



October 7, 2011

Memorandum

To: Members of the Board

From: Melissa L. Loughan, Assistant Director
Wendy M. Payne

Through: Wendy M. Payne, Executive Director

Subj: Federal Entity- **Tab B-Federal Entity Government-wide**¹

MEETING OBJECTIVES

- To approve the revised language for the government-wide reporting entity open issues and obtain member feedback on the completed government-wide portion of the Exposure Draft (ED).

The primary objective for the October Board meeting is to approve the revised language for the consolidation of FASB-based information without conversion and the revised language for non-core entity disclosures.

Another particular area that staff has presented for discussion is the issue of addressing the effect of the proposed changes on how the Federal Reserve System is treated. In addition, staff has completed the draft of the other areas of the government-wide portion (basis for conclusions and questions for respondents) for the Board's review and the secondary objective is to obtain member feedback on this area and the document. As staff is also requesting input on the entire Draft ED, there are brief topics presented on these in the issue paper.

Specific questions related to these objectives are included on page 3 and within the Staff Issue Paper specific to the topic for discussion. Member feedback on the completed draft will be helpful in ensuring staff has a strong basis for developing the component entity portion.

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.

BRIEFING MATERIAL

- ***Staff Issue Paper***
- ***Draft Exposure Draft***
- ***Appendix 1— Marked Version of Language for Government-wide Issues***

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

BACKGROUND

As you may recall at the August meeting, the Board deliberated and requested staff to:

- prepare revised wording on the consolidation of FASB-based information for the Board's review and
- prepare a revised disclosure section for non-core entities that focuses on three broad objectives-- nature of the relationship, nature and magnitude of the activity during the period and balances at the end of the period, and future risks and exposures to gains or loss. The examples of information included should be presented in a manner that demonstrates they could be provided to satisfy all three objectives.

In addition, staff has completed a draft of the other areas of the government-wide portion (basis for conclusions and questions for respondents) for the Board's review. Therefore, staff wanted to gather the Board's feedback on these areas.

NEXT STEPS

After receiving the Board's feedback, staff will assess if any open issues remain (other than related party) on the government-wide section of the ED. The Board may wish to consider if a Preliminary Views document or a Discussion Memorandum should be issued to solicit input on the government-wide portion as it appears the Board will be spending some time on the component reporting entity piece. It doesn't appear much time would be required to get the document ready for this and it might be beneficial as the Board would be working on the component entity portion during this time. The feedback may have an impact and perhaps assist with developing the more detailed options for the component reporting entity section.

The detailed options for the component entity will be the agenda topic for December.

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

BOARD QUESTIONS

- 1. Does the Board agree with revised language to address the consolidation of FASB Statements?**
- 2. Does the Board agree with the revised language for Disclosures for Non-core entities?**
- 3. Should a listing of non-core entities be incorporated into the Disclosures for Non-core Entities?**
- 4. Does the Board agree that OPTION 2 is preferred for explaining the deletion of SFFAC 2 language excluding the Federal Reserve System and its effect on reporting?**
- 5. Does the Board agree with the general rationale offered in OPTION 2?**
- 6. Does the Board approve the draft Basis for Conclusions? (Editorial comments may be directed to staff before or after the meeting. Staff is seeking approval of the overall structure, detail, and rationale proposed.)**
- 7. Does the Board agree with the proposed Questions for Respondents for the government-wide portion of the ED?**
- 8. Does the Board wish to offer additional Questions for Respondents for consideration?**
- 9. Does the Board wish to issue a Preliminary Views document or a Discussion Memorandum to solicit input on the government-wide portion?**

Staff Issue Paper October 2011 Board Meeting

Revised Language-- Consolidation of FASB-based Information without Conversion

In June, the Board agreed consolidation of FASB and FASAB based information was acceptable, line items would reference disclosures breaking out the numbers and describing the accounting policies used, and no reconciliation between the two GAAP based amounts would be included. Upon reviewing draft language in August, the Board requested revisions so the focus would be on information about material FASB amounts that contributed significantly to separately reported amounts. The Board also agreed that the question to respondents should be a broader question and no alternative position regarding flexibility in determining whether to convert would be offered. [See the August 2011 Minutes for a complete discussion of the topic.]

Based on the August meeting, staff presents the following revised language for each section of the ED.

Basis for conclusions under the heading “Consolidation of FASB-based and FASAB-based Information”:

See ***Appendix 1— Marked Version of Language for Government-wide Issues*** for a copy of the Standard language that includes tracked changes since the August Board meeting. The language below incorporates all staff suggested changes for a clean read.

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

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

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

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

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

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

Government-wide Reporting Entity Consolidation and Disclosure

Core government entities

1. The Statement provides for consolidation³ of core government entities' financial statements to facilitate an assessment of the financial position of the federal government and the cost of operations financed by taxpayers.

² In October 1999, FASAB was recognized as the Rule 203 standards-setting body for the federal government.

³ Consolidation is a method of accounting that combines the accounts of those entities line by line on a uniform basis of accounting and eliminates balances and transactions among the entities. For selected financial statements such as the statement of budgetary resources, a combined financial statement which does not eliminate balances and transactions among the entities is acceptable.

Consolidation aggregates the individual financial statements of entities comprising a reporting entity and results in presentation of information for a single economic entity representing core taxpayer supported activities, resources, and obligations where accountability rests with the Congress and the President.

