Federal Accounting Standards Advisory Board

August 5, 2011

Memorandum

To: Members of the Board

From: Melissa L. Loughan, Assistant Director

Wendy M. Payne

Through: Wendy M. Payne, Executive Director

Subj: Federal Entity- **Tab B1-Federal Entity**-(1st Distribution contains resolution of June meeting issues, 2nd Distribution will be on the next phase--Component Entity)[1]

MEETING OBJECTIVES

- To review staff recommendations and approve resolution of government-wide reporting entity open issues from the June Board meeting.

The primary objective for the August Board meeting is to review staff recommendations and approve the staff proposed language for the consolidation of FASB-based information without conversion and the revised language required disclosures about non-core entities', specifically incorporating an example for referring to separately published financial statements. In addition, staff also ensured consistency in language regarding how we present entities included in the report versus those consolidated as a core entity. Specific questions related to these objectives are included on pages 6 and 9 of the Staff Issue Paper.

BRIEFING MATERIAL

- ***Staff Issue Paper (beginning at page 3 of this memo)***
- ***Appendix 1— Draft Exposure Draft***

You may electronically access all of the briefing material at http://www.fasab.gov/board-activities/meeting/briefing-materials/ .

[1] The staff prepares Board meeting materials to facilitate discussion of issues at the Board meeting. This material is presented for discussion purposes only; it is not intended to reflect authoritative views of the FASAB or its staff. Official positions of the FASAB are determined only after extensive due process and deliberations.

BACKGROUND

As you may recall at the June 2011 meeting, the Board reviewed options for related parties in the context of the federal government. However, the Board did not come to agreement at the June meeting on this issue because some questioned whether the category was needed. Staff was requested to incorporate the revisions and suggestions agreed to by the Board into the related party language. The Board will determine at a later date if the related party issue will be addressed in the entity project.

The Board considered issues regarding consolidation of information from entities having different fiscal year ends, consolidation of FASB based information for core entities, and disclosure of information relating to non-core entities. The Board agreed to the following regarding the consolidation issues:

- remain silent regarding the consolidation of core entities with different fiscal year-ends.
- consolidation of FASB and FASAB based information is acceptable in the government-wide statements with disclosure of material differences in methods used or policies for specified amounts. However, no reconciliation of the differences between the two GAAP based amounts would be required.
- approved the wording for the basis of accounting for non-core entities, however the Board requested staff revisit the wording of the required disclosures for non-core entities.

The Board also considered a staff developed draft illustration guide with example entities. The draft guide was intended to demonstrate how the proposed standard would be applied and, for two of the example entities, the draft guide included different scenarios to illustrate how a change in circumstances can lead to a different outcome. Board members agreed with the decisions illustrated in the draft guide and offered suggestion.

For the August meeting, the Board requested staff to:

- develop revised language for the consolidation of FASB statements
- revisit the required disclosure for non-core entities to incorporate a reference to the financial information as an example of an option
- review ED for consistency in language.

NEXT STEPS

After receiving the Board's feedback, staff will assess if any open issues remain (other than related party) on the government-wide section of the ED. Staff continues the process of finalizing the basis for conclusions and other standards areas. The complete government-wide portion of the proposed standards will be available at the next meeting.

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If you have any questions or comments or would like to provide feedback prior to the meeting, please contact me by telephone at 202-512-5976 or by e-mail at loughanm@fasab.gov.

Staff Issue Paper
August 2011 Board Meeting

At the June meeting, it was agreed that staff would

- develop guidance for the consolidation of FASB-based information without conversion
- revise the required disclosures regarding non-core entities, specifically incorporate an example for referring to separately published financial statements
- review Draft ED for consistency in language regarding how we present entities included in the report versus those consolidated as a core entity

This paper addresses each of the above items. The following paper (which will come in the 2nd distribution) moves on to the next phase -- component entity reporting by establishing the objective for component entity reports.

Develop Guidance for the Consolidation of FASB-based Information without Conversion

The issue of the Consolidation of FASB-based Information was presented at the June meeting. After much discussion, it was decided that FASB-based information can be consolidated with FASAB amounts with a disclosure of the accounting policies as needed. Specifically, the Board agreed consolidation of FASB and FASAB based information is acceptable in government-wide statements. Further, it was agreed line items would reference disclosures breaking out the numbers where there are material policy differences and describing the accounting policies used. The Board also agreed the disclosure would not reconcile or show the differences between the two GAAP based amounts. No amounts would change (other than as a result of eliminations) in preparing the consolidated government-wide statements.

Based on the June meeting, staff believes the following explanation should be included in the basis for conclusions under the heading “Consolidation of FASB-based and FASAB-based Information”:

> The Board has considered the issue of federal entities following GAAP for nongovernmental entities promulgated by the private sector Financial Accounting Standards Board (FASB GAAP). For example, federal government corporations, the U.S. Postal Service, certain component entities of the U.S. Department of the Treasury, and some smaller entities in the executive and legislative branches have historically applied FASB GAAP and continue to do so. SFFAS 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*, recognizes that “general purpose financial reports prepared in conformity with accounting standards issued by the FASB also may be regarded as in conformity with GAAP for those entities that have in the past issued such reports.” SFFAS 34 also provides that a federal entity preparing audited financial statements for the first time may adopt FASB standards in the rare case that the needs of its primary users would be best met through the application of FASB standards. The acceptance of

these practices raises the question of whether the information prepared under FASB standards may be consolidated with information prepared under FASAB standards in consolidated reports prepared by other component entities and in the consolidated government-wide entity.

