Federal Accounting Standards Advisory Board

September 7, 2007

Memorandum

To: Members of the Board

From: Melissa L. Loughan

Through: Wendy M. Payne, Executive Director

Subj: **Federal Entity—TAB G**[1]

At the July Board meeting, the Board discussed the approach for the Federal Entity project. It was agreed that staff would focus on developing proposed standards relating to the boundaries of the reporting entity and specific criteria for each. In addition, staff would concurrently consider potential amendments to SFFAC 2.

Attached is an issue paper that discusses general principles that will be relied upon in establishing the boundaries of the Federal Reporting Entity. Staff recommends the Federal Reporting Entity include entities, organizations, transactions, and activities for which:

- the federal government is financially accountable;
- the federal government exercises control over; and
- the nature and significance of their relationship with the federal government are such that the exclusion would cause the government's financial statements to be misleading or incomplete.

Also, to assist with the Board's understanding of how these general principles would be conveyed in a proposed standard, attached is an outline of a proposed standards statement. The goal for the September Board meeting will be to obtain the Board's feedback on these general principles. Specifically, staff requests feedback on the following:

- Does the Board agree with the staff recommendation for the general principles that will be relied upon in establishing the boundaries of the Federal Reporting Entity? Staff would like the Board's comments on each of the three—whether the Board agrees and any other suggestions prior to developing the specific criteria.

Staff plans to move forward by developing specific, detailed criteria for each of the broad areas identified for the Board's consideration at the next Board meeting. Please feel free to contact me at 202-512-5976 or by email at loughanm@fasab.gov to discuss any comments or questions you may have.

[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.

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Boundaries of the Federal Reporting Entity

Importance of Defining the Boundaries of the Reporting Entity

Defining the boundaries of the reporting entity draws the circle around which entities, organizations, transactions, and activities should be included in the financial report of the federal government. Clearly defining the boundaries of a reporting entity ensures that the financial statements contain all the information essential for fair presentation of the financial position and results of operations of the reporting entity and excludes information that would not result in fair presentation. Defining the boundaries also ensures consistency and completeness in what reporting entities encompass.

The boundaries of the Federal Reporting Entity are critical because the decision whether to include or exclude entities, organizations, transactions, and activities can impact the financial statements and the picture they provide to users. In fact, some would consider establishing the boundaries of the Federal Reporting Entity (and what's included in the consolidated financial statements) as having a greater impact on the federal government's financial reporting than any other issue.

Determining the boundaries of the Federal Reporting Entity determines which entities, organizations, transactions, and activities will be encompassed by the Federal Reporting Entity's general purpose financial report. While drawing the boundaries may be difficult, it provides an opportunity to identify and sharpen the focus on the activities and relationships where the Federal government actively participates.

For purposes of defining the boundaries of the Federal Reporting Entity, those entities, organizations, transactions, and activities that are considered to be within the boundaries of the reporting entity are consolidated. Just as there are ones that are within the boundaries, there will also naturally be entities, organizations, transactions, and activities that are outside the boundaries. Although they are considered outside the boundaries, some reporting may be considered appropriate. A corollary objective in this project will be to consider reporting and other disclosures for those that are outside the boundaries and not qualifying for consolidation.

What does Concepts 2, *Entity and Display* currently say about the Boundaries of the Reporting Entity?

38. The ultimate aggregation of entities is into the entire Federal Government which, in reality, is the only independent economic entity—although some would say the entire country is the ultimate economic entity. The Federal Government entity would encompass all of the resources and responsibilities existing within the component entities, whether they are part of the Executive, Legislative, or Judicial branches (although, as noted in paragraph 5, FASAB's recommendations pertain only to the Executive Branch). The aggregation would include organizations for which the Federal Government is financially accountable as well as other organizations for which the nature and significance of their relationship with the government (see paragraphs 39 through 50) are such that their exclusion would cause the Federal Government's financial statements to be misleading or incomplete.

Criteria for Including Components in a Reporting Entity

39. Regardless of whether a reporting entity is the U.S. Federal Government, or an organization, suborganization, or program, there can be uncertainty as to what should be included and inconsistency as to what is included in the reporting entity. The identification and application of specified criteria can reduce this uncertainty and inconsistency.