2. Core government entities should apply SFFAS 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*.
3. SFFAS 34 recognizes that a limited number of federal entities prepare and publish financial reports pursuant to the accounting and reporting standards issued by the Financial Accounting Standards Board (FASB). SFFAS 34 provides that general purpose federal financial reports prepared in conformity with accounting standards issued by the FASB also may be regarded as in conformity with GAAP. The consolidated government-wide entity should consolidate component entity financial statements for core government entities prepared in accordance with SFFAS 34 without conversion for any differences in accounting policies among the entities. The following disclosures are required where the amounts prepared pursuant to FASB standards are material to the line item and there is a difference between FASAB and FASB accounting principles or standards:
 - a. descriptions of the different accounting policies and methods applied and the related amounts included in the line item for each policy and method
 - b. identities of component entities that prepared financial statements pursuant to FASB standards as permitted by SFFAS 34, paragraphs 9 – 11 and contributed significantly to the separately reported line item

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

Staff proposes the following Questions for Respondents:

The Statement would require consolidation of FASAB and FASB based information without conversion for core government entities in accordance with SFFAS 34. This Statement also would require disclosures of the different policies and methods and the related amounts if the FASB amounts are material to the line item and there is a difference in the accounting principles or standards.

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

Do you agree or disagree with the above referenced requirement?

Please provide the rationale for your answers.

QUESTIONS FOR THE BOARD:

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

Revised disclosures for non-core entities

At the August meeting, staff presented revised disclosures that incorporated an example for referring to separately published financial statements and also clarified that examples provided in the standard were strictly examples of information and not specific requirements or required disclosures. The Board agreed the language was clearer regarding the intent of the examples, but there was still some concern with the language.

After deliberation, the Board requested staff revise the non-core entity disclosures. The Board requested that the non-core entity disclosures be revised to reflect 3 broad objectives. The three objectives the Board agreed to were: the nature of the relationship, nature and magnitude of the activity during the period and balances at the end of the period, and future risks and exposures to gains and losses. The Board agreed the objectives articulated could be achieved through the examples (or similar type information) provided in the Draft ED. The Board also agreed the types of information that could fulfill the three broad objectives could be provided in a flexible way and that some information might contribute to meeting multiple objectives.

Based on this, staff proposes the following revisions to the Disclosures:
See ***Appendix 1— Marked Version of Language for Government-wide Issues*** for a copy of the Standard language that includes tracked changes since the August Board meeting. The language below incorporates all staff suggested changes for a clean read.

Disclosures⁴ for Non-core Entities

1. Both qualitative and quantitative factors should be considered in determining whether a non-core entity should be presented separately due

⁴ These may include disclosures required by other standards.

to its significance or aggregated⁵ with other non-core entities. For each significant entity and aggregation of entities disclose information to meet the following objectives:

- a. **Relationship:** The nature of the federal government's relationship with the non-core entity.
 - b. **Relevant Activity:** Nature and magnitude of relevant activity during the period and balances at the end of the period.
 - c. **Future exposures:** A description and, if possible, quantification, of the federal government's exposure to gains and losses from the future operations of the non-core entity.
2. Examples of information⁶ that may meet the above objectives and provide the necessary understanding of the non-core entity's relationship, activities, and future exposures specific to the federal government include but are not limited to:
- a. The name and description of the non-core entity
 - b. The nature of the relationship between the federal government and the non-core entity including any control or influence over the non-core entity and/or the percentage of ownership interest and voting rights, including key statutory or other legal authorities relating to potential financial impacts
 - c. For intervention actions, the primary reasons for the intervention and a brief description of the federal government's plan relative to operating or disposing of the entity (including timeframes) and/or a statement that the intervention is not expected to be permanent
 - d. A description and summary of assets, liabilities, revenues, expenses, gains, and losses recognized in the financial statements of the core government entity as a consequence of transactions with or interests in the non-core entity and the basis for determining the amounts reported
 - e. Summary financial statements, condensed financial information for the non-core entity (e.g. assets, liabilities, fund balances, total expenditures and sources of revenues), or key indicators. For example, if the federal government's risk of exposure is significant, then a set of summary financial statements may be appropriate, whereas if the exposures are limited then key indicators of financial

⁵ Aggregation may be based on non-core entity type, class, investment, or a particular event deemed significant by the preparer. The goal would be concise, meaningful and transparent disclosures.

⁶ No individual example is itself a required disclosure nor are they required in the aggregate. Therefore, the examples are not alternatives or substitutes one for another. Instead, a disclosure that provides an understanding of the one of the objectives should be provided.

impacts with selected financial info (net position and net results) might be appropriate.

- f. A general reference to non-core entity financial statements and how they can be obtained
- g. Key terms of contractual agreements regarding potential financial impacts (including those terms of the arrangements to provide financial support and liquidity, including events or circumstances that could expose the federal government to a loss)
- h. The nature of, and changes in, the risks associated with the control or involvement with the entity during the period or other indicators of financial health or changes in financial health
- i. The amount that best represents the federal government's maximum exposure to gain or loss from its involvement with the non-core entity, including how the maximum exposure to gain or loss is determined. If this cannot be quantified, that fact should be disclosed.
- j. Other information that would provide an understanding of the potential financial impact, including financial-related exposures to potential gain and risk of loss to the government-wide reporting entity, resulting from the non-core entity

QUESTIONS FOR THE BOARD:

Does the Board agree with the revised language for Disclosures for Non-core entities?

Previously certain members had suggested that a listing of the non-core entities in a note disclosure would be meaningful. Providing a listing of the non-core entities would be a means of explicitly stating in one place which entities are core (consolidated) versus non-core (disclosed). There appeared to be some resistance by other members because there was a question regarding the cost versus benefit of providing such information since there might be numerous entities for consideration, though materiality provisions would apply. Staff notes there wasn't clear direction from the Board on this issue and has included a question below.

Should a listing of non-core entities be incorporated into the Disclosures for Non-core Entities?