The Board has considered such issues on several occasions and provided concepts as follows:

> The reporting entities of which the components [preparing reports under FASB or regulatory accounting standards] are a part can issue consolidated, consolidating, or combining statements that include the components' financial information prepared in accordance with the other accounting standards. They need to be sensitive, however, to differences resulting from applying different accounting standards that could be material to the users of the reporting entity's financial statements. If these differences are material, the standards recommended by FASAB and issued by OMB and GAO should be applied. The components would need to provide any additional disclosures recommended by FASAB and included in the OMB issued standards that would not be required by the other standards. (SFFAC 2, Entity and Display, par. 78 (excerpt from section on "Financial Reporting For An Organizational Entity"))

The Board determined in SFFAS 34 that FASB-based statements are acceptable in certain circumstances. While there are significant differences between FASB and FASAB standards, both standards result in accrual basis information and disclosures that aid users in understanding the information. Given the decisions taken in SFFAS 34, members do not believe requiring a conversion of FASB-based information to FASAB-based information for consolidated financial reports of larger entities is justifiable.

Users may be confused by the presentation of different amounts for the same component in the consolidated financial reports of larger entities; particularly when both amounts would be in accordance with GAAP for federal entities per SFFAS 34. In addition, conversion imposes a cost and it is not clear that the cost is justifiable based on benefits to the user. This Statement proposes that amounts derived for component entities in compliance with SFFAS 34 be consolidated without adjustment. However, if this leads to consolidation in a single line item of amounts measured differently due to differences between FASB and FASAB standards then disclosure of the different accounting policies and the related amounts should be required. Such disclosures will aid the reader in understanding the information provided.

One member believes that the preparer ought to be permitted to convert of FASB-based amounts to FASAB-based amounts if necessary to fairly present the consolidated financial statements. The member believes that while component entity user needs may be met by FASB-based information, it is possible that users of a larger component's financial reports may need FASAB-based information. This member favors providing that choice to the preparer.

Staff proposes the following language be included under Government-wide Reporting Entity Consolidation and Disclosure, Core government entities.

Government-wide Reporting Entity Consolidation and Disclosure

Core government entities

1. The Statement provides for consolidation[2] of core government entities' financial statements to facilitate an assessment of the financial position of the federal government and the cost of operations financed by taxpayers. Consolidation aggregates the individual financial statements of entities comprising a reporting entity and results in presentation of information for a single economic entity representing core taxpayer supported activities, resources, and obligations where accountability rests with the Congress and the President.

2. Core government entities should apply the GAAP hierarchy established in SFFAS 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*.

3. The consolidated government-wide entity should consolidate component entity financial statements prepared in accordance with SFFAS 34 without conversion for any differences in accounting policies among the entities.[3] However, the following additional disclosures are required regarding any material line items including both FASB and FASAB amounts:

    a. descriptions of the different accounting policies and methods applied and the related amounts included in the line item

    b. identities of specific component entities that reported FASB based information in accordance with SFFAS 34, paragraphs 9 - 11

[Similar requirements would be included in the component entity section of the standards.]

[Note: The language in SFAFC 2 presented above would be amended. A separate section of the ED will be developed to present any proposed conforming amendments to the concepts.]

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[2] Consolidation is a method of accounting that combines the accounts of those entities line by line on a uniform basis of accounting and eliminates balances and transactions among the entities. For selected financial statements such as the statement of budgetary resources, a combined financial statement which does not eliminate balances and transactions among the entities is acceptable.

[3] SFFAS 34 recognized that a limited number of federal entities prepare and publish financial reports pursuant to the accounting and reporting standards issued by the Financial Accounting Standards Board (FASB). SFFAS 34 provided that general purpose federal financial reports prepared in conformity with accounting standards issued by the FASB also may be regarded as in conformity with GAAP.

Staff proposes the following Questions for Respondents:

The Statement would require consolidation of FASAB and FASB based information and a disclosure that separately presents the FASAB and FASB amounts and also details accounting methods used. One member believes that the preparer should be permitted to convert any FASB based information to FASAB based information if considered necessary for fair presentation.

Refer to paragraphs XX and XX of the proposed standards and paragraph AXX-AXX in Appendix A - Basis for Conclusions for a discussion and related explanation.

Do you agree or disagree with the above referenced requirement?

Do you agree or disagree with the suggestion to permit the preparer to convert FASB information to FASAB information?

Please provide the rationale for your answers.

QUESTIONS FOR THE BOARD:

Does the Board agree with the proposed language to address the consolidation of FASB Statements?

Does the Board agree with the proposed Question for Respondents?

Revise the required disclosures regarding non-core entities, specifically incorporate an example for referring to separately published financial statements

The Board requested staff include a reference to non-core entity financial statements in the examples for non-core disclosure requirements. Additionally, clarify that the items listed in subparagraph a.-d. are examples of information that may be disclosed and are not specific requirements. Particular emphasis was on subparagraph a. because it included a listing of specific items-- "Summary financial statements, condensed financial information for the entity (e.g. assets, liabilities, fund balances, total expenditures and sources of revenues), or key indicators. For example, if the federal government's risk of exposure is significant, then a set of summary financial statements may be appropriate, whereas if the exposures are limited then key indicators of financial impacts with selected financial info (net position and net results) might be appropriate." which might have been misinterpreted.

