Federal Accounting Standards Advisory Board

June 10, 2011

To: Members of the Board

From: Melissa L. Loughan, Assistant Director

Ross Simms, Assistant Director

Through: Wendy M. Payne, Executive Director

Subj: Federal Entity – Draft Illustration Guide - TAB **F**[1]

MEETING OBJECTIVE

The objective of the meeting is to review draft illustrations applying the draft standards from the government-wide perspective.

BRIEFING MATERIAL

Attachment 1 – Draft Illustration Guide

BACKGROUND

FASAB agreed to develop an Illustration Guide with example entities (similar to the Appendix in Governmental Accounting Standards Board Statement 14, *The Financial Reporting Entity*). The draft Illustration Guide provided in *Attachment 1 – Draft Illustration Guide* includes a range of examples including some that are clear, some that move towards the center of the spectrum, and some that may be considered controversial. Also, for two of the example entities (Epsilon Corporation and Bicycle America, Inc.), the draft Illustration Guide provides different scenarios to illustrate how a change in a circumstance can lead to a different outcome.

[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

The different scenarios for Epsilon Corporation relate to management's ability to assert that while listed in the budget, the entity is receiving federal financial assistance. In the first scenario, management does not make this assertion and the entity is consolidated without consideration of whether it exhibits core or non-core characteristics. In the second scenario, management makes this assertion and is included based on meeting the control principle. In assessing whether Epsilon is core or non-core, staff concluded that it is non-core. This illustrates the fact that – as currently drafted—the standards would not provide an opportunity to consider whether entities listed in the Budget have non-core characteristics. Therefore, some non-core entities may not be identified. Staff believes this is consistent with the Board's intent because it is a cost-beneficial approach to addressing many diverse entities. The illustration provides an opportunity to confirm this conclusion with the members.

The different scenarios for Bicycle America were included as an option for developing illustrations. Staff wondered if it would be helpful to provide illustrations for which key aspects were varied but other aspects were the same. This would focus the readers' attention on the critical factors.

Staff is seeking member input on:

1 – the depth of analysis included in the illustrations and whether members believe it is at an acceptable level

2 – the specific decisions illustrated in the analysis and whether members might disagree with some conclusions reached

3 – any observations or concerns about the structure of the standards drawn from the illustrations

4 – general suggestions for improvement before additional illustrations are developed.

NEXT STEPS

Based on the Board's feedback, staff will continue developing examples for the Illustration Guide.

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If you have questions or need additional information, please contact us (Melissa at 202-512-5976 or by email at loughanm@fasab.gov and Ross at 202-512-2512 or by email at simmsr@fasab.gov) as soon as possible. We will be able to consider and respond to your request more fully in advance of the meeting.

Attachment

Table of Contents

Preamble

The examples presented in this Appendix are intended to demonstrate how the provisions of the proposed standard would be applied to a particular set of hypothetical circumstances. For simplicity, the decisions regarding presentation and/or disclosure are based solely on the hypothetical circumstances presented and are structured to parallel the decision flowchart in Appendix XX of the ED.

The examples are for illustrative purposes only. They do not indicate a preferred method and are nonauthoritative. Application of the ED to individual entities requires consideration of the circumstances specific to that entity.

ABC Department

Background

Congress established ABC department to promote entrepreneurship and innovation as a means to address national economic and environmental challenges. Provisions that govern ABC are generally prescribed in the XYZ Act and ABC accomplishes its mission through various agencies, grants to research institutions, and contracts with universities and not-for-profit (NFP) organizations.

Governance Structure

The executive leadership of ABC consists of a secretary, deputy secretary, and three assistant secretaries. The President nominates and the Senate confirms each of these officials.

In addition, Congress primarily monitors ABC's activities through hearings and audits. Audits have been conducted to determine whether:

- Assertions regarding ABC's achievements are supported by reliable evidence.
- ABC is conducting its operations in accordance with established legislation.
- The department is managing its resources in an efficient and effective manner.
- ABC has established adequate internal control to safeguard its assets.