Addressing the Federal Reserve System

Par. 47 of SFFAC 2, *Entity and Display* provides that the Federal Reserve System would be excluded from the government-wide reporting entity. It was agreed that as part of the federal entity project, the exclusion would be reconsidered. Par. 47 of SFFAC 2 states:

In establishing and monitoring monetary policy, the Federal Reserve System, i.e., the Board of Governors of the Federal Reserve System and the Federal Reserve Banks, could be considered as functioning consistent with the indicative criteria presented in paragraph 44. However, 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. Therefore, the Federal Reserve System would not be considered part of the government-wide reporting entity. Payments made to or collections received from the Federal Reserve System would be reported in the financial statements of the Federal Government. Certain other disclosures might also be appropriate in the financial statement for the entire government.

As you might recall, over the course of the project staff provided an educational session on the Federal Reserve System and Federal Reserve representatives provided an informational briefing to the Federal Entity Task Force.

Although it has been staff's position not to address *specific* entities in the Statement or Basis for Conclusion, staff believes the Federal Reserve System will have to be addressed specifically because:

1.) Paragraph 47 in SFFAC 2 needs to be rescinded
2.) There is one Federal Reserve System so it would be impossible to explain why the SFFAC 2 language is being deleted without some mention of the Federal Reserve System. Therefore, it appears appropriate to refer to it or address it at a high level so that respondents are able to understand the consequences of the deletion. However, staff believes there are several options and levels of detail for the Board's consideration. Options include:

1. Rescind par. 47 (along with other sections of SFFAC 2). Brief explanation would be provided in the basis for conclusions.

2. Rescind par. 47 (along with other sections of SFFAC 2). Federal Reserve System would be provided as a potential example of a *Quasi Governmental and/or Financially Independent Entity* and explanation would be provided in the basis for conclusions.

3. Address Federal Reserve System by incorporating the conclusion of option 1 or option 2 above into the Standard language so that the Federal Reserve System is explicitly identified as a non-core entity. Also, rescind par. 47 (along with other sections of SFFAC 2).

The language for each option is included below:

OPTION 1 Rescind par. 47 (along with other sections of SFFAC 2). Brief explanation would be provided in the basis for conclusions.

Staff notes that similar to the Federal Reserve System, par. 48-50 in SFFAC 2 addresses Government Sponsored Enterprises and Bailout Entities and states these entities would not be considered part of the government-wide reporting entity. The language in SFFAC 2 is as follows and staff believes, like the Federal Reserve System language, it would be rescinded:

Government Sponsored Enterprises

48. There are also several Federally chartered but privately owned and operated financial institutions that have been established as financial intermediaries to facilitate the flow of investment funds to specific segments of the private sector. These entities are called government sponsored enterprises (GSE). Examples are the Federal National Mortgage Association, the Farm Credit Banks, and the Federal Home Loan Banks. By law, each of these GSEs is subject to oversight from a specific Federal agency. However, they are not included in the Federal budget section entitled "Federal Programs by Agency and Account." Nor, as currently constituted, do they function in a manner consistent with the indicative criteria presented in paragraph 44. Thus they would not be considered part of the government-wide reporting entity nor the reporting entity to which they have been assigned for oversight.

49. On the other hand, there are "political expectations" associated with the GSEs, the most significant of which is an expectation that legislation would be enacted to support a GSE experiencing severe financial difficulties. (Political expectations are different than "moral obligations" established by many states. There is no statutory authority that defines whether and how a political expectation would be met. With a moral obligation, the manner in which it may be met is usually explicitly defined in statute.) Therefore, agencies assigned oversight responsibility for a GSE(s) would need to consider making disclosures of the government's relationship with the GSE(s) and other information that would provide an understanding of the possibility of a contingent liability.

Bailout Entities

50. The Federal Government occasionally bails out, i.e., guarantees or pays debt, for a privately owned entity whose failure could have an adverse impact on the nation's economy, commerce, national security, etc. As a condition of the bail out, the Federal Government frequently obtains rights similar to the authorities associated with the indicative criteria presented in paragraph 44. The existence of these rights does not make the bailed out entity part of the Federal Government reporting entity or any of the other reporting entities that are part of the Federal Government. Disclosure of the relationship(s) with the bailed out entity(ies) and any actual or potential material costs or liabilities would be appropriate.

The first option is to provide a brief explanation and no further analysis or assessment of the Federal Reserve System.

Proposed Language for Basis for Conclusion

1. SFFAC 2 identified certain entities or types of entities (the Federal Reserve System, Government Sponsored Enterprises, and Bailout Entities) that could be included in the government-wide reporting entity based on the established concepts but that should not be included.⁷ This Statement establishes principles

⁷ SFFAC 2, *Entity and Display*, par. 47-50.

to ensure users of GPFFR are provided comprehensive financial information while recognizing the complexity of the federal government and its relationships with varied organizations. The new principles can be applied to the entities previously excluded and conclusions reached to include the entities—either as core or non-core entities—or to continue to exclude the entities. SFFAC 2 is being amended to ensure that concepts provide a framework for standards-setting but do not themselves establish standards by listing specific exclusions.

OPTION 2 Rescind par. 47 (along with other sections of SFFAC 2). Federal Reserve System would be provided as a potential example of a *Quasi Governmental and/or Financially Independent Entity* and explanation would be provided in the basis for conclusions.

This option is similar to the option above, and that language should be included in the appropriate basis for conclusions section explaining SFFAC 2 rescissions (unless the Board determines a separate Concepts Statement should be issued to address SFFAC 2 rescissions). In addition, this option provides additional analysis of the Federal Reserve System as a potential type of non-core entity, specifically a Quasi Governmental and/or Financially Independent Entity.