40. The Governmental Accounting Standards Board (GASB) has established criteria for what would be included in a state or local government reporting entity. These criteria relate to financial accountability, which includes appointment of a voting majority of the organization's governing board, together with imposition of will, and financial benefit to or burden on a primary government. These criteria, while in part relevant, must be tailored to the Federal Government environment. First, there are not as many different types of entities in the Federal Government as there are in state and local governments. Second, the Congress and others with oversight authority frequently establish explicit rules for what to include as part of a Federal reporting entity. Finally, as indicated, with the exception of the Federal Government as a whole, all the reporting units are components of a larger entity, namely the Federal Government, rather than independent economic entities.

Conclusive Criterion

41. There are two types of criteria that should be considered when deciding what to include as part of a financial reporting entity. The first is a **conclusive criterion**, i.e., an inherent conclusion that for financial reporting purposes, any organization meeting this criterion is part of a specified larger entity.

42. Appearance in the Federal budget section currently entitled “Federal Programs by Agency and Account” is a conclusive criterion. Any organization, program, or budget account, including off-budget accounts and government corporations, included in that section should be considered part of the U.S. Federal Government, as well as part of the organization with which it appears. This does not mean, however, that an appropriation that finances a subsidy to a non-Federal entity would, by itself, require the recipient to be included in the financial statements of the organization or program that expends the appropriation.

Indicative Criterion

43. There are instances when, for political or other reasons, an organization (including a government corporation), program, or account is not listed in the “Federal Programs by Agency and Account,” yet the general purpose financial statements would be misleading or incomplete—in regard to the objectives for Federal financial reporting—if the organization, program, or account were not included therein. These organizations, programs, or accounts would normally be considered to be operating at the “margin” of what would be considered a governmental function in contrast to providing a more basic governmental function. Thus, in addition to the conclusive criterion, there are several **indicative criteria** that should be considered in the aggregate for defining a financial reporting entity in the Federal Government. No single indicative criterion is a conclusive criterion in the manner that appearance in the “Federal Programs by Agency and Account” section of the budget is. Nor can weights be assigned to the indicative criteria. Thus, while the indicative criteria are presented in descending order of importance, judgment must be based on a consideration of all of the indicative criteria.

44. The indicative criteria for determining whether an organization not listed in the “Federal Programs by Agency and Account” section of the budget is nevertheless part of a financial reporting entity are as follows:

- It exercises any sovereign power of the government to carry out Federal functions. Evidence of sovereign powers are the power to collect compulsory payments, e.g., taxes, fines, or other compulsory assessments; use police powers; conduct negotiations involving the interests of the United States with other nations; or borrow funds for Government use.
- It is owned by the Federal Government, particularly if the ownership is of the organization and not just the property. Ownership is also established by considering who is at risk if the organization fails, or identifying for whom the organization's employees work.
- It is subject to the direct or continuing administrative control of the reporting entity, as revealed by such features as (1) the ability to select or remove the governing authority or the ability to designate management, particularly if there is to be a significant continuing relationship with the governing authority or management with respect to carrying out important public functions (in contrast to selections and designations in which there is little continuing communication with, or accountability to, the appointing official); (2) authority to review and modify or approve budget requests, budgetary adjustments, or amendments or rate or fee changes; (3) ability to veto, overrule, or modify governing body decisions or otherwise significantly influence normal operations; (4) authority to sign contracts as the contracting authority; (5) approval of hiring, reassignment, and removal of key personnel; (6) title to, ability to transfer title to, and/or exercise control over facilities and property; and (7) right to require audits that do more than just support the granting of contracts. (While many of these criteria exist in a client contractor relationship, it is not necessarily intended that an entity's contractor be considered as part of the reporting entity.)
- It carries out Federal missions and objectives.
- It determines the outcome or disposition of matters affecting the recipients of services that the Federal Government provides.
- It has a fiduciary relationship with a reporting entity, as indicated by such factors as the ability of a reporting entity to commit the other entity financially or control the collection and disbursement of funds; and other manifestations of financial interdependency, such as a reporting entity's responsibility for financing deficits, entitlement to surpluses (although not necessarily the assets acquired from failed units), or the guarantee of or "moral responsibility" for debt or other obligations.