The audits are conducted by the Government Accountability Office (GAO) and ABC's Inspector General (IG). The GAO is an independent agency that works for Congress and ABC's IG is appointed by the President and confirmed by the Senate.

Budget and Finance Considerations

ABC relies on appropriated public funds to conduct its mission and is enumerated in the *Budget of the United States Government: Analytical Perspectives – Supplemental Materials schedule Federal Programs by Agency and Account* (Budget). Congress and the President consider ABC's request for resources and determine the amount needed to operate and provide services. The appropriation describes the terms and conditions that ABC must adhere to when spending the funds. For the fiscal year, the appropriation specifies the budget authority and certain limitations on the use of funds for each of ABC's agencies.

Periodically, ABC must provide Congress and the President with information on its financial and operational plans and performance. ABC meets the requirements through various reports that discuss matters such as:

- Economic concerns and recommended strategies for addressing them
- Proposed activities that may be of interest to particular Congressional committees or subcommittees
- The status of on-going projects

- Activities completed during the period
- Resource needs and justification for such needs
- Net costs, financial position, budgetary resources, systems, and internal control.

Application of the Proposed Standard

The following analyses illustrate how the proposed standard may be applied to determine whether ABC Department should be included in the government-wide reporting entity and, if so, what information should presented.

Step 1- Analysis against Inclusion Principles

The first step is to decide whether ABC should be included in the government-wide reporting entity. To accomplish this step, ABC's circumstances are analyzed against the inclusion principles of In the Budget; Majority Ownership Interest (Majority Ownership); Control with Expected Benefits or Risk of Loss (Control); and Misleading to Exclude Principle, respectively. Generally, once it is determined that the circumstances satisfy one of the principles, no additional analysis is needed for this step.

The first inclusion principle is that entities listed in the Budget should be included in the government-wide reporting entity, and the circumstances indicate that ABC meets this principle. However, for those instances where entity management believes that the entity is actually a non-federal organization receiving federal assistance, the ED permits entity management to review the facts and circumstances to confirm whether the entity is not an organization for which the Congress and the President should be held accountable. Consequently, entity management would proceed to analyze the entity against the subsequent inclusion principles.

Given the circumstances, ABC's management does not question whether the entity should be included in the government-wide reporting entity. Next, a determination can be made regarding ABC's presentation.

Step 2 - Decision Regarding Presentation and/or Disclosure

The ED provides that entities listed in the Budget and for which management has not asserted that the entity is actually a non-federal entity receiving federal assistance are presumed to qualify as core government entities. Also, such entities should be consolidated. Because ABC meets these criteria it is consolidated with other core government entities and no additional analyses are needed.

Epsilon Corporation

Background

Congress and the President established Epsilon Corporation as a government corporation to insure consumer funds placed in trust with certain types of institutions. Federal legislation discusses provisions that govern Epsilon's activities.

Governance Structure

The U.S. Code lists Epsilon as a government corporation. It is led by a seven member board of directors and each board member is appointed by the President and confirmed by the Senate. In addition, to ensure a bi-partisan effort, no more than four of the appointees may be from the same political party. Board members serve seven-year terms. Also, Congress monitors Epsilon's activities by conducting hearings on Epsilon's programs and requesting GAO and OIG audits.

Budget and Finance Considerations

Epsilon does not receive appropriations, but is permitted to receive premiums from the institutions it insures. However, legislation limits how Epsilon can invest these proceeds and, to help ensure that Epsilon remains financially viable, legislation requires that the entity maintain a level of its funds in reserve. The board of directors is permitted to determine the level of the reserve and Epsilon is listed in the Budget. If Epsilon encounters a shortfall, the entity may borrow a limited amount of funds from the U.S. Department of the Treasury but any additional funding requirements must be obtained from premium assessments.

Also, Epsilon is required to periodically report to Congress and the President on matters such as:

- Program performance results
- Financial position, results of operations, and cashflows
- Adequacy of systems
- Adequacy of internal control

Application of the Proposed Standard - Scenario A (Management does not assert that Epsilon is actually a Non-Federal Entity Receiving Federal Financial Assistance)

The following analyses illustrate how the proposed standard may be applied to determine whether Epsilon should be included in the government-wide reporting entity and, if so, what information should be presented.