Proposed Language for Basis for Conclusion (Same language as Option 1 plus the following under “Quasi Governmental and/or Financially Independent Entity”)

1. SFFAC 2 identified certain entities or types of entities (the Federal Reserve System, Government Sponsored Enterprises and Bailout Entities) that could be included in the government-wide reporting entity based on the established concepts but that should not be included.⁸ This Statement establishes principles to ensure users of GPFFR are provided comprehensive financial information while recognizing the complexity of the federal government and its relationships with varied organizations. The new principles can be applied to the entities previously excluded and conclusions reached to include the entities—either as core or non-core entities—or to continue to exclude the entities. SFFAC 2 is being amended to ensure that concepts provide a framework for standards-setting but do not themselves establish standards by listing specific exclusions.

“Quasi Governmental and/or Financially Independent Entity”

[NOTE: The following is a preliminary staff draft for discussion purposes. Consultation with general counsel and other experts may result in changes if the Board selects this option.]

2. An example of a Quasi Governmental and/or Financially Independent Entity would be the Federal Reserve System (the Board of Governors of the Federal

⁸ SFFAC 2, *Entity and Display*, par. 47-50.

Reserve System and the Federal Reserve Banks).⁹ An analysis of the present facts shows the Federal Reserve System meets the inclusion principles (discussed above); specifically, it meets the principle of control with expected benefit or loss. For example, the Federal Reserve System derives its authority from the U.S. Congress. Further, the members of the Board of Governors are appointed by the President and confirmed by the Senate for 14-year terms. In addition, the Chairman and Vice Chairman of the Board of Governors are also appointed by the President and confirmed by the Senate for four-year terms. The Board of Governors supervises and regulates the operations of the Federal Reserve Banks.¹⁰ As for the expected benefit or loss, the Board of Governors requires the Reserve Banks to remit their net earnings after providing for their expenses, dividends, and capital to the U.S. Treasury.¹¹

3. The Federal Reserve System is subject to oversight by Congress, which periodically reviews its activities and can alter its responsibilities by statute. Also, the Federal Reserve System must work within the framework of the overall objectives of economic and financial policy established by the government. Congress chartered the Federal Reserve Banks for a public purpose and they are operated in the public interest rather than for profit or to benefit any private group. The Reserve Banks are the operating arms of the central banking system, and they combine both public and private elements in their makeup and organization.¹²
4. While chartered and overseen by elected officials, the Federal Reserve System is considered an independent central bank because its decisions do not have to be ratified by the President or anyone else in the executive or legislative branch of government. It does not receive funding appropriated by Congress, and the terms of the members of the Board of Governors span multiple presidential and congressional terms. Once appointed, Governors may not be removed from office for their policy views. The lengthy terms and staggered appointments are intended to contribute to the insulation of the Federal Reserve System as a whole--from day-to-day political pressures to which it might otherwise be subject.¹³ Therefore, the Federal Reserve System can be most accurately described as "independent within the government."
5. The Federal Reserve System presently has the attributes of a non-core entity described in the Statement and many of the characteristics of the Quasi

⁹ The Federal Reserve System often referred to as the Federal Reserve or simply "the Fed" is the central bank of the United States. It is a federal system, composed of a central, governmental agency—the Board of Governors—in Washington, D.C., and twelve regional Federal Reserve Banks.

¹⁰ The summary information about the Federal Reserve is based on the FAQs at the Federal Reserve website at <http://www.federalreserve.gov/faqs>.

¹¹ Approximately 95% of the Reserve Banks' net earnings have been paid to the Treasury since the Federal System began operations in 1914. (Staff working on reference)

¹² Ibid

¹³ The summary information about the Federal Reserve is based on the FAQs at the Federal Reserve website at <http://www.federalreserve.gov/faqs>.

Governmental and/or Financially Independent Entity. Specifically, the Federal Reserve System is not listed in the schedule of accounts in the President's Budget (although certain information is included in an appendix to be transparent regarding activities). While the governance structure provides for a Board that is appointed, those appointments are for much longer periods than is customary for core entities. Further, the Federal Reserve System structure appears to offer a degree of independence in fact and appearance. Therefore, based on present circumstances, the Federal Reserve System should be included in the government-wide report and disclosures consistent with the non-core entity provisions in the Statement should be provided.

OPTION 3 Address Federal Reserve System by incorporating language of option 1 or option 2 above into the Standard language. *Note:* Staff does not believe this fits into a principally based focus but includes this option as certain members may believe, due to the prominence of the Federal Reserve System and the fact it was addressed in a Concepts Statement previously, it should be addressed in the Statement. However, staff believes with a principals based approach one should be able to walk through the methodology of the standard with any entity and determine the appropriate presentation method.

Staff recommendation: Staff believes OPTION 2 (which is really OPTION 1 with an explanation of the impact the changes may have on how the Federal Reserve System is reported in the consolidated financial report) most adequately addresses not only why the paragraphs within SFFAC 2 were rescinded but also provides a brief analysis of how one might analyze the Federal Reserve System against the principles articulated within the standard at a very high level.

NOTE: Staff also shared a preliminary draft of this with staff at the Federal Reserve for comment on the facts presented above. Staff does not expect to receive an opinion on the conclusions offered at this time.

QUESTIONS FOR THE BOARD:

Does the Board agree that OPTION 2 is preferred for explaining the deletion of SFFAC 2 language excluding the Federal Reserve System and its effect on reporting?

Does the Board agree with the general rationale offered in OPTION 2?

Basis for Conclusions Language

Staff recognizes this project to date has a long history and the decision regarding what to capture in the basis for conclusions can be a difficult one. The history of the inclusion principles (what they are called presently in the ED) can be interesting by itself as at one point they were called indicative principles, and then consolidation principles.