The Board recognized in the June meeting there should be careful wording and balance as certain information should be in the notes and shouldn't be referenced. Further, if a reference isn't worded properly it may require the information that it is incorporated by reference to be subject to just as much audit scrutiny as the basic information presented directly. However, the standard shouldn't tell the preparer what they can't do; it should state what is required. For example, members believed a reference to additional financial information was fine as long as that information isn't required and it didn't make the information subject to audit.

Most members appeared comfortable with the permissive language offered by the current proposal but thought it may need to be clearer by adding the option for the example of the reference.

Staff proposes two revisions to the language:

1. Add the reference to the list of examples in paragraph 5

2. Revise the preamble to paragraph 5 so it is clear the examples are not required

Staff has included the entire Disclosures section so it may be read in context; paragraph 5 is the paragraph with the revisions under consideration.

Disclosures[4] for Non-core Accountable Entities

1. Determining significant non-core accountable entities should be based on both qualitative and quantitative materiality considerations. Information about other entities not deemed material and similar type entities may be aggregated, where appropriate.[5] For each significant entity and aggregation of entities include the following:

2. Nature of the federal government's relationship, including the name and description of the entity. Such information also would include as appropriate:

    a. The nature of any control over the entity and/or the percentage of ownership interest and voting rights
    b. For intervention actions, the primary reasons for the intervention and a brief description of the government's plan[6] relative to operating or

[4] These may include disclosures accomplished through existing reporting requirements.
[5] Aggregation is flexible and based on the preparer's judgment. It may be based on non-core accountable entity type, class, investment, or a particular event deemed significant by the preparer. The goal would be concise, meaningful and transparent disclosures.
[6] The plan may include options being considered, plans for ending the intervention, information regarding the length of such arrangement, or plans to change terms of such arrangement.

disposing of the entity (including timeframes) and/or a statement that the intervention is not expected to be permanent

3. For any core government entity transactions with the non-consolidated non-core accountable entities (which are accounted for by the core government entity in accordance with the GAAP hierarchy established in SFFAS 34), a summary of amounts reported in the core government entity financial statements and the basis for determining the amounts reported

4. The amount that best represents the federal government's maximum exposure to gain or loss from its involvement with the non-core entity, including how the maximum exposure to gain or loss is determined. If this cannot be quantified, that fact should be disclosed.

5. Additional information that would provide an understanding of the potential financial impact, including financial-related exposures to potential gain and risk of loss to the government-wide reporting entity, resulting from the entity. Examples of information[7] that may provide the necessary understanding include but are not limited to:

   a. Summary financial statements, condensed financial information for the entity (e.g. assets, liabilities, fund balances, total expenditures and sources of revenues), or key indicators. For example, if the federal government's risk of exposure is significant, then a set of summary financial statements may be appropriate, whereas if the exposures are limited then key indicators of financial impacts with selected financial info (net position and net results) might be appropriate.

   b. a general reference to non-core entity financial statements and how they can be obtained

   c. key terms of contractual agreements regarding financial impacts (including those terms of the arrangements to provide financial support and liquidity, including events or circumstances that could expose the federal government to a loss)

   d. the nature of, and changes in, the risks associated with the control or involvement with the entity such as changes in bond ratings, publicly-traded share prices, or other indicators of financial health or changes in financial health

   e. key statutory or other legal authorities relating to financial impacts

[7] No individual example is itself a required disclosure. Therefore, the examples are not alternatives or substitutes one for another. Instead, a disclosure that provides an understanding of the potential financial impact should be provided.

QUESTION FOR THE BOARD:

Does the Board agree with the proposed language to include a reference to non-core entity financial statements and the revisions to the preamble to paragraph 5?

Review Draft ED for consistency in language regarding how we present entities included in the report versus those consolidated as a core entity

Staff reviewed the Draft ED and modified the language accordingly to address concerns related to the wording of how entities may be included in the report versus part of the entity. Staff reviewed the language to ensure consistency in how this was conveyed in the Draft ED.

Staff ensured the ED was consistent by stating the ED guides preparers of GPFFR in determining what organizations are required to be <u>included in the financial reports</u> and what information should be presented. Staff scrubbed the language for terminology that suggested an entity was in the federal entity as this was often confusing when one considered core entities and non-core entities. The tracked changes are included in the Draft ED.

QUESTION FOR THE BOARD:

Does the Board agree with the revisions to the ED?

Introduction

Purpose

1. The federal government's relationships with other entities have become increasingly complex. Public policy decisions can be carried out in a variety of ways and involve increasingly complex organizations and relationships. To meet federal financial reporting objectives, it is important to develop standards that can be used to identify organizations that must be included in the financial reports of the government-wide reporting entity and each component reporting entity.

2. Notwithstanding these complexities, general purpose federal financial reports for the government-wide reporting entity should be broad enough to report the Congress and the President's accountability for those organizations. In addition, component reporting entity reports should allow the Congress and the President to hold management accountable for implementation of public policy decisions. Although Statement of Federal Financial Accounting Concepts (SFFAC) 2, *Entity and Display*, addresses identifying reporting entities and criteria for including components in a reporting entity, questions have continued in this area that resulted in the need for a standard.[1]

3. This Statement guides preparers of general purpose federal financial reports[2] (GPFFR) in determining what organizations are required to be included in the financial reports and what information should be presented. This will ensure that users of GPFFR are provided with comprehensive financial information about federal reporting entities and their involvements so that federal financial reporting objectives are met.

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Materiality

4. The provisions of this Statement need not be applied to immaterial items. The determination of whether an item is material depends on the degree to which omitting or misstating information about the item makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or the misstatement.