Step 1- Analysis against Inclusion Principles

The first step is to decide whether Epsilon should be included in the government-wide reporting entity. To accomplish this step, Epsilon's circumstances are analyzed against the inclusion principles of Budget, Majority Ownership, Control, and Misleading to Exclude Principle, respectively. Generally, once it is determined that the circumstances satisfy one of the principles, no additional analysis is needed for the step.

The first inclusion principle is that entities listed in the Budget should be included in the government-wide reporting entity and the circumstances indicate that Epsilon meets this principle. However, for those instances where entity management believes that the entity is actually a non-federal organization receiving federal assistance, the ED permits entity management to review the facts and circumstances to confirm whether the entity is not an organization for which the Congress and the President should be held accountable. Consequently, entity management would proceed to analyze the entity against the subsequent inclusion principles.

Given the circumstances, Epsilon's management does not question whether the entity should be included in the government-wide reporting entity. Next, a determination can be made regarding Epsilon's presentation.

Step 2 - Decision Regarding Presentation and/or Disclosure

The ED provides that entities listed in the Budget and for which management has not asserted that the entity is actually a non-federal entity receiving federal assistance are presumed to qualify as core government entities. Also, such entities should be consolidated. Because Epsilon meets these criteria it is consolidated with other core government entities and no additional analyses are needed.

<u>Application of the Proposed Standard – Scenario B (Management Asserts that Epsilon is actually a Non-Federal Entity Receiving Federal Financial Assistance)</u>

The following analyses illustrate how the proposed standard may be applied to determine whether Epsilon should be included in the government-wide reporting entity and, if so, what information should be presented.

Step 1- Analysis against Inclusion Principles

The first step is to decide whether Epsilon should be included in the government-wide reporting entity. To accomplish this step, Epsilon's circumstances are analyzed against the inclusion principles of Budget, Majority Ownership, Control, and Misleading to Exclude Principle, respectively. Generally, once it is determined that the circumstances satisfy one of the principles, no additional analysis is needed for the step.

The first inclusion principle is that entities listed in the Budget should be included in the government-wide reporting entity and the circumstances indicate that Epsilon meets this principle. However, for those instances where entity management believes that the entity is actually a non-federal organization receiving federal assistance, the ED permits entity management to review the facts and circumstances to confirm whether the entity is not an organization for which the Congress and the President should be held accountable.

Consequently, entity management would proceed to analyze the entity against the subsequent inclusion principles.

Because Epsilon's management asserts that Epsilon is a non-federal entity that receives federal assistance, the next step is to analyze Epsilon's circumstances against the next inclusion principle, Majority Ownership.

The ED specifies that when the federal government holds a majority ownership interest in an entity, the entity should be included in the government-wide reporting entity. Ownership interest may be indicated by holding over 50% of the interest in voting rights or residual assets of an entity. However, the circumstances do not provide such indicators that the government acquired an ownership interest in Epsilon. As a result, the Control inclusion principle is considered.

The ED discusses that an entity controlled with the expectation of benefits or risk of loss should be included in the government-wide reporting entity. A pervasive indicator of control with the expectation of benefits or risk of loss is that the federal government unilaterally appoints or removes a majority of the governing board members of the entity. In the case of Epsilon, the federal government demonstrates a level of control as each of the governing board members are appointed by the President and confirmed by the Senate. Considering that Epsilon meets the Control inclusion principle, Epsilon is included in the government-wide reporting entity and the next step is to determine whether Epsilon is a core government or non-core accountable entity.

Step 2 - Analysis to determine core/non-core status

To assist in making decisions about how to present Epsilon, this step involves establishing whether Epsilon is a core government or non-core accountable entity. Core government entities should be consolidated, while non-core accountable entities should be disclosed.