In addition, our analysis now has a step for assessing organizations against the core and non-core entity attributes (that were not envisioned earlier in the project). Further, this has been a fluid project and many of the final decisions have only just been solidified; enabling staff to draft a basis for conclusions (BfC).

Therefore, staff found decisions about the level of detail and what should be related regarding the history, a bit challenging. However, as the title indicates the basis for conclusions should capture the rationale for those decisions of the Board that led to proposed standards. The details of the minutes will remain as a permanent record and further detail of deliberations and other ideas considered by the Board throughout the federal entity project.

Therefore, staff requests Board input if the BfC is at the level of detail expected and covered all the notions the Board believed pertinent to be included in the BfC.

QUESTION FOR THE BOARD:

Does the Board approve the draft Basis for Conclusions? (Editorial comments may be directed to staff before or after the meeting. Staff is seeking approval of the overall structure, detail, and rationale proposed.)

Questions for Respondents

Staff developed an initial list of Questions for Respondents for the Board's consideration. Staff believes the questions addresses the main provisions of the Statement.

QUESTIONS FOR THE BOARD:

Does the Board agree with the proposed Questions for Respondents for the government-wide portion of the ED?

Does the Board wish to offer additional Questions for Respondents for consideration?

Next Steps

As noted in the transmittal, after receiving the Board's feedback, staff will assess if any open issues remain (other than related party) on the government-wide section of the ED. Staff believes the Board may wish to consider if a Preliminary Views (PV) document or a Discussion Memorandum (DM) should be issued to solicit input on the government-wide portion as it appears the Board will be spending some time on the component reporting entity piece.

Staff believes it would take approximately 2 meetings to have this ready but much of that depends on the outcome of this meeting. Based on staff's assessment at this date, staff believes a PV or DM could be prepared by February or April 2012 (depending on the Board's decision on related party and how many additional Illustrations to include in the Illustration Guide).

Staff believes it would be beneficial as the Board would be working on the component entity portion during the time the PV or DM is out for comment. The feedback may have an impact and perhaps assist with developing the more detailed options for the component reporting entity section.

Staff recognizes that issuing a PV or DM may delay work on the component entity phase or extend the total project by approximately 6 months, but staff believes the input, benefit and value added from that time would be well worth it. Further, the Board could use it as an opportunity to gain insight from the community, especially regarding differences that should be considered at the component entity level.

Staff believes having public input sooner may prevent major reconsideration later and may provide valuable input in the component entity phase of the project.

QUESTION FOR THE BOARD:

Does the Board wish to issue a Preliminary Views document or a Discussion Memorandum to solicit input on the government-wide portion?



Federal Accounting Standards Advisory Board

**Government-wide and
Component Reporting Entities**

Statement of Federal Financial Accounting Standards

Exposure Draft

Written comments are requested by Date 90 days after issuance

Month Date, Year

Working Draft – Comments are Not Requested on This Draft

THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

The Secretary of the Treasury, the Director of the Office of Management and Budget (OMB), and the Comptroller General, established the Federal Accounting Standards Advisory Board (FASAB or “the Board”) in October 1990. FASAB is responsible for promulgating accounting standards for the United States Government. These standards are recognized as generally accepted accounting principles (GAAP) for the federal government.

An accounting standard is typically formulated initially as a proposal after considering the financial and budgetary information needs of citizens (including the news media, state and local legislators, analysts from private firms, academe, and elsewhere), Congress, federal executives, federal program managers, and other users of federal financial information. The proposed standards are published in an exposure draft for public comment. In some cases, a discussion memorandum, invitation for comment, or preliminary views document may be published before an exposure draft is published on a specific topic. A public hearing is sometimes held to receive oral comments in addition to written comments. The Board considers comments and decides whether to adopt the proposed standard with or without modification. After review by the three officials who sponsor FASAB, the Board publishes adopted standards in a Statement of Federal Financial Accounting Standards. The Board follows a similar process for Statements of Federal Financial Accounting Concepts, which guide the Board in developing accounting standards and formulating the framework for federal accounting and reporting.

Additional background information is available from the FASAB or its website:

- “Memorandum of Understanding among the Government Accountability Office, the Department of the Treasury, and the Office of Management and Budget, on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board.”
- “Mission Statement: Federal Accounting Standards Advisory Board”, exposure drafts, Statements of Federal Financial Accounting Standards and Concepts, FASAB newsletters, and other items of interest are posted on FASAB’s website at: www.fasab.gov.

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ISSUE DATE

TO: ALL WHO USE, PREPARE, AND AUDIT FEDERAL FINANCIAL INFORMATION

The Federal Accounting Standards Advisory Board (FASAB or the Board) is requesting comments on the exposure draft of a proposed Statement of Federal Financial Accounting Standards entitled, TITLE. Specific questions for your consideration appear on page 7 but you are welcome to comment on any aspect of this proposal. If you do not agree with the proposed approach, your response would be more helpful to the Board if you explain the reasons for your position and any alternative you propose. Responses are requested by DUE DATE.

All comments received by the FASAB are considered public information. Those comments may be posted to the FASAB's website and will be included in the project's public record.

We have experienced delays in mail delivery due to increased screening procedures. Therefore, please provide your comments in electronic form. Responses in electronic form should be sent by e-mail to fasab@fasab.gov. If you are unable to provide electronic delivery, we urge you to fax the comments to (202) 512-7366. Please follow up by mailing your comments to:

Wendy M. Payne, Executive Director
Federal Accounting Standards Advisory Board
Mailstop 6K17V
441 G Street, NW, Suite 6814
Washington, DC 20548

The Board's rules of procedure provide that it may hold one or more public hearings on any exposure draft. No hearing has yet been scheduled for this exposure draft. or A public hearing has been scheduled at 9:00 AM on Month Day, Year, in Room 7C13 at the GAO Building, 441 G Street, NW, Washington, D.C..