[1] SFFAC 2 is a Concepts Statement and is considered Other Accounting Literature, see SFFAS 34, *The Hierarchy of Generally Accepted Accounting Principles (GAAP) Including the Application of Standards Issued by FASB* for more information regarding the hierarchy.

[2] The term general purpose federal financial report is used throughout this Statement as a generic term to refer to the report that contains the entity's financial statements that are prepared pursuant to generally accepted accounting principles. In the federal government, the report for the U.S. government-wide reporting entity is known as the Financial Report of the U.S. Government and for component reporting entities it is usually called the Performance and Accountability Report, the Agency Financial Report, or the Annual Management Report.

Effective Date

5. The proposed standards are effective for periods beginning after September 30, 20XX. Earlier implementation is encouraged.

Proposed Standards

Applicability

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6. This Statement applies to federal entities that prepare general purpose federal financial reports (GPFFR) in conformance with Statement of Federal Financial Accounting Standards (SFFAS) 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*.

7. This Statement does not require any entity to prepare and issue GPFFR. The purpose of this Statement is to enable entities preparing and issuing GPFFR to determine what organizations should be included in the financial reports of the government-wide reporting entity and each component reporting entity. The Statement also provides information about and required disclosures for related parties.

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Definitions

8. Definitions in paragraphs 9 through 12 are presented first because of their importance in understanding the Statement. Other terms shown in boldface type the first time they appear in this document are presented in the Glossary at Appendix C. Users of this document may want to examine all definitions before reviewing the Statement and Basis for Conclusions.

9. **Reporting Entity** The term "reporting entity" refers to both the government-wide reporting entity and component reporting entities that issue a General Purpose Federal Financial Report (GPFFR) because either there is a statutory or administrative requirement to prepare the GPFFR or they choose to prepare one. Statement of Federal Financial Accounting Concepts (SFFAC) 2 explains for the entity to be a reporting entity,[3] it would need to meet all of the following criteria:

   a. There is a management responsible for controlling and deploying resources, producing outputs and outcomes, executing the budget or a portion thereof (assuming that the entity is included in the budget), and held accountable for the entity's performance.

   b. The entity's scope is such that its financial statements would provide a meaningful representation of operations and financial condition.

   c. There are likely to be users of the financial statements who are interested in and could use the information in the statements to help them make resource allocation and other decisions and hold the entity accountable for its deployment and use of resources.

[3] SFFAC 2, par. 29-37, provides a discussion on Identifying the Reporting Entity for General Purpose Financial Reporting.

10. **Government-wide Reporting Entity** The government-wide reporting entity includes all organizations for which the Congress and the President are accountable based on principles established in this Statement.

Deleted: entities existing within the federal government, which includes all component reporting entities within the executive, legislative, and judicial branches as well as other

11. **Component Reporting Entity** Component reporting entity is used broadly to refer to a reporting entity within a larger reporting entity[4] that issues GPFFR. Examples of component reporting entities include entities such as executive departments, legislative agencies, federal courts, independent agencies, and government corporations. Component reporting entities would also include sub-components (entities that are part of a larger component reporting entity) that prepare GPFFR. One example is a bureau of a larger department that prepares stand alone financial reports. Other examples include commercial functions, revolving funds, and/or other accounts for which GPFFR are prepared.

12. **Control with expected benefits or risk of loss** Control with expected benefits or risk of loss is the power to govern the financial and/or operating policies of another organization with expected benefits or the risk of loss[5] to the federal reporting entity.

Organizational Approach to Defining Reporting Entities

13. The federal government is unique because its constitutionally established powers, motivations, and functions are different than other organizations. It is an extremely complex organization responsible for the common defense and general welfare of the Nation. Although there are other perspectives,[6] such as a program perspective, in understanding the composition of the federal government, an organizationally based approach appears most appropriate in determining entities for inclusion in GPFFRs.

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14. Focusing on organizations helps to identify who is accountable because there is a management responsible for controlling and deploying resources to produce outputs and outcomes. Each organization operates under an established governance structure intended to meet an established public policy objective. Governance structures allow for varying degrees of autonomy in relation to the Congress, the President, and appointed officials.

[4] The larger reporting entity could be the government-wide reporting entity or another component reporting entity.
[5] The expected benefit or risk of loss may be financial or non-financial. For example, a non-financial benefit would be the federal government benefits from a service being provided on its behalf.
[6] SFFAC 2, par. 13-28 discusses the budget and program perspective of the federal government, as well as the intertwining of the perspectives.

15. Accountability demands comprehensive reporting. To provide comprehensive reporting, the federal government must report on organizations that serve varied purposes and have complex governance structures and finances. Some differences in purposes and governance structures require differences in presentation of financial information. For example, certain organizational distinctions must be maintained for financial reports to meet budgetary integrity, operating performance, and stewardship reporting objectives established in SFFAC 1. In such cases, disclosures about the organization rather than financial information consolidated across all organizations may better meet these objectives.

16. Thus, decisions about reporting entities are taken in two steps – first, determining what organizations are to be included in the reports and second, identifying the means to present relevant information about organizations.

17. This Statement first establishes the principles for including organizations (see Principles for Inclusion in the Government-wide Report) then a distinction will be made between core government entities and non-core accountable entities (see Core Government Entities and Non-core Accountable Entities which describes these types of entities) for those organizations. Lastly, the presentation of financial information based on those decisions is addressed (see Government-wide Reporting Entity Consolidation and Disclosure).