The ED provides indicators of core government entities and one such indicator is that the entity is primarily financed through non-exchange revenues. In contrast, Epsilon is financed by premiums rather than tax dollars and is delegated the authority to carry on its affairs in a manner similar to a private enterprise. Additionally, Epsilon only has limited authority to borrow federal funds. In due course, financial shortfalls are recovered through premium assessments. These are indicators of a non-core accountable entity.

Also, the ED provides that for core government entities, the governance structure may involve the appointment of organizational leaders through the political process. While Epsilon's governance structure involves the appointment of leaders through the political process, the leaders serve seven-year terms. The longer appointments lessen opportunities for political involvement. Thus, overall, Epsilon demonstrates a degree of non-core accountable entity characteristics. Now proceed to Step 3 to analyze how Epsilon should be presented or disclosed.

Step 3 - Decision Regarding Presentation and/or Disclosure

Based on the results of Step 2, a decision can be made regarding how Epsilon should be presented or disclosed. Because it was determined that overall Epsilon demonstrates a degree of non-core accountable entity characteristics, the ED provides for disclosure.

Because Epsilon's financial viability is of interest to the financial markets and ultimately, the public, there is a high expectation regarding disclosures about Epsilon and its relationship with the federal government. Information may be provided about the potential financial impact to the federal government resulting from the relationship. For example, given the limited risks, the disclosures could discuss the amount of support offered by the federal government and selected financial information, such as Epsilon's net position and results.

Scholars University

Background

Congress and the President chartered Scholars University as a private, NFP educational institution and the EDU Act discusses the mission of the university.

Governance Structure

Scholars University is governed by a 29 member board of trustees. The board controls and directs the university's affairs and interests. The Secretary of Education is an ex-officio member of the board and the remaining members are elected by the board for three-year terms.

The board determines the university's tuition and fee structure and the university is subject to the Secretary's annual inspection.

Budget and Finance Considerations

To support its mission, Scholars University receives revenue from student tuitions and fees. In addition, the university is listed in the Budget under the Department of Education and it receives appropriations to support its academic programs, including support for construction projects, capital improvements, and maintenance. Although the appropriations discuss limitations on how the funds may be used, the university generally has discretion over how it chooses to allocate funds for its academic programs and construction activities.

Also, to encourage self-sufficiency, appropriations provide matching support for the university's endowment. The university is permitted to receive private contributions, but must provide a financial report to the Secretary of Education that presents the sources of its receipts and the object of its disbursements during the reporting period. Also, legislation discusses parameters for investing the endowment fund corpus and income.

Application of the Proposed Standard

The following analyses illustrate how the proposed standard may be applied to determine whether Scholars University should be included in the government-wide reporting entity and what information should be presented.

Step 1- Analysis against Inclusion Principles

The first step is to decide whether Scholars University should be included in the government-wide reporting entity. To accomplish this step, Scholars University's circumstances are analyzed against the inclusion principles of Budget, Majority Ownership, Control, and Misleading to Exclude Principle, respectively. Generally, once it is determined that the circumstances satisfy one of the principles, no additional analysis is needed for the step.

The first inclusion principle is that entities listed in the Budget should be included in the government-wide reporting entity and the circumstances indicate that

Scholars University meets this principle. However, for those instances where entity management believes that the entity is actually a non-federal organization receiving federal assistance, the ED permits entity management to review the facts and circumstances to confirm whether the entity is not an organization for which the Congress and the President should be held accountable. Consequently, entity management would proceed to analyze the entity against the subsequent inclusion principles.

Given its mission, governance structure, and primary source of revenues, Scholars' management believes that the university is actually a non-federal entity receiving federal assistance. Consequently, the next inclusion principle, Majority Ownership is considered.

The ED specifies that when the federal government holds a majority ownership in an entity, the entity should be included in the government-wide reporting entity. Ownership interest may be indicated by holding over 50% of the interest in voting rights or residual assets of an entity. However, the circumstances do not provide such indicators that the government acquired an ownership interest in Scholars. As a result, the Control inclusion principle is considered.