45. The entity or any of the above criteria are likely to remain in existence for a time, i.e., the interest in the entity and its governmental characteristics is more than fleeting.

46. In applying the indicative criteria, the materiality of the entities and their relationship with one another should be considered. Materiality should not be measured solely in dollars. Potential embarrassment to any of the entities' stakeholders should also be considered. Thus, a bias toward expansiveness and comprehensiveness would be justified, particularly if it could contribute to maintenance of fiscal control.[1]

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[1] Any uncertainty as to what to consider as a reporting entity would be resolved by OMB in consultation with the appropriate Congressional committees.

High-level Comparison Charts

Figure 1 presents a high-level summary of FASAB's current guidance in SFFAC 2 regarding conclusive and indicative criteria as well as the requirements of the Governmental Accounting Standards Board and the Financial Accounting Standards Board. Figure 2 presents a high-level summary of selected international requirements on the subject. The most apparent shortcoming in the FASAB literature is that it resides entirely in a concept statement. Of the references provided in Figures 1 and 2, FASAB is the only standard setter that has not included in its standards requirements for consolidation.

In reviewing the consolidation requirements, staff notes that with the exception of GASB, **control** is the main consideration factor for most other standard-setters. GASB's focus is financial accountability. Another interesting point to note is that the Public Sector Accounting Board (PSAB) of Canada revised their reporting entity standard in 2003. Prior to 2003, the reporting entity standard was based on accountability and ownership or control. However, the current standard and approach is based on control. In approving the revised approach, the PSAB decided that both ownership and accountability are more in the nature of subsets of control. For example, control may be exercised through ownership, but not necessarily only through ownership.

Figure 1: Comparison of U.S. Standards				
Country	**Document**	**Scope**	**Consolidation Requirement**	**Definition / Criteria**
United States of America	FASAB Statement of Federal Financial Accounting Concepts No. 2, *Entity and Display*	Federal Sector	Financial Accountability and existence of a Significant Relationship where exclusion would cause the financial statements to be misleading or incomplete. (¶ 38)	Conclusive criterion • Any organization, program, or budget account, including off-budget accounts and government corporations, included in the Federal budget section currently entitled "Federal Programs by Agency and Account." Indicative criteria • It exercises any sovereign power of the government to carry out Federal functions. • It is owned by the Federal Government • It is subject to the direct or continuing administrative control of the reporting entity. • It carries out Federal missions and objectives. • It determines the outcome or disposition of matters affecting the recipients of services that the Federal Government provides. • It has a fiduciary relationship with a reporting entity.
	GASB Statement No. 14, *The Financial Reporting Entity*	State and Local Government Entities	Financial Accountability	A primary government is financially accountable for legally separate components under either of the following circumstances: a. The primary government appoints a voting majority of the organization's governing board and (1) it is able to impose its will on that organization or (2) there is potential for the organization to provide specific financial benefits to, or impose specific financial burdens on the primary government. b. If an organization is fiscally dependent on the primary government. (¶ 20)
	FASB Statement of Financial Accounting Standards No. 96	Private Sector Entities	Controlling Financial Interest	The usual condition for a controlling financial interest is ownership of a majority voting interest, and, therefore, as a general rule ownership by one company, directly or indirectly, of over fifty percent of the outstanding voting shares of another company is a condition pointing toward consolidation. (¶ 13)