18. PLACEHOLDER – DESCRIBE WHAT STANDARD WILL ADDRESS REGARDING COMPONENT REPORTING ENTITIES

Principles for Inclusion in the Government-wide Report

19. General purpose federal financial reports for the government-wide reporting entity should be broad enough to report the Congress and the President's accountability for organizations. This ensures that the financial reports contain all the information essential for fair presentation of the government's financial position and results of operations. To determine which organizations should be included[7] in the government-wide report, this Statement provides three principles for inclusion in the GPFFR and requires inclusion of entities if it would be misleading to exclude them (see par. 36).

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Clearly defining which entities should be included in the government-wide reporting entity

20. An organization meeting any of the three principles below is included in the government-wide GPFFR:

[7] Included means basic information includes information regarding the entity.

a. In the Budget;

b. Majority Ownership Interest; or

c. Control with expected benefits or risk of loss.

In the Budget

21. An entity listed in the *Budget of the United States Government: Analytical Perspectives- Supplemental Materials* schedule *Federal Programs by Agency and Account* should be included in the government-wide report unless it meets the exception provided in the next paragraph.

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22. If the preparer believes an entity listed in the schedule *Federal Programs by Agency and Account* is actually a non-federal organization receiving federal financial assistance,[8] a review of the facts and circumstances is conducted to confirm the entity is not an organization for which the Congress and the President are accountable. Therefore, such an organization should be assessed against the next two principles (*Ownership* and *Control*) to determine if it should be included in the government-wide report for the purpose of meeting accountability goals.

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Majority Ownership Interest

23. The federal government (directly or through its components) may have an ownership interest[9] in an entity. An ownership interest is a legal claim on the net residual assets of an entity or holding shares or other formal equity structure.

24. The holding of an ownership interest often entitles the holder to an interest in voting rights, but not always. In the federal government there may be instances of ownership interest with voting rights or ownership interest without voting rights.

25. Majority ownership interest exists with over 50% of the votes or the net residual assets[10] of an entity. When the federal government holds a

[8] As defined by the Single Audit Act Amendments of 1996, federal financial assistance is assistance that non-Federal entities receive or administer in the form of grants, loans, loan guarantees, property, cooperative agreements, interest subsidies, insurance, food commodities, direct appropriations, or other assistance.

[9] Ownership interest is defined as the possession of substantially all of the benefits and risks incident to ownership, *FASAB Glossary FASAB Pronouncements as Amended as of June 30, 2010.*

[10] For example, the federal government may hold more equity in preferred stock than all other stockholders but the preferred stock may be non-voting.

majority ownership in an entity it should be included in the government-wide report.[11]

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Control with Expected Benefits or Risk of Loss

26. An entity that is controlled by the federal government with the expectation of benefits or risk of loss to the federal reporting entity should be included in the government-wide report. For these purposes, such control is defined as follows:

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Control with expected benefits or risk of loss is the power to govern the financial and/or operating policies of another entity with expected benefits or the risk of loss[12] to the federal reporting entity. <u>Both</u> the power and either the expected benefit or risk of loss aspects of the definition should be met to justify inclusion of an entity. Hereafter, control with expected benefits or risk of loss is referred to simply as "control."

27. Control refers to the ability to control and should be assessed at the reporting date regardless of the federal government's ability to change it in the future. In determining if control exists, it is necessary to determine the substance of the relationship between the federal government and the entity as it may not be completely reflected by the legal form of the relationship.

28. Control does not necessarily mean the federal government has responsibility for the management of the day-to-day operations of an entity. It is the federal government's authority to determine the policies governing those activities that indicates control.

29. Determining whether control exists requires the application of professional judgment. The federal government achieves its objectives through a wide range of entities which individually will fall somewhere along a continuum. At one end of the continuum, it will be clear that an entity does not have the power to act independently and is controlled by the federal government—such as an Executive Department. At the other end, the entity will have the power to act independently and, while the federal government may have a level of influence, it will be clear that it does not have control—such as a state government.

[11] Ownership interests 50% or less should be accounted for in accordance with the appropriate accounting standards per the GAAP hierarchy. However, the entity should still be assessed against the control and the misleading to exclude inclusion principles.

[12] The expected benefit or risk of loss may be financial or non-financial. For example, a non-financial benefit would be the federal government benefits from a service being provided on its behalf.

Indicators of Control

30. As discussed in the following paragraphs, there are indicators that should be considered in determining whether the federal government controls an entity. As noted above, much judgment and consideration needs to be given to the nature of the relationship between the federal government and the entity in order to determine whether control exists.

31. Certain indicators[13] provide persuasive evidence that control exists. These indicators provide strong evidence of control, however; the absence of one or more of these specific indicators does not lead to a presumption that control is not present. Typically, meeting any one of these indicators would mean control is present. These indicators are when the federal government has the authority to:

   a. Unilaterally appoint or remove a majority of the governing board members of another entity;

   b. Direct the governing body on the financial and operating policies of the entity;

   c. Unilaterally dissolve the entity thereby having access to the assets and responsibility for the obligations; or

   d. Establish or amend the fundamental purpose and mission of the entity, which may include authorizing the entity to exercise sovereign power of the federal government and requiring the entity to carry out federal missions and objectives.