Notice of the date and location of any public hearing on this document will be published in the *Federal Register* and in the FASAB's newsletter.

Tom L. Allen

Chairman

Executive Summary

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Questions for Respondents

The FASAB encourages you to become familiar with all proposals in the Statement before responding to the questions in this section. In addition to the questions below, the Board also would welcome your comments on other aspects of the proposed Statement.

The Board believes that this proposal would improve federal financial reporting and contribute to meeting the federal financial reporting objectives. The Board has considered the perceived costs associated with this proposal. In responding, please consider the expected benefits and perceived costs and communicate any concerns that you may have in regard to implementing this proposal.

Because the proposals may be modified before a final Statement is issued, it is important that you comment on proposals that you favor as well as any that you do not favor. Comments that include the reasons for your views will be especially appreciated.

The questions in this section are available in a Word file for your use at www.fasab.gov/exposure.html. Your responses should be sent by e-mail to fasab@fasab.gov. If you are unable to respond electronically, please fax your responses to (202) 512-7366 and follow up by mailing your responses to:

Wendy M. Payne, Executive Director
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Washington, DC 20548

All responses are requested by insert date.

Q1. The Board is proposing an entity with accounts listed in the *Budget of the United States Government: Analytical Perspectives- Supplemental Materials* schedule *Federal Programs by Agency and Account* to be included in the government-wide report unless the preparer believes the entity is a non-federal organization receiving federal financial assistance.

Refer to paragraphs 21-22 of the proposed standards and paragraphs A13-A19 in Appendix A - Basis for Conclusions for a discussion and related explanation.

- a. **Do you agree or disagree with the *In the Budget* inclusion principle? Please provide the rationale for your answer.**
- b. **Do you agree or disagree with the exception provision provided for a non-federal organization receiving federal financial assistance? Please provide the rationale for your answer.**

Q2. The Board is proposing that when the federal government holds a majority ownership in an entity it should be included in the government-wide report.

Refer to paragraphs 23-25 of the proposed standards and paragraphs A20-A21 in Appendix A - Basis for Conclusions for a discussion and related explanation.

Do you agree or disagree with the *Majority Ownership* inclusion principle? Please provide the rationale for your answer.

Q3. The Board is proposing that an entity that is controlled by the federal government with the expectation of benefits or risk of loss to the federal reporting entity should be included in the government-wide report.

Refer to paragraphs 26-35 of the proposed standards and paragraphs A22-A26 in Appendix A - Basis for Conclusions for a discussion and related explanation.

Do you agree or disagree with the *Control with expected Benefits or Risk of Loss* inclusion principle? Please provide the rationale for your answer.

Q4. For purposes of the Statement, control is defined as follows:

Control with expected benefits or risk of loss is the power to govern the financial and/or operating policies of another entity with expected benefits or the risk of loss¹ to the federal reporting entity.

In addition, the Statement provides indicators for determining if control is present.

Refer to paragraphs 27-32 of the proposed standards and paragraphs A22-A26 in Appendix A - Basis for Conclusions for a discussion and related explanation.

- a. **Do you agree or disagree with the definition of *control*? Please provide the rationale for your answer.**
- b. **Do you believe the indicators are helpful and clear? Please provide the rationale for your answer.**

Q5. The Board is proposing inclusion of an entity in the government-wide report if it would be misleading to exclude the entity even though it does not meet the established inclusion principles.

Refer to paragraphs 36-37 of the proposed standards and paragraphs A27-A29 in Appendix A - Basis for Conclusions for a discussion and related explanation.

Do you agree or disagree *Misleading to Exclude principle*? Please provide the rationale for your answer.

Q6. The Board proposes that core government entities are (1) generally taxpayer supported as evidenced by their inclusion in the budget, (2) governed by the Congress and the President, (3) imposing or may impose risks and rewards on the taxpayer, and/or (4) providing core federal government goods and services on a non-market basis.

Refer to paragraphs 39-41 of the proposed standards and paragraphs A32-A37 in Appendix A - Basis for Conclusions for a discussion and related explanation.

Do you agree or disagree with the core government attributes? Please provide the rationale for your answer.

Q7. The Board proposes that non-core entities are those that (1) receive limited or no taxpayer support, (2) have less direct involvement by the Congress and President, (3)

¹ The expected benefit or risk of loss may be financial or non-financial. For example, a non-financial benefit would be the federal government benefits from a service being provided on its behalf.

are more likely to provide market based goods and services, and (4) impose limited risks and rewards on the taxpayers.

Refer to paragraphs 42-44 of the proposed standards and paragraphs A38-A43 in Appendix A - Basis for Conclusions for a discussion and related explanation.

Do you agree or disagree with the non-core entity attributes? Please provide the rationale for your answer.

Q8. The Statement provides examples of types of non-core entities which include but are not limited to: quasi governmental and/or financially independent entities, receiverships and conservatorships, and federal government intervention actions. The non-core entity types are presented to assist in identifying entities that are non-core entities. The Statement also discusses characteristics for each type that might help preparers and users identify non-core entities. Although presentation is not required by type, the Board believed it would be beneficial to include these types to guide the application of the non-core characteristics.

Refer to paragraphs 45-55 of the proposed standards and paragraphs A44 and A54 in Appendix A - Basis for Conclusions for a discussion and related explanation.

Do you agree or disagree with the non-core entity types and characteristics? Please provide the rationale for your answer.