Figure 2: Comparison of National and International Standards				
Country	**Document**	**Scope**	**Consolidation Requirement**	**Definition / Criteria**
Australia	Australian Accounting Standard AAS 24, *Consolidated Financial Reports*	Private and public sector entities, excluding those at the "whole-of-government" level for each State, Territory and the Federal Government	Control	Control means the capacity of an entity to dominate decision making, directly or indirectly, in relation to the financial and operating policies of another entity so as to enable that other entity to operate with it in pursuing the objectives of the controlling entity. (¶ 18)
Canada	CICA Handbook Section 1590, *Subsidiaries*	Profit-oriented enterprises	Control	Control of an enterprise is the continuing power to determine its strategic operating investing and financing policies without the co-operation of others. (¶ .03)
	Public Sector Accounting Recommendations, Section PS 1300, *Government Reporting Entity*	Federal, provincial, territorial and local governments	Control	Control is the power to govern the financial and operating policies of another organization with expected benefits or the risk of loss to the government from the other organization's activities. (¶ .08)
International Accounting Standards Board	International Accounting Standard IAS 27, *Consolidated Financial Statements and Accounting for Investments in Subsidiaries*	Private sector parent entities	Control	Control is the power to govern the financial and operating policies of an enterprise so as to obtain benefits from its activities. (¶ 6)
International Federation of Accountants	International Public Sector Accounting Standard 6, *Consolidated Financial Statements and Accounting for Controlled Entities*	Public sector entities other than Government Business Enterprises	Control	Control is the power to govern the financial and operating policies of another entity so as to benefit from its activities. (¶ 8)

Defining Boundaries of the Reporting Entity in Relation to the Objectives of Federal Financial Reporting

The nature of entities, organizations, transactions and activities that should be included in a Federal Reporting Entity should be determined by reference to the objectives of federal financial reporting.

The objectives of federal financial reporting, as detailed and discussed in SFFAC 1 are as follows:

Objective 1--Budgetary Integrity

Federal financial reporting should assist in fulfilling the government's duty to be publicly accountable for monies raised through taxes and other means and for their expenditure in accordance with the appropriations laws that establish the government's budget for a particular fiscal year and related laws and regulations. *Federal financial reporting should provide information that helps the reader to determine:*

1A. How budgetary resources have been obtained and used and whether their acquisition and use were in accordance with the legal authorization.
1B. The status of budgetary resources.
1C. How information on the use of budgetary resources relates to information on the costs of program operations and whether information on the status of budgetary resources is consistent with other accounting information on assets and liabilities.

Objective 2--Operating Performance

Federal financial reporting should assist report users in evaluating the service efforts, costs, and accomplishments of the reporting entity; the manner in which these efforts and accomplishments have been financed; and the management of the entity's assets and liabilities. *Federal financial reporting should provide information that helps the reader to determine:*

2A. The costs of providing specific programs and activities and the composition of, and changes in, these costs.
2B. The efforts and accomplishments associated with federal programs and the changes over time and in relation to costs.
2C. The efficiency and effectiveness of the government's management of its assets and liabilities.

Objective 3--Stewardship

Federal financial reporting should assist report users in assessing the impact on the country of the government's operations and investments for the period and how, as a result, the government's and the nation's financial condition has changed and may change in the future.

Federal financial reporting should provide information that helps the reader to determine:

- 3A. Whether the government's financial position improved or deteriorated over the period.
- 3B. Whether future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due.
- 3C. Whether government operations have contributed to the nation's current and future well-being.

Objective 4--Systems and Control

Federal financial reporting should assist report users in understanding whether financial management systems and internal accounting and administrative controls are adequate to ensure that:

- 4A. Transactions are executed in accordance with budgetary and financial laws and other requirements, consistent with the purposes authorized, and are recorded in accordance with federal accounting standards;
- 4B. Assets are properly safeguarded to deter fraud, waste, and abuse; and
- 4C. Performance measurement information is adequately supported.

The Objectives phase of the overall Concepts Project related to the evaluation of the reporting objectives as presented in Statement of Federal Financial Accounting Concepts (SFFAC) 1, *Objectives of Federal Financial Reporting.* Evaluation of the reporting objectives focused on (1) clarifying the broad federal financial reporting objectives by determining if they are still valid and appropriate and whether additional objectives are necessary and (2) defining FASAB's strategic directions by clarifying its near-term role in achieving those broad objectives as the nature of the Board's involvement may vary for each objective. The Board agreed to maintain the current broad objectives of federal financial reporting in SFFAC 1.[2]

SFFAC 1 provides that the "objectives are designed to guide the Board in developing accounting standards to enhance the financial information reported by the federal government to (1) demonstrate its accountability to internal and external users of federal financial reports, (2) provide useful information to internal and external users of federal financial reports, and (3) help internal users of financial information improve the