32. Other indicators provide evidence that control exists, but must be considered in the aggregate and often require the application of professional judgment in assessing. These indicators are when the federal government has the ability to:

   a. Provide significant input into the appointment of members of the governing body of the entity or being involved in the appointment or removal of a significant number of members;

   b. Access entity's assets or direct the ongoing use of those assets;

   c. Appoint or remove key executives or personnel;

   d. Approve the budgets or business plans for the entity;

   e. Require audits;

   f. Veto, overrule, or modify governing board decisions or otherwise significantly influence normal operations;

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[13] The indicators noted in par. 31 and 32 provide support for both the power and/or benefit part of the control definition. As noted in par. 26 a federal reporting entity should meet both the power and benefit elements for determining whether control exists. These are indicators and may list one or both elements of the definition.

g. Finance the deficits of and provide financial support to or settle liabilities;

h. Direct the entity to work with the government to provide services to taxpayers which may include determining the outcome or disposition of matters affecting the recipients of services;

i. Establish, rescind, or amend management policies;

j. Establish limits or restrictions on borrowing and investments of the entity; or

k. Restrict the capacity to generate revenue of the entity, especially the sources of revenue.

Situations Where Control Does Not Exist

33. Because of the uniqueness of the federal government, control would not be inferred from:

a. The authority to exercise regulatory powers over an entity; or

b. Economic dependency of the entity on the federal government.

34. The federal government has the power to regulate many entities by use of its sovereign and legislative powers. For example, the federal government has the power to regulate the behavior of entities by imposing conditions or sanctions on their operations. However, the governing bodies of the regulated entities make decisions within the regulatory framework. Regulatory powers do not constitute control for purposes of this Statement because the federal government's interest in these entities extends only to the regulatory aspects of the operations.

35. Certain entities may be economically dependent on the federal government but ultimately retain discretion as to whether to accept funding or do business with the federal government. For example, many not-for-profits rely on federal government funding but that does not mean they are controlled by the federal government. Although the federal government may be able to influence entities dependent on federal funding or business through purchasing power, the federal government does not govern their financial and operating policies.

Misleading to Exclude Principle

36. There may be instances when an organization does not meet the inclusion principles in this Statement (ie. It is not included in the Federal Programs by Agency and Account, there is not majority ownership, or it may be

difficult to provide sufficient evidence it meets the control principle) yet the government-wide financial report would be misleading or incomplete if the entity were excluded.[14]

37. This Statement requires inclusion of entities in the government-wide report if it would be misleading to exclude them.

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Organizations--Core Government Entities and Non-core Accountable Entities

38. The principles above would be used to assess what organizations to include in reports. To assist in making decisions about presentation, a distinction will be made between core (or general) government entities and non-core accountable entities. This assessment is based on the degree to which the following characteristics are met: the entity is taxpayer supported, is governed by the Congress and the President, imposes or may impose risks and rewards on the taxpayer, and/or provides core federal government goods and services on a non-market basis. However, not all characteristics are required to be met; classification is based on the assessment as a whole.

<u>Core government entities</u>

39. Core (or general) government entities generally provide core federal goods and services on a non-market basis.[15] Such entities are financed primarily through taxes, fees, and other non-exchange revenues as evidenced by inclusion in the budget. Significant risks and rewards fall to the taxpayer for core government entities.

40. Accountability for core government entities rests with the President and the Congress. Their governance structure is vertically integrated with elected officials as evidenced by the chain of command and manner of decision making. Vertical integration may include the establishment of organizational authorities, development and approval of budgets, and the appointment of organizational leaders by the Congress and the President or their agents.

41. Entities listed in the budget and for which management has not asserted the entity is actually a non-federal entity receiving non-federal assistance (see par. 21-22) are presumed to qualify as core government entities while greater judgment will be needed to classify other entities.

[14] Although situations such as this would be considered rare, this Statement provides for situations that may arise.

[15] Goods and services are provided on a non-market basis when they are provided free of charge or at charges that are not economically significant.

Non-core accountable entities

42. Federal officials may rely on organizations that have a greater degree of autonomy than core government entities to fulfill public policy objectives. Such entities may maintain a separate legal identity, have a governance structure that vests greater decision making authorities in a governing body to insulate the entity from political influence, and/or allow for relative financial independence.

43. Maintaining a distinction between the finances of such entities and core government entities will more effectively meet federal financial reporting objectives. Such a distinction allows core government entity financial statements to reveal the costs to taxpayers as well as how such entities have impacted the net position of the core government. However, federal financial reporting objectives can not be met without further information regarding such entities. Therefore, these entities are included for accountability purposes but are considered “non-core accountable entities.”

44. Non-core accountable entities may provide core federal government goods and services but are more likely to provide goods and services on a market basis.[16] Non-core accountable entities receive limited or no taxpayer support. Accountability rests with the Congress and the President, but they have less direct involvement in decision making than is true in core government entities. Limited risks and rewards fall to the taxpayers.

45. In addition to organizations for which the Congress and the President are accountable, the federal government may be able to exercise significant influence over certain entities or be subject to significant influence from certain entities. Such parties are referred to as “related parties.” See Related Party discussion beginning at par. XX for definition, disclosures and additional information. NOTE: The issue of influence on the government will be addressed when the Board next considers Related Parties

[16] Goods and services are provided on a market basis when prices are determined in a competitive marketplace between willing buyers and sellers.

Government-wide Reporting Entity Consolidation and Disclosure

Core government entities

46. The Statement provides for consolidation[17] of core government entities' financial statements to facilitate an assessment of the financial position of the federal government and the cost of operations financed by taxpayers. Consolidation aggregates the individual financial statements of entities comprising a reporting entity and results in presentation of information for a single economic entity representing core taxpayer supported activities, resources, and obligations where accountability rests with the Congress and the President.