Q9. The Board proposes core government entities be consolidated in the government-wide financial statements. The Board proposes non-core entities be disclosed in the government-wide report. The Statement allows flexibility in the disclosures as long as the disclosures are consistent with the objectives described in Disclosures for Non-core Entities after considering the Factors in Determining Non-Core Entity Disclosures.

Refer to paragraphs 57-68 of the proposed standards and paragraphs A57-A71 in Appendix A - Basis for Conclusions for a discussion and related explanation.

- a. **Do you agree or disagree that core government entities should be consolidated? Please provide the rationale for your answer.**
- b. **Do you agree or disagree that non-core entities should be disclosed? Please provide the rationale for your answer.**

c. Do you agree or disagree with the Disclosures for Non-core Entities? Please provide the rationale for your answer.

d. Do you or disagree with the Factors in Determining Non-Core Entity Disclosures? Please provide the rationale for your answer.

Q10. The Statement would require consolidation of FASAB and FASB based information without conversion for core government entities. This Statement also would require disclosures of the different policies and methods and the related amounts if the FASB amounts are material to the line item and there is a difference in the accounting principles or standards.

Refer to paragraph 59 of the proposed standards and paragraphs A58-61 in Appendix A - Basis for Conclusions for a discussion and related explanation.

Do you agree or disagree with the above referenced requirement? Please provide the rationale for your answers.

Q11. The Statement provides a Flowchart at Appendix XX to assist with implementation.

Refer to Appendix B and paragraph A56 in Appendix A - Basis for Conclusions for a discussion and related explanation.

Do you find the Flowchart helpful? Please provide the rationale for your answer.

Q12. SFFAC 2 identified certain entities or types of entities (the Federal Reserve System, Government Sponsored Enterprises and Bailout Entities) that could be included in the government-wide report based on the established concepts but that should not be included. The Board is proposing new principles that can be applied to the entities previously excluded and conclusions reached to include the entities—either as core or non-core entities—or to continue to exclude the entities. Therefore, SFFAC 2 is being amended to remove those provisions (as the standards within this Statement apply).

Refer to paragraphs A72-A76 in Appendix A - Basis for Conclusions for a discussion and related explanation.

Do you agree or disagree? Please provide the rationale for your answer.

Q13. Are there other unique situations that should be addressed within this Statement? Please explain fully and also how the situation is not addressed by this Statement when considered in its entirety.

Introduction

Purpose

1. The federal government and its relationships with other entities have become increasingly complex. Public policy decisions can be carried out in a variety of ways and involve increasingly complex organizations and relationships. To meet federal financial reporting objectives, it is important to develop standards that can be used to identify organizations that must be included in the financial reports of the government-wide reporting entity and each component reporting entity.
2. Notwithstanding these complexities, general purpose federal financial reports for the government-wide reporting entity should be broad enough to report the Congress and the President's accountability for those organizations. In addition, component reporting entity reports should allow the Congress and the President to hold management accountable for implementation of public policy decisions. Although Statement of Federal Financial Accounting Concepts (SFFAC) 2, *Entity and Display*, addresses identifying reporting entities and criteria for including components in a reporting entity, questions have continued in this area that resulted in the need for a standard.²
3. This Statement guides preparers of general purpose federal financial reports³ (GPFFR) in determining what organizations are required to be included in the financial reports and what information should be presented. This will ensure that users of GPFFR are provided with comprehensive financial information about federal reporting entities and their involvements so that federal financial reporting objectives are met.

Materiality

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

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

³ The term general purpose federal financial report is used throughout this Statement as a generic term to refer to the report that contains the entity's financial statements that are prepared pursuant to generally accepted accounting principles. In the federal government, the report for the U.S. government-wide reporting entity is known as the Financial Report of the U.S. Government and for component reporting entities it is usually called the Performance and Accountability Report, the Agency Financial Report, or the Annual Management Report.

Effective Date

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

Proposed Standards

Applicability

6. This Statement applies to federal entities that prepare general purpose federal financial reports (GPFFR) in conformance with Statement of Federal Financial Accounting Standards (SFFAS) 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*.
7. This Statement does not require any entity to prepare and issue GPFFR. The purpose of this Statement is to enable entities preparing and issuing GPFFR to determine what organizations should be included in the financial reports of the government-wide reporting entity and each component reporting entity. The Statement also provides information about and required disclosures for related parties.

Definitions

8. Definitions in paragraphs 9 through 12 are presented first because of their importance in understanding the Statement. Other terms shown in boldface type the first time they appear in this document are presented in the Glossary at Appendix C. Users of this document may want to examine all definitions before reviewing the Statement and Basis for Conclusions.
9. **Reporting Entity** The term “reporting entity” refers to both the government-wide reporting entity and component reporting entities that issue a General Purpose Federal Financial Report (GPFFR) because either there is a statutory or administrative requirement to prepare the GPFFR or they choose to prepare one. Statement of Federal Financial Accounting Concepts (SFFAC) 2 explains for the entity to be a reporting entity⁴, it would need to meet all of the following criteria:
 - a. There is a management responsible for controlling and deploying resources, producing outputs and outcomes, executing the budget or a portion thereof (assuming that the entity is included in the budget), and held accountable for the entity’s performance.
 - b. The entity’s scope is such that its financial statements would provide a meaningful representation of operations and financial condition.

⁴ SFFAC 2, par. 29-37, provides a discussion on Identifying the Reporting Entity for General Purpose Financial Reporting.