The ED discusses that an entity controlled with the expectation of benefits or risk of loss should be included in the government-wide reporting entity. While the ED lists several indicators that provide persuasive evidence that control exists, those indicators do not appear to be present in the case of Scholars. For example, one indicator is that the federal government unilaterally appoints or removes a majority of the governing board members. However, Scholars' board of trustees elects its respective board members. In addition, while the federal government does have a level of influence, Scholars' board of trustees primarily directs the university's affairs and the university is permitted to seek sources of revenue to operate virtually in a self-sustaining manner.

Given the limited influence that the federal government may exhibit with respect to Scholars, the Misleading to Exclude Principle may be considered. As discussed in the ED, this principle concerns the notion that the government-wide financial report may be misleading if an entity were excluded. Because Scholars generally provides market-based services and its governance structure has a level of insulation from political influence, Scholars may not be considered a candidate for inclusion in the government-wide report and additional analyses are not needed.

[Note: Scholars University may be a candidate for related party disclosure. This matter will be discussed as more progress is made on the related party area of the ED.]

Education Research Institute (ERI)

Background

ERI was established through a public law specifying the organization's:

- status as a tax exempt non-profit
- purpose and duties
- governance structure
- sources of financing
- reporting requirements

The purpose of the ERI is to assist state and local officials in making informed decisions regarding effective education methods. The ERI will use an open process to identify priority areas for research, fund and oversee high-quality research programs, and disseminate the results of its research. The ERI may not mandate adoption of its recommendations.

Governance Structure

ERI is governed by a board of directors which has 15 members. Two members are specific federal officials within the Department of Education. The remaining 13 are appointed by the President and confirmed by the Senate and serve six-year terms. One of these 13 appointed members will serve as chairperson. To ensure a bi-partisan effort, no more than seven of the appointees may be from the same political party. The appointees are subject to certain financial disclosure and conflict of interest requirements but are not federal government employees.

Budget and Finance Considerations

The legislation creating ERI designates funding of $1 per elementary school student to be made available from the general fund of the US Treasury to the ERI trust fund. The board of directors is authorized to establish an annual budget not to exceed the amounts available in the trust fund. The ERI also may receive donations consistent with laws regulating fund raising by tax exempt organizations.

The ERI must provide annually an audited financial report to the comptroller general and relevant Congressional committees.

Application of the Proposed Standard

The following analyses illustrate how the proposed standard may be applied to determine whether ERI should be included in the government-wide reporting entity and, if so, what information should be presented.

Step 1- Analysis against Inclusion Principles

The first step is to decide whether ERI should be included in the government-wide reporting entity. To accomplish this step, ERI's circumstances are analyzed against the inclusion principles of Budget, Majority Ownership, Control, and Misleading to Exclude Principle, respectively. Generally, once it is determined that the circumstances satisfy one of the principles, no additional analysis is needed for the step.

The first inclusion principle is that entities listed in the Budget should be included in the government-wide reporting entity and the circumstances indicate that ERI meets this principle. However, for those instances where entity management believes that the entity is actually a non-federal organization receiving federal assistance, the ED permits entity management to review the facts and circumstances to confirm whether the entity is not an organization for which the Congress and the President should be held accountable. Consequently, entity management would proceed to analyze the entity against the subsequent inclusion principles.

In this instance, ERI's management questions whether the entity is actually a non-federal entity receiving federal assistance. Consequently, the next inclusion principle, Majority Ownership is considered.

The ED specifies that when the federal government holds a majority ownership in an entity, the entity should be included in the government-wide reporting entity. Ownership interest may be indicated by holding over 50% of the interest in voting rights or residual assets of an entity. However, the circumstances do not provide such indicators that the government acquired an ownership interest in ERI. Therefore, the Control inclusion principle is considered.

The ED discusses that an entity controlled with the expectation of benefits or risk of loss should be included in the government-wide reporting entity. A pervasive indicator of control with the expectation of benefits or risk of loss is that the federal government unilaterally appoints or removes a majority of the governing board members of the entity. In the case of ERI, the federal government appoints 13 of the 15 board members and the two remaining board members are federal officials. Accordingly, the circumstances concerning ERI indicate that Control exists and it appears that ERI is an entity that should be included in the government-wide reporting entity. Now, the next step is to analyze whether ERI is a core government or non-core accountable entity.