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[2] *FASAB's Strategic Directions Report: Clarifying FASAB's Near-Term Role in Achieving the Objectives of Federal Financial Reporting*, November 2006

government's management."[3] Further, the objectives "reflect many of the needs expressed by current and potential users of federal financial information."[4]

In addition to the reporting objectives, SFFAC 1 discusses accountability and users' information needs as the foundation of Governmental financial reporting. Specifically, par. 71 states "It may be said that "accountability" and its corollary, "decision usefulness," comprise the two fundamental values of governmental accounting and financial reporting. They provide the foundation for the objectives of federal financial reporting." Further, par. 71 adds "The assertion of accountability therefore leads to identifying, first, those to whom government is accountable and, second, the information needed to maintain and demonstrate that accountability."

SFFAC 1 explains that the federal government has a special responsibility to report on its actions and the results of those actions. SFFAC 1 contains a lengthy discussion about the information needs of both internal and external users. It explains that reports should provide information useful to the citizens, their elected representatives, federal executives, and program managers because it is an essential part of accountability in government.

Considering the Board determined that the federal financial reporting objectives are still valid and appropriate in the Objectives Phase of the Conceptual Framework Project, it is important that those be considered in the Federal Entity Phase. SFFAC 1 is very clear that the objectives were designed to help ensure the accountability of the federal government and to better inform decisions influenced by the financial information about the government. There is a focus on the needs of current and potential users of federal financial information. As noted, SFFAC 1 discusses accountability and users' information needs as the foundation of Governmental financial reporting

It appears the overriding objective of federal financial reporting is accountability and user needs. In fact, in each of the four objectives there are several references to user information and accountability. Therefore, the notion of accountability and users' information needs should be of reference when considering the boundaries of the reporting entity.

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[3] SFFAC 1, par. 3

[4] SFFAC 1, par. 4

The Public Sector Committee of the IFAC issued a series of studies to provide information that contributes to public sector financial reporting, accounting, and auditing. The IFAC Public Sector Accounting Study 8, *The Government Financial Reporting Entity*, considered what resources and entities should be considered as part of national governments for financial reporting purposes. The study determined that there is widespread acceptance that financial information should be prepared for accountability and to a lesser extent, decision making purposes. [5]

With respect to boundaries, the study showed there are two distinct views about how to determine the boundaries of the reporting entity in order to best satisfy information for accountability and decision making purposes. The study revealed that one view is that they can be met by demonstrating compliance with authorized allocation of funds or spending mandates. An alternate view is that it can be met by reporting on all the resources for which the government is responsible where responsible can be those things the government controls or owns.[6] The study revealed the predominant criterion used to determine the boundaries of a government reporting entity to be compliance with authorized allocation of public funds.[7]

Staff believes both perspectives should be considered when defining the boundaries of the Federal Reporting Entity. Both support accountability and user needs which is consistent with the objectives of federal financial reporting.

FINANCIALLY ACCOUNTABLE

The boundaries of the Federal Reporting Entity should naturally include all the entities, organizations, transactions, and activities that the federal government is financially accountable for. Meaning, it would include all the entities, organizations, transactions, and activities that are funded wholly or predominantly by public funds, ie. President's Budget. This boundary is perhaps one of the most straight-forward as users are interested in the government's accountability of those funds and specifically, knowing

[5] IFAC Public Sector Accounting Study 8, *The Government Financial Reporting Entity,* par. .027 (Issued July 1996)

[6] IFAC Public Sector Accounting Study 8, par. .028-.029

[7] IFAC Public Sector Accounting Study 8, par. .032

how efficiently the policies of the federal government were carried out with respect to the resources entrusted.

Including those entities and organizations that the federal government is financially accountable for is consistent with SFFAC 2. Specifically, SFFAC 2 par. 38 that states "The aggregation would include organizations for which the Federal Government is financially accountable.." Further par. 42 of SFFAC 2 states "Appearance in the Federal budget section currently entitled Federal Programs by Agency and Account" is a conclusive criterion…" that it is part of the U.S. Federal Government.