- c. There are likely to be users of the financial statements who are interested in and could use the information in the statements to help them make resource allocation and other decisions and hold the entity accountable for its deployment and use of resources.
10. **Government-wide Reporting Entity** The government-wide reporting entity includes all organizations for which the Congress and the President are accountable based on principles established in this Statement.
11. **Component Reporting Entity** Component reporting entity is used broadly to refer to a reporting entity within a larger reporting entity⁵ that issues GPFFR. Examples of component reporting entities include entities such as executive departments, legislative agencies, federal courts, independent agencies, and government corporations. Component reporting entities would also include sub-components (entities that are part of a larger component reporting entity) that prepare GPFFR. One example is a bureau of a larger department that prepares stand alone financial reports. Other examples include commercial functions, revolving funds, and/or other accounts for which GPFFR are prepared.
12. **Control with expected benefits or risk of loss** Control with expected benefits or risk of loss is the power to govern the financial and/or operating policies of another organization with expected benefits or the risk of loss⁶ to the federal reporting entity.

Organizational Approach to Defining Boundaries

13. The federal government is unique because its constitutionally established powers, motivations, and functions are different than other organizations. It is an extremely complex organization responsible for the common defense and general welfare of the Nation. Although there are other perspectives,⁷ such as a program perspective, in understanding the composition of the federal government, an organizationally based approach appears most appropriate in determining entities for inclusion in GPFFRs.
14. Focusing on organizations helps to identify who is accountable because there is a management responsible for controlling and deploying resources to produce outputs and outcomes. Each organization operates under an established

⁵ The larger reporting entity could be the government-wide reporting entity or another component reporting entity.

⁶ The expected benefit or risk of loss may be financial or non-financial. For example, a non-financial benefit would be the federal government benefits from a service being provided on its behalf.

⁷ SFFAC 2, par. 13-28 discusses the budget and program perspective of the federal government, as well as the intertwining of the perspectives.

governance structure intended to meet an established public policy objective. Governance structures allow for varying degrees of autonomy in relation to the Congress, the President, and appointed officials.

15. Accountability demands comprehensive reporting. To provide comprehensive reporting, the federal government must report on organizations that serve varied purposes and have complex governance structures and finances. Some differences in purposes and governance structures require differences in presentation of financial information. For example, certain organizational distinctions must be maintained for financial reports to meet the reporting objectives established in SFFAC 1. In such cases, disclosures about the organization rather than financial information consolidated across all organizations may better meet these objectives.
16. Thus, decisions about reporting entities are taken in two steps – first, determining what organizations are to be included in the reports and second, identifying the means to present relevant information about organizations.
17. This Statement first establishes the principles for including organizations (see Principles for Inclusion in the Government-wide Report) then a distinction will be made between core government entities and non-core entities (see Core Government Entities and Non-core Entities which describes these types of entities) for those organizations. Lastly, the presentation of financial information based on those decisions is addressed (see Government-wide Reporting Entity Consolidation and Disclosure).
18. PLACEHOLDER – DESCRIBE WHAT STANDARD WILL ADDRESS REGARDING COMPONENT REPORTING ENTITIES

Principles for Inclusion in the Government-wide GPFFR

19. General purpose federal financial reports for the government-wide reporting entity should be broad enough to report the Congress and the President's accountability for organizations. This ensures that the financial reports contain all the information essential for fair presentation of the government's financial position and results of operations. To determine which organizations should be included⁸ in the government-wide report, this Statement provides three principles for inclusion in the GPFFR and requires inclusion of entities if it would be misleading to exclude them (see par. 36).
20. An organization meeting any of the three principles below is included in the government-wide GPFFR:

⁸ Included means basic information includes information regarding the entity.

- a. In the Budget;
- b. Majority Ownership Interest; or
- c. Control with expected benefits or risk of loss.

In the Budget

- 21. An entity with accounts listed in the *Budget of the United States Government: Analytical Perspectives- Supplemental Materials* schedule *Federal Programs by Agency and Account* should be included in the government-wide report unless it meets the exception provided in the next paragraph.
- 22. If the preparer believes an entity listed in the schedule *Federal Programs by Agency and Account* is actually a non-federal organization receiving federal financial assistance,⁹ a review of the facts and circumstances is conducted to confirm the entity is not an organization for which the Congress and the President are accountable. Therefore, such an organization should be assessed against the next two principles (*Ownership* and *Control*) to determine if it should be included in the government-wide report for the purpose of meeting accountability goals.

Majority Ownership Interest

- 23. The federal government (directly or through its components) may have an ownership interest¹⁰ in an entity. An ownership interest is a legal claim on the net residual assets of an entity or holding shares or other formal equity structure.
- 24. The holding of an ownership interest often entitles the holder to an interest in voting rights, but not always. In the federal government there may be instances of ownership interest with voting rights or ownership interest without voting rights.

⁹ As defined by the Single Audit Act Amendments of 1996, federal financial assistance is assistance that non-Federal entities receive or administer in the form of grants, loans, loan guarantees, property, cooperative agreements, interest subsidies, insurance, food commodities, direct appropriations, or other assistance.

¹⁰ Ownership interest is defined as the possession of substantially all of the benefits and risks incident to ownership, *FASAB Glossary FASAB Pronouncements as Amended as of June 30, 2010*.

25. Majority ownership interest exists with over 50% of the votes or the net residual assets¹¹ of an entity. When the federal government holds a majority ownership in an entity it should be included in the government-wide report.¹²

Control with Expected Benefits or Risk of Loss

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

Control with expected benefits or risk of loss is the power to govern the financial and/or operating policies of another entity with expected benefits or the risk of loss¹³ to the federal reporting entity. Both the power and either the expected benefit or risk of loss aspects of the definition should be met to justify inclusion of an entity. Hereafter, control with expected benefits or risk of loss is referred to simply as “control.”

27. Control refers to the ability to control and should be assessed at the reporting date regardless of the federal government’s ability to change it in the future. In determining if control exists, it is necessary to determine the substance of