Step 2 - Analysis to determine core/non-core status

To assist in making decisions about how to present ERI in the government-wide report, this step involves establishing whether ERI is a core government or non-core accountable entity. Core government entities should be consolidated, while non-core accountable entities should be disclosed.

The ED provides indicators of core government entities and one such indicator is that core government entities are primarily financed through non-exchange revenues. Although it is permitted to obtain funding from other sources, ERI is primarily supported by taxpayers. The ERI Trust Fund is ultimately funded through taxes.

Also, ERI's governance structure involves the appointment of board members through the political process. While this provides some indication of a core government entity, the terms of each member may be considered long and the long terms may limit opportunities for political involvement in governance. Thus, on balance, ERI presents a degree of characteristics indicative of a core government entity. Now, proceed to Step 3 to analyze whether ERI should be consolidated or disclosed.

Step 3 - Decision Regarding Presentation and/or Disclosure

Based on the results of Step 2, a decision can be made regarding how ERI should be consolidated or disclosed. Given that ERI is a core government entity, the ED provides for consolidation of the entity with other core government entities.

Mediation, Inc.

Background

Mediation was established as a 501(c)(3) through a public law specifying the organization's:

- status and operating location
- purpose and duties
- governance structure
- sources of financing
- reporting requirements

The corporation is authorized to operate as a non-member NFP organization within the District of Columbia. The purpose of the Corporation is to ensure that low-income individuals have access to mediation services to resolve non-criminal legal disputes. A network of local government and nonprofit organizations will be developed to deliver services financed by grants.

Governance Structure

The governing board comprises 13 members appointed by the President and confirmed by the Senate for three-year terms. The chairperson is selected by the President from among the members. No more than seven members may be affiliated with the same political party.

Budget and Finance Considerations

An annual appropriation is provided in the federal budget. The appropriation is made to a large federal department which transfers cash to the Corporation. The Corporation manages its cash balances similar to other non-profits and may retain any interest earnings on unspent funds. In addition, the Corporation may apply for and receive grants from any grant making organization—public or private.

Annual audited financial reports are required to be publicly available.

Application of the Proposed Standard

The following analyses illustrate how the proposed standard may be applied to determine whether Mediation should be included in the government-wide reporting entity and, if so, what information should be presented.

Step 1- Analysis against Inclusion Principles

The first step is to decide whether Mediation should be included in the government-wide reporting entity. To accomplish this step, Mediation's circumstances are analyzed against the inclusion principles of Budget, Majority Ownership, Control, and Misleading to Exclude Principle, respectively. Generally, once it is determined that the circumstances satisfy one of the principles, no additional analysis is needed for the step.

The first inclusion principle is that entities listed in the Budget should be included in the government-wide reporting entity and the circumstances indicate that Mediation meets this principle. Mediation is listed in the Budget as a program under a large federal department.

However, for those instances where entity management believes that the entity is actually a non-federal organization receiving federal assistance, the ED permits entity management to review the facts and circumstances to confirm whether the entity is not an organization for which the Congress and the President should be held accountable. Consequently, entity management would proceed to analyze the entity against the subsequent inclusion principles.

In this instance, Mediation's management questions whether the organization is actually a non-federal entity receiving federal assistance. Consequently, the next inclusion principle, Majority Ownership is considered.

The ED specifies that when the federal government holds a majority ownership in an entity, the entity should be included in the government-wide reporting entity. Ownership interest may be indicated by holding over 50% of the interest in voting rights or residual assets of an entity. However, the circumstances do not provide such indicators that the government acquired an ownership interest in Mediation. Therefore, the Control inclusion principle is considered.