However, there are numerous entities or organizations that are self-sustaining or dependent on the government for limited funding or that may not rely on government funding. Determining boundaries for the Federal Reporting Entity strictly by financial accountability would provide only a portion or fragmented view of the federal reporting entity. Therefore financially accountable for is not the only consideration when determining the boundaries of the federal entity.

CONTROL

As noted in the **High-level Comparison Chart,** control is used to determine the boundaries of entities for many standard setters. Most of the definitions of control adopted may be viewed as primarily in the private sector. However, a common definition has been applied in certain public sectors as well. Staff believes the notion of control should also be considered when defining the boundaries of the Federal Reporting Entity.

However, there are difficulties when applying the concept of control to determine the boundaries of the Federal Reporting Entity. Specifically, a determination for the definition and characteristics of control will have to be made. For example, some may believe the concept of control is not appropriate because the federal government could potentially control all of the resources through sovereign powers to tax and regulate. However, use of the power to control via regulation would clearly give rise to a federal entity of meaningless dimension.[8] The existence of control will depend on facts in

[8] IFAC Public Sector Accounting Study 8, par. 051

differing cases and naturally will require much judgment. The application of the concept of control in relation to defining the boundaries of the Federal Reporting Entity will require the establishment of rules or guidance to ensure consistency with the diverse activities in the federal government.

Staff notes that including the concept of control is consistent with SFFAC 2. Specifically, par. 44 identifies the following indicative criteria relating to control:

> It is subject to the direct or continuing administrative control of the reporting entity, as revealed by such features as (1) the ability to select or remove the governing authority or the ability to designate management, particularly if there is to be a significant continuing relationship with the governing authority or management with respect to carrying out important public functions (in contrast to selections and designations in which there is little continuing communication with, or accountability to, the appointing official); (2) authority to review and modify or approve budget requests, budgetary adjustments, or amendments or rate or fee changes; (3) ability to veto, overrule, or modify governing body decisions or otherwise significantly influence normal operations; (4) authority to sign contracts as the contracting authority; (5) approval of hiring, reassignment, and removal of key personnel; (6) title to, ability to transfer title to, and/or exercise control over facilities and property; and (7) right to require audits that do more than just support the granting of contracts. (While many of these criteria exist in a client contractor relationship, it is not necessarily intended that an entity's contractor be considered as part of the reporting entity.)

The criteria and characteristics for control will require more judgment and be the discussion of a future staff paper. However, the criteria included in SFFAC 2 would be the starting point in determining the criteria to be included in the proposed standards.

OTHER SIGNIFICANT RELATIONSHIPS

In addition to financially accountable and control, there is a third general principle that should be considered in defining the boundaries of the Federal Reporting Entity. There may be instances where not controlled and the government is not financially accountable for, yet the nature and significance of the relationship with the federal entity is such that excluding them would make the general purpose financial reports misleading or incomplete.

Staff believes it is appropriate to include a third broad area that addresses these types of relationships. Staff notes this would be consistent with current language included in SFFAC 2 par. 38 that states the aggregation for the Federal Government includes "other organizations for which the nature and significance of their relationship with the government are such that their exclusion would cause the Federal Government's financial statements to be misleading or incomplete."

CONCLUSION

Based on the above, staff recommends that the general principles that will be relied upon in establishing the boundaries of the Federal Reporting Entity be as follows:

The Federal Reporting Entity includes all entities, organizations, transactions, and activities for which

- the federal government is financially accountable;
- the federal government exercises control over; and
- the nature and significance of their relationship with the federal government are such that the exclusion would cause the government's financial statements to be misleading or incomplete.

As noted, these are considered the general principles that will be relied upon in establishing the boundaries of the Federal Reporting Entity. From these general principles, staff will develop detailed criteria for each. It is important to have specific criteria for what organizations should be included in a reporting entity's financial statements and also to ensure consistency.

At the July Board meeting, the Board decided that staff should focus on developing the proposed standards. The Board suggested the proposed standards should build upon what is currently in SFFAC 2 and any proposed changes could be incorporated as needed. Staff believes these general principles are consistent with the framework established in SFFAC 2. However, staff believes presenting the broad general principles in the proposed standard would allow for an expansion of the detailed criteria that may go beyond what is in SFFAC 2 and resolve some of the outstanding issues. Based upon the Board's approval of the broad areas of the boundaries of the federal reporting entity noted above, staff will develop detailed criteria for each.

To assist with the Board’s understanding of how these general principles would be conveyed in a proposed standard, attached is an outline of a proposed standards statement. Staff believes that the project (and proposed standards) also should address the boundaries of Federal Component Entity reports. This topic will be addressed in a future paper.

Does the Board agree with the staff recommendation for the general principles that will be relied upon in establishing the boundaries of the Federal Reporting Entity?

Staff would like the Board’s comments on each of the three—whether the Board agrees and any other suggestions prior to developing the specific criteria.

OUTLINE
Proposed Standards
The Reporting Entity and Consolidation

Transmittal
Preamble
Executive Summary
Acronyms
Questions for Respondents

Introduction

EXPLAIN IMPORTANCE OF REPORTING ENTITY AND CONSOLIDATION

The reporting entity and consolidation issues are very important in financial reporting. Most would agree that accounting information pertains to entities and entities use financial reports to communicate information to people concerned or interested in the entity.

Therefore, the primary reason for defining the reporting entity is to ensure that users of the financial reports will be provided with complete financial information about the entity and its involvements. By clearly defining the financial activities relevant to the reporting entity, reports would enable users to understand the activities encompassed by the organization. The structure of the federal government has become increasingly complex and, as such, it is important to identify its components and activities that would be consolidated with each entity's financial statements.

Clearly defining the reporting entity and the components consolidated in the statements allows users to make the best use of the information. Identifying the entities for inclusion in the Federal Government's financial statements is critical to creating transparent reports to support accountability.

Consolidation high-lights the ultimate aggregation of entities is into the entire Federal

Government; which, in reality, is the only independent economic entity. Although many government organizations prepare their own financial statements, individually those financial statements provide a partial or fragmented view of the Federal Government. Without a consolidated statement for the entire Federal Government, it is impossible to get a complete picture. A complete and consolidated statement of the Federal Government allows for sound decision-making and accountability.

EXPLAIN BASIC PREMISES FOR THE STANDARD

- Does not prescribe specifics of which are in or out, instead provides general principles and criteria for each
- Substance of relationship is determining factor, regardless of legal form of relationship
- Decisions are made at of the reporting date based on legislative framework regardless of government's ability to change it in the future

Boundaries of the Federal Reporting Entity

Clearly defining the boundaries of a reporting entity ensures that the financial statements contain all the information essential for fair presentation of the financial position and results of operations of the reporting entity and excludes information that would not result in fair presentation. Defining the boundaries also ensures consistency and completeness in what reporting entities encompass.

Assessing whether an entity should be included with a reporting entity is often difficult and requires the exercise of professional judgment and the consideration of many factors and indicative characteristics.

The Boundaries of the Federal Reporting Entity and therefore what should be included in the consolidated financial statements are critical because the decision whether to include or exclude organizations can impact the financial statements and the picture they provide to users. In fact, some would consider establishing the boundaries of the Federal Reporting Entity (and what's included in the consolidated financial statements) as having a greater impact on the federal government's financial reporting than any other issue.

Determining the boundaries of the Federal Reporting Entity determines which entities, organizations, transactions, and activities will be encompassed by the Federal Reporting Entity's general purpose financial report. While drawing the boundaries may be difficult, it provides an opportunity to identify and sharpen the focus on the activities and relationships that the Federal government actively participates.

The Federal Reporting Entity includes all entities, organizations, transactions, and activities for which

- the federal government is financially accountable;
- the federal government exercises control over; and
- the nature and significance of their relationship with the federal government are such that the exclusion would cause the government's financial statements to be misleading or incomplete.

Standards

The Federal Government Reporting Entity should comprise the organizations for which it is financially accountable.

Criteria for Determining Whether Financially Accountable For

The Federal Reporting Entity would encompass all the resources and responsibilities existing within the Federal Government, which includes the Executive, Legislative and Judicial branches[9]. Accordingly, any organization, program or budget account, including off-budget accounts and government corporations, included in the *Budget of the United States Government Analytical Perspectives* section currently entitled *Federal Programs by Agency and Account* should be considered part of the Federal Reporting Entity.

[9] Although FASAB's standards only pertain to the Executive Branch, information should be included from the other branches for completeness of the Federal Reporting Entity.

The Federal Government Reporting Entity should comprise the organizations it exercises control over.

<u>Define Control</u>

<u>Criteria for Determining Whether Control Exists</u>

CONSIDER Excerpt from SFFAC 2

Indicators of Control

- It is subject to the direct or continuing administrative control of the reporting entity, as revealed by such features as (1) the ability to select or remove the governing authority or the ability to designate management, particularly if there is to be a significant continuing relationship with the governing authority or management with respect to carrying out important public functions (in contrast to selections and designations in which there is little continuing communication with, or accountability to, the appointing official); (2) authority to review and modify or approve budget requests, budgetary adjustments, or amendments or rate or fee changes; (3) ability to veto, overrule, or modify governing body decisions or otherwise significantly influence normal operations; (4) authority to sign contracts as the contracting authority; (5) approval of hiring, reassignment, and removal of key personnel; (6) title to, ability to transfer title to, and/or exercise control over facilities and property; and (7) right to require audits that do more than just support the granting of contracts. (While many of these criteria exist in a client contractor relationship, it is not necessarily intended that an entity's contractor be considered as part of the reporting entity.)

The Federal Government Reporting Entity should comprise the organizations for which the nature and significance of their relationship with the federal government are such that the exclusion would cause the government's financial statements to be misleading or incomplete.

CONSIDER Excerpt from SFFAC 2

- There are instances where entities that may not meet the first two characteristics listed above, yet the nature and significance of the relationship is such that excluding them would make the general purpose financial reports misleading or incomplete.

- It exercises any sovereign power of the government to carry out Federal functions.

Evidence of sovereign powers are the power to collect compulsory payments, e.g., taxes, fines, or other compulsory assessments; use police powers; conduct negotiations involving the interests of the United States with other nations; or borrow funds for Government use.

- It carries out Federal missions and objectives.
- It determines the outcome or disposition of matters affecting the recipients of services that the Federal Government provides.
- It has a fiduciary relationship with a reporting entity, as indicated by such factors as the ability of a reporting entity to commit the other entity financially or control the collection and disbursement of funds; and other manifestations of financial interdependency, such as a reporting entity's responsibility for financing deficits, entitlement to surpluses (although not necessarily the assets acquired from failed units), or the guarantee of or "moral responsibility" for debt or other obligations.

EXCLUSIONS --Organizations meeting the above would be excluded from the reporting entity in the following situation:

- *Temporary Existence of one of the above criteria.* Organizations should be excluded if one of the above conditions or criteria is for the short-term or temporary. Meaning, organizations should only be included in the reporting entity when the criteria being met, is likely to remain in existence for a time, it is more than fleeting.

- *The organizations and functions pertain to monetary policy.* In the United States, the organization and functions pertaining to monetary policy are traditionally separated from and independent of the other central government organizations and functions in order to achieve more effective monetary and fiscal policies and economic results. For example, the Federal Reserve System would not be considered part of the Federal Entity.

- *GSEs, bail outs*

- *Others….*

- *Required Disclosures for exclusions*

Federal Component Reporting Entities

Define Component Reporting Entities

Boundaries of Component Reporting Entities

Materiality

--Consider if any special language should be included regarding materiality (other than the standard immateriality box).

-- SFFAC 2 includes the following in par. 46. "In applying the indicative criteria, the materiality of the entities and their relationship with one another should be considered. Materiality should not be measured solely in dollars. Potential embarrassment to any of the entities' stakeholders should also be considered. Thus, a bias toward expansiveness and comprehensiveness would be justified, particularly if it could contribute to maintenance of fiscal control. Paragraph Footnote: Any uncertainty as to what to consider as a reporting entity would be resolved by OMB in consultation with the appropriate Congressional committees."