47. Core government entities should apply the GAAP hierarchy established in SFFAS 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*.

48. The consolidated government-wide entity should consolidate component entity financial statements prepared in accordance with SFFAS 34 without conversion for any differences in accounting policies among the entities.[18] However, the following additional disclosures are required regarding any material line items including both FASB and FASAB amounts:

    a. descriptions of the different accounting policies and methods applied and the related amounts included in the line item

    b. identities of specific component entities that reported FASB based information in accordance with SFFAS 34, paragraphs 9 - 11

[Similar requirements would be included in the component entity section of the standards.]

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[17] Consolidation is a method of accounting that combines the accounts of those entities line by line on a uniform basis of accounting and eliminates balances and transactions among the entities. For selected financial statements such as the statement of budgetary resources, a combined financial statement which does not eliminate balances and transactions among the entities is acceptable.

[18] SFFAS 34 recognized that a limited number of federal entities prepare and publish financial reports pursuant to the accounting and reporting standards issued by the Financial Accounting Standards Board (FASB). SFFAS 34 provided that general purpose federal financial reports prepared in conformity with accounting standards issued by the FASB also may be regarded as in conformity with GAAP.

Non-core accountable entities

49. For those organizations not classified as core government entities, this Statement provides for judgment by the preparer in determining the appropriate disclosures based on the factors and principles provided herein.

50. Non-core accountable entities include but are not limited to: quasi governmental and/or financially independent entities, receiverships and conservatorships, and federal governmental intervention actions. In some cases, the relationship with the federal government is not expected to be permanent. The non-core entity types are presented to assist in identifying entities that are non-core accountable entities.

51. Non-core entities need not be grouped by type and no distinction is made by type for purposes of determining the appropriate presentation or disclosure. These types of entities and any other types of entities identified as non-core should provide disclosures consistent with Disclosures for Non-core Accountable Entities as detailed in par. 62 to 67 below after considering the factors listed in par. 62.

Quasi Governmental and/or Financially Independent Entities

52. Quasi Governmental and/or Financially Independent Entities are hybrid entities where accountability and transparency of these unique organizations are important yet they differ from core entities when assessing the governance and/or the financial (risk and rewards) arrangements.

53. Governance differences typically lead to greater independence. Characteristics may include the following:

   a. Longer appointments of key executives or governing boards allow these appointees a degree of independence from the Congress and the President.

   b. Delegated operational authority to provide a service or execute a program in a manner similar to private business enterprises.

   c. May possess private sector legal characteristics.

   d. May be voluntarily affiliated with the federal government and share purposes to implement government policies.

54. Financial differences typically lead to greater fiscal autonomy. Characteristics may include the following:

a. Primary funding is derived from a source other than through appropriations.

b. Delegated financial authority to provide a service or execute a program in a manner similar to private business enterprises.

c. Sells goods and/or services to individuals outside of the government reporting entity as its principal activity.

d. Intended to, in the normal course of its operations, maintain its operations and meet its liabilities from revenues received from sources outside of the government reporting entity.

55. Examples of Quasi Governmental and/or Financially Independent Entities may include Federally Funded Research and Development Centers (FFRDCs) However, details may differ among FFRDCs and some may potentially be core entities and therefore flexibility is necessary for determining the most meaningful presentation. The accompanying Illustrative Guide offers examples that may be useful in application.

56. Additional examples of Quasi Governmental and/or Financially Independent Entities may include museums, performing arts organizations and universities, venture capital funds, [OTHER GENERIC AND SPECIFIC CASES WILL BE ADDED AS NEEDED TO AVOID UNINTENDED CONSEQUENCES.] The accompanying Illustrative Guide offers examples that may be useful in application.

Receiverships and Conservatorships[19]

57. There are certain federal entities whose mission may include taking control or ownership of failed financial institutions such as banks with no goal to maintain control or ownership. For example, certain federally-created entities may act as a receiver to liquidate failing financial institutions or as a conservator to guide such institutions back to safe and sound conditions.[20]

Federal Government Intervention Actions

58. The federal government with its broad responsibility may often intervene for the well being of the country, but those actions are not expected to be permanent. The federal government's intervention in exceptional

[19] This differs slightly from federal interventions because receivership activities are considered part of the normal activities and mission of the federal reporting entities that perform them and the duration is typically shorter.

[20] For example, the Federal Deposit Insurance Corporation (FDIC) is an independent agency created by the Congress with the mission "to maintain stability and public confidence in the nation's financial system by: insuring deposits; examining and supervising financial institutions for safety and soundness and consumer protection; and, managing receiverships."

circumstances, such as an economic crisis situation or military occupation is not intended to be permanent.

59. Although there is no specific time limit, the federal government's intention is not to make such interventions permanent. Typically federal government intervention actions in these instances are not routine activities and strategic planning documents are unlikely to include objectives to routinely initiate such interventions or to permanently operate entities acquired through past interventions.

60. Examples of intervention actions include:

    a. Temporary control-- the federal government seizes control of an established entity but expects to relinquish or cede control.

    b. Temporary ownership--the federal government acquires an ownership interest of an entity but expects to end its interest as soon as practicable.

61. Temporary situations that exist at fiscal year-end must be assessed to confirm they are not expected to be permanent.