The ED discusses that an entity controlled with the expectation of benefits or risk of loss should be included in the government-wide reporting entity. A pervasive indicator of control with the expectation of benefits or risk of loss is that the federal government unilaterally appoints or removes a majority of the governing board members of the entity. In the case of Mediation, the federal government appoints all of the governing board members. Accordingly, the circumstances concerning Mediation indicate that Control exists and the next step is to analyze whether Mediation is a core government or non-core accountable entity.

Step 2 - Analysis to determine core/non-core status

To assist in making decisions about how to present Mediation in the government-wide report, this step involves establishing whether Mediation is a core government or non-core accountable entity. Core government entities should be consolidated, while non-core accountable entities should be disclosed.

The ED provides indicators of core government entities and one such indicator is that core government entities are primarily financed through non-exchange revenues. Although Mediation receives its financial support through a federal department, its mission is ultimately financed by taxes. Another indicator of a core government entity is that the governance structure of core government entities involves the appointment of leaders through the political process. Mediation demonstrates this characteristic as all of its board members are appointed by the President and confirmed by the Senate for three-year terms. Thus, overall, Mediation exhibits a level of characteristics indicative of a core government entity.

Next, proceed to Step 3 to analyze whether Mediation should be consolidated or disclosed.

Step 3 - Decision Regarding Presentation and/or Disclosure

Based on the results of Step 2, a decision can be made regarding whether Mediation should be consolidated or disclosed. Given that Mediation is a core government entity, the ED provides for consolidation of the entity with other core government entities.

Bicycle America, Inc. (Scenario A)

Background

A nation-wide network of shops and trails was created to encourage greater reliance on bicycles for transportation. Individual jurisdictions invested in the effort to create a coast to coast network and ensure wide access to bicycling. Shares in the venture were held by local bicycle shops in all major cities and Bicycle America (BA) began operations. BA was able to finance its operations from user fees until it encountered some serious financial challenges. The federal government intervened and enacted legislation to provide funding with provisions as described below.

Governance Structure

BA is governed by a board of directors. The board controls and directs the organization's affairs and interests. Board members are elected by the shareholders to serve three-year terms.

The funding legislation established a temporary advisory committee to monitor BA's financial condition and inform Congress of potential issues that may warrant additional actions.

Budget and Finance Considerations

BA was organized to be a self-sustaining entity, deriving its revenues from user fees. As part of the intervention, the federal government extended a short-term loan to BA. The federal assistance to BA is not explicitly presented in the Budget, but is part of a larger federal program.

Application of the Proposed Standard

The following analyses illustrate how the proposed standard may be applied to determine whether BA should be included in the government-wide reporting entity and, if so, what information should be presented.

Step 1- Analysis against Inclusion Principles

The first step is to decide whether BA should be included in the government-wide reporting entity. To accomplish this step, BA's circumstances are analyzed against the inclusion principles of Budget, Majority Ownership, Control, and Misleading to Exclude Principle, respectively. Generally, once it is determined that the circumstances satisfy one of the principles, no additional analysis is needed for the step.

The first inclusion principle is that entities listed in the Budget should be included in the government-wide reporting entity and the circumstances indicate that BA does not meet this principle. BA is not explicitly listed in the Budget; therefore, the organization is analyzed against the Majority Ownership principle.

The ED specifies that when the federal government holds a majority ownership in an entity, the entity should be included in the government-wide reporting entity. Ownership interest may be indicated by holding over 50% of the interest in voting rights or residual assets of an entity. However, the circumstances do not provide such indicators that the government acquired a majority ownership interest in BA. The federal government provided BA with a loan and did not receive an ownership interest in the organization. Therefore, the Control inclusion principle is considered.

The ED discusses that an entity controlled with the expectation of benefits or risk of loss should be included in the government-wide reporting entity. A pervasive indicator of control with the expectation of benefits or risk of loss is that the federal government unilaterally appoints or removes a majority of the governing board members of the entity. In the case of BA, board members are elected by shareholders rather than subject to political appointment, but a committee was established primarily to advise Congress on possible future actions. Accordingly, the circumstances do not exhibit Control characteristics.

