

Standards Watch

What Should be Included in the Financial Statements of our Nation's Government?

By: Tom L. Allen, CPA

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The Federal Accounting Standards Advisory Board (FASAB) has a very important project on its agenda—the Federal Entity project—with the purpose of clearly defining the boundaries of the U.S. government reporting entity as a whole and its component reporting entities. In this column, I will provide an update on the board's work on the Federal Entity project since staff reported on it in the Spring 2010 issue of the *Journal*.¹

Defining the boundaries of the reporting entity draws the circle around which entities, organizations, transactions and activities should be included in the financial reports of the federal government. Clearly defining the boundaries of a reporting entity ensures that the financial statements contain all the information reflecting an entity's financial assets and obligations as well as financial risk assumed for other organizations. Defining the boundaries also ensures consistency in financial reporting from one period to the next.

Statement of Federal Financial Accounting Concepts (SFFAC 2), *Entity and Display*, defines the criteria to consider when deciding what to include as part of a financial reporting entity. However, SFFAC 2 is a concepts statement that is intended to guide the members of the board in developing future standards and, while they can be used by preparers when guidance is lacking in the standards, concepts statements are not considered an authoritative

source of generally accepted accounting principles (GAAP).

The severity of the recent financial crisis resulted in the federal government undertaking a number of unprecedented actions that required federal financial managers to make decisions about the accounting and reporting of such actions after the fact and with limited GAAP guidance. This situation highlights the importance of federal accounting standards that preparers and auditors use to help them determine the appropriate accounting and reporting for each scenario that arises.

FASAB, with the help of a Federal Entity Task Force, is drafting a proposed standard. The proposal has not been approved in final form but certain aspects can be described in some detail at this stage. The draft proposal would require an organization meeting any of the three principles below to be included in the consolidated financial report of the U.S. government:

- In the budget;
- Majority ownership interest; or
- Control with expected benefits or risk of loss.

Once an entity is determined to be included in the government-wide reporting entity, the proposal would classify the entity as either a "core" or "non-core" entity based upon the degree to which 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 (see *Figure 1*).

Core entities would be consolidated; non-core entities would be subject to more flexible disclosures.²

There are several advantages of providing financial reporting standards that clearly define the reporting entity. One of those is that financial statement preparers, both at the government-wide level and at the department or agency level, will be provided guidance that can be consistently applied by them and their auditors. Another is that the criteria will be in place for programs and entities already in existence as well as new ones that may be created. This is important because, as we found with the current financial crisis, the relationship between the federal government and other entities can change very quickly.

One does not need to look very far to find a classic example of why the federal government needs accounting standards for defining the federal reporting entity—government-sponsored enterprises (GSE). When I began serving on FASAB in 2006, numerous newspaper articles talked about the market assumptions that the federal government backed GSE securities even though, by law, GSE securities carry a disclaimer of any U.S. obligation.



FIGURE 1: DRAFT STAFF PROPOSAL

However, in 2008, it was determined by the federal government that two large GSEs—Fannie Mae and Freddie Mac—could not continue to operate safely and soundly and fulfill their critical public mission. To restore the balance between safety and soundness and mission, the federal government placed Fannie Mae and Freddie Mac into conservatorship, a statutory process designed to stabilize a troubled institution with the objective of returning the entities to normal business operations. The federal government will act as the conservator to operate the GSEs until they are stabilized. On the path from legislative idea to GSE to conservatorship to yet another form, many questions about federal reporting might arise and standards are needed to ensure fair presentation of financial position and financial risk.

The federal government is seeing more and more unique relationships. For example, public-private partnerships can be seen as part of a growing trend that raise questions about control and the balance of risk and reward. FASAB is also starting a new technical agenda project titled “Risk Assumed,” which should also help better reflect risk that may be assumed as a result of the unique responsibilities of the federal government. Please take time to comment on these exposure drafts when they are finalized and posted for comment at www.fasab.gov. ■

Defining Federal Entities by Core and Non-Core

Core (or general) government entities:

- Generally provide core federal goods and services on a non-market basis, and are financed primarily through taxes and other non-exchange revenues.
- Receive taxpayer support as evidenced by inclusion in the budget.
- Accountability rests with elected officials.
- Significant risks and rewards fall to the taxpayer.
- Their governance structure is vertically integrated as evidenced by the establishment of organizational authorities and budgets by elected officials, and the appointment of organizational leaders through the political process.

Non-core entities:

- May provide core federal government goods and services but are more likely to provide goods and services on a market basis.
- Receive limited or no taxpayer support.
- Accountability rests with elected officials but elected officials have less direct involvement in decision-making than is true in core government entities.
- Limited risks and rewards fall to the taxpayers.

End Notes

1. “Defining the Boundaries of the Federal Government Reporting Entity: FASAB is Laying the Chalk Lines of this Wide Field in its Federal Entity Project,” by Melissa Loughan, CPA, *Journal of Government Financial Management*, Spring 2010, pp. 42–49.

2. Additional information is available on the Federal Entity project page at www.fasab.gov.



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