Factors in Determining Non-Core Accountable Entity Disclosures

62. Materiality is an overarching consideration in financial reporting. Preparers should consider both qualitative and quantitative materiality in determining non-core accountable entity disclosures. Beyond materiality, the following factors[21] should be considered in making judgments about the extent of appropriate non-core accountable entity disclosures:

    - ***Relevance to reporting objectives of reporting entity*** - Significance of the entity in light of the reporting objectives. This would include the significance of the balances and/or information regarding results of operations and financial position to meeting the operating performance and stewardship reporting objectives.

    - ***Nature of the potential benefits or risks/exposures associated with the relationship***- Information is needed to provide an understanding of the potential financial impact, including financial-related exposures to potential gain and risk of loss to the core entity resulting from the entity's operations.

    - ***Organization views/perspective***- How the organization itself accounts for or reports on its relationship with the federal government.

[21] The factors are presented in a list for consideration in the aggregate; no individual weights should be assigned or interpreted.

For example, whether the organization views itself as an extension of the federal government or operationally independent of the President and the Congress may influence the amount of information disclosed.

- ***Complexity of the relationship***- The more complex relationships would involve more detail to ensure the relationship is understood by the readers.
- ***Extent to which the information interests, or may be expected to interest, a wide audience*** - Due to the sensitivity, materiality of the transactions or even perhaps a notable news headline, or other reasons, interested parties may expect some type of disclosures regarding the organization or the relationship with the federal government.
- ***Extent to which there are not alternative sources of reliable information***- An objective of general purpose federal financial reporting is to meet the needs of users who may have limited access to information or statements and lack the ability to demand the desired information.

Disclosures[22] for Non-core Accountable Entities

63. Determining significant non-core accountable entities should be based on both qualitative and quantitative materiality considerations. Information about other entities not deemed material and similar type entities may be aggregated, where appropriate.[23] For each significant entity and aggregation of entities include the following:

64. Nature of the federal government's relationship, including the name and description of the entity. Such information also would include as appropriate:

   a. The nature of any control over the entity and/or the percentage of ownership interest and voting rights
   b. For intervention actions, the primary reasons for the intervention and a brief description of the government's plan[24] relative to operating or disposing of the entity (including timeframes) and/or a statement that the intervention is not expected to be permanent

[22] These may include disclosures accomplished through existing reporting requirements.
[23] Aggregation is flexible and based on the preparer's judgment. It may be based on non-core accountable entity type, class, investment, or a particular event deemed significant by the preparer. The goal would be concise, meaningful and transparent disclosures.
[24] The plan may include options being considered, plans for ending the intervention, information regarding the length of such arrangement, or plans to change terms of such arrangement.

65. For any core government entity transactions with the non-consolidated non-core accountable entities (which are accounted for by the core government entity in accordance with the GAAP hierarchy established in SFFAS 34), a summary of amounts reported in the core government entity financial statements and the basis for determining the amounts reported

66. The amount that best represents the federal government's maximum exposure to gain or loss from its involvement with the non-core entity, including how the maximum exposure to gain or loss is determined. If this cannot be quantified, that fact should be disclosed.

67. Additional information that would provide an understanding of the potential financial impact, including financial-related exposures to potential gain and risk of loss to the government-wide reporting entity, resulting from the entity. Examples of information[25] that may provide the necessary understanding include but are not limited to:

    a. Summary financial statements, condensed financial information for the entity (e.g. assets, liabilities, fund balances, total expenditures and sources of revenues), or key indicators. For example, if the federal government's risk of exposure is significant, then a set of summary financial statements may be appropriate, whereas if the exposures are limited then key indicators of financial impacts with selected financial info (net position and net results) might be appropriate.

    b. a general reference to non-core entity financial statements and how they can be obtained

    c. key terms of contractual agreements regarding financial impacts (including those terms of the arrangements to provide financial support and liquidity, including events or circumstances that could expose the federal government to a loss)

    d. the nature of, and changes in, the risks associated with the control or involvement with the entity such as changes in bond ratings, publicly-traded share prices, or other indicators of financial health or changes in financial health

    e. key statutory or other legal authorities relating to financial impacts

[25] No individual example is itself a required disclosure. Therefore, the examples are not alternatives or substitutes one for another. Instead, a disclosure that provides an understanding of the potential financial impact should be provided.

Basis of Accounting for Non-core accountable entities[26]

68. Non-core accountable entities disclosed in the government-wide report should be reported on accrual based standards provided in generally accepted accounting principles for its specific type of entity. This includes generally accepted accounting principles for any domain (FASAB, Governmental Accounting Standards Board, or Financial Accounting Standards Board).

69. Although a common fiscal year-end is encouraged, it is not mandatory and the cost and benefits of establishing a common fiscal year-end may be considered. If non-core accountable entities have a different fiscal year-end than the core government-wide entity, financial information included for non-core accountable entities should be for the year ended within the core government entity's year end, while being timely and accurate.

70. Any significant changes in information occurring from the non-core entity's financial statement date to the core government entity's year end should be disclosed.

Related Party Government-wide Reporting Entity

Related Party Disclosures for Government-wide Reporting Entity

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Part II of Proposed Standard

Component Reporting Entities

[26] Core government entities should apply the GAAP hierarchy established in SFFAS 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*.

Effect on Existing Concepts

This Statement affects existing Concepts is amended as follows: COMPARE FINAL TO SFFAC 2 to determine any necessary amendments

Effective Date

71. These standards are effective for periods beginning after September 30, XX. Earlier implementation is encouraged.

The provisions of this Statement need not be applied to immaterial items.