend that the terms of the three governmental trustees are staggered to ensure they complete their terms at different times.

Size of Board of Trustees

The FAF proposes to change the size of the Board from 16 members to a range of 14 to 18 members. Our previous comments regarding international convergence notwithstanding, we do not consider this change to be necessary. If the Board is concerned with being able to react to a changing environment, a staggering of the trustee terms would allow the replacement of individuals with the necessary expertise in a timely fashion. We suggest the use of consultants to instruct existing Board members as a way to mitigate any lack of expertise on the Board until such time as a vacancy on the Board occurs.

We also find the proposal to potentially increase the size of the Board to 18 to be inconsistent with the recommendation to reduce the size of the FASB from seven to five. The suggested reduction in the size of the FASB seems to acknowledge the likelihood that international convergence will reduce the role of the FASB and, if this is the case, it would seem to follow that the size of the Board would also decrease.

Enhanced Governance and Oversight

We support the proposal for the trustees to take a more active oversight role as to the efficiency and effectiveness of the standard-setting process. We believe this would be particularly valuable in monitoring agenda setting and in reviewing the GASB's responsiveness to constituents' comments and concerns. In addition, given the GASB's funding problems (discussed below), we suggest that trustees take a more active role in ensuring the proper linkage between the size of the GASB's budget and its technical agenda. As described later, we also believe the Governmental Accounting Standards Advisory Council (GASAC) should serve in a more active capacity in reviewing topics and issues for GASB's technical agenda.

While we support a more active oversight role by the trustees, we do not believe the trustees should interfere with the independent standard-setting processes of either the GASB or the FASB.

GASB Funding

We support a stable funding model for the GASB, one that provides it with adequate funding to carry out its role as the independent standard-setter for state and local governments. Since 2002, when the FAF decided to stop accepting contributions from certified public accounting firms and reallocated additional indirect costs to the GASB, NASACT has taken a variety of actions to address the GASB funding problem. NASACT has worked closely with GFOA, the National Association of State Treasurers, and the other major state and local government organizations to achieve adequate funding for the GASB. However, finding a solution under a variety of *voluntary* funding models has been very elusive.

NASACT acknowledged the problems associated with the voluntary funding approach in its letter to the FAF on June 29, 2007, in which we stated, "The voluntary nature of these programs makes it difficult to mount significant collection efforts. It may be time to discuss options for mandatory funding and to develop a methodology that protects the sovereignty of state governments consistent with the Tower Amendment concepts."

However, in that same letter we suggested a more rigorous review by the FAF of the GASB's budget. We are concerned that GASB's expenses continue to increase despite the existence of significant deficits. Accordingly, we believe the GASB's budget should be reduced as part of a multi-faceted solution to the overall funding problem.

As you know, the FAF approached NASACT and the other major state government organizations in December 2007 and requested that state governments take primary responsibility to fund the GASB. FAF argued correctly that states are sovereign units of government and have the responsibility to determine generally accepted accounting principles in their respective jurisdictions. In many cases, a state comptroller or state auditor has this specific responsibility either through state statute or regulation, and in some cases, also has the responsibility to determine the appropriate accounting principles for various local governments. In all cases, states have designated this responsibility to the GASB.

NASACT is currently working with state and local government organizations to arrive at a satisfactory funding model. Funding through a non-mandated process is our first choice. However, as we stated in June 2007, if a satisfactory voluntary model cannot be developed and agreed to, we believe it may be time to discuss options for a *mandatory* model that acknowledges and protects the sovereignty rights afforded state governments.

GASB Current Size, Term Length, and Composition

We agree with the FAF's proposal to retain the GASB's current size, term length, and composition

GASB Chair - Technical Agenda

The FAF proposes that the GASB chair have the decision-making authority to set the GASB's technical agenda. We understand that this is a change that is considered "best practice" in the corporate environment.

We disagree with this proposal and do not believe this should be considered a "best practice," at least not in the public sector. Governments are intended to be participatory, inclusive, and transparent. Having one person solely in charge of the technical agenda would, in our opinion, place too much authority in the hands of the chair and serves to effectively dilute the input of not only the other six board members, but also the GASAC. We believe the agenda-setting process should continue to be determined by a majority vote of the GASB. Further, we believe the GASAC's role should be strengthened to include more authoritative input into the topics and issues that are ultimately placed on the technical agenda.

In closing, NASACT was instrumental in the creation of GASB in 1984, and we remain committed today to maintaining an independent standard setting process. We recognize that change is inevitable, and in many cases, desirable. We are watching with great interest the progress on convergence of international accounting standards and the direct effect this might have on the FASB, and indirectly, on the composition and role of the FAF.

We hope our comments are useful to the FAF as it examines the issues and recommendations outlined in the Special Governance Committee's report. Should you have any questions about the comments contained within this letter, please contact Kinney Poynter, NASACT Executive Director, at (859) 276-1147 or me at (605) 773-3378.

Respectfully,

Vernon L. Larson

President of NASACT, 2007-08 State Treasurer, South Dakota

cc: NASACT Executive Committee

NASACT Government Accounting and Market Oversight Committee