Next, the Misleading to Exclude Principle may be considered. As discussed in the ED, this principle concerns the notion that the government-wide financial report may be misleading if an entity were excluded. BA generally provides market-based services and primarily operates independently of the federal government. Also, the loan to BA was of a short duration minimizing the risks to taxpayers and indicating a temporary relationship. Consequently, BA may not be considered a candidate for inclusion in the government-wide reporting entity and additional analyses are not needed.

[Note: BA may be a candidate for related party disclosure. This matter will be discussed as more progress is made on the related party area of the ED.]

Bicycle America, Inc. (Scenario B)

Background

A nation-wide network of shops and trails was created to encourage greater reliance on bicycles for transportation. Individual jurisdictions invested in the effort to create a coast to coast network and ensure wide access to bicycling. Shares in the venture were held by local bicycle shops in all major cities and Bicycle America (BA) began operations. BA was able to finance its operations from user fees until it encountered some serious financial challenges. The federal government intervened and enacted legislation to provide funding with provisions as described below.

Governance Structure

BA is governed by a board of directors. The board controls and directs the organization's affairs and interests. Board members are elected by the shareholders to serve three-year terms.

The funding legislation established a temporary advisory committee to monitor BA's financial condition and inform Congress of potential issues that may warrant additional actions.

Budget and Finance Considerations

BA was organized to be a self-sustaining entity, deriving its revenues from user fees. As part of the intervention, the federal government extended a long-term loan to BA. The federal assistance to BA is not explicitly presented in the Budget, but is part of a larger federal program.

In addition, the federal government received shares that carry 51% of the voting rights of BA common stock.

Application of the Proposed Standard

The following analyses illustrate how the proposed standard may be applied to determine whether BA should be included in the government-wide reporting entity and, if so, what information should be presented.

Step 1- Analysis against Inclusion Principles

The first step is to decide whether BA should be included in the government-wide reporting entity. To accomplish this step, BA's circumstances are analyzed against the inclusion principles of Budget, Majority Ownership, Control, and Misleading to Exclude Principle, respectively. Generally, once it is determined that the circumstances satisfy one of the principles, no additional analysis is needed for the step.

The first inclusion principle is that entities listed in the Budget should be included in the government-wide reporting entity and the circumstances indicate that BA does not meet this principle. BA is not explicitly listed in the Budget; therefore, the organization is analyzed against the Majority Ownership principle.

The ED specifies that when the federal government holds a majority ownership in an entity, the entity should be included in the government-wide reporting entity. Ownership interest may be indicated by holding over 50% of the interest in voting rights or residual assets of an entity. The circumstances involving BA demonstrate this characteristic as the federal government acquired 51% of the voting rights in BA. Therefore, BA is included in the government-wide reporting entity and the next step is to analyze whether BA is a core government or non-core accountable entity.

Step 2 - Analysis to determine core/non-core status

To assist in making decisions about how to present BA in the government-wide report, this step involves establishing whether BA is a core government or non-core accountable entity. Core government entities should be consolidated, while non-core accountable entities should be disclosed.

The ED provides indicators of core government entities and one such indicator is that core government entities are primarily financed through non-exchange revenues. However BA primarily finances its operations through fees rather than taxes. Another indicator of a core government entity is that the governance structure of core government entities involves the appointment of leaders through the political process. Conversely, BA is governed by a board of directors who are primarily not selected by political involvement. Thus, overall, BA does not exhibit a level of characteristics indicative of a core government entity.

Next, proceed to Step 3 to analyze whether the presentation and/or disclosure of BA.

Step 3 - Decision Regarding Presentation and/or Disclosure

Based on the results of Step 2, a decision can be made regarding the presentation and/or disclosure of BA. Given that BA is a non-core accountable entity, the ED provides for disclosure. The information that may be disclosed includes the nature of the federal government’s relationship with BA, noting the percentage of voting rights, a description of the reason for federal government action, and the plan for managing the interest in BA, considering that a long-term financing arrangement had been provided.

Other Possible Illustrations to be Included

Federally Funded Research and Development Center
Federal Marketing Order
Entrepreneurial Fund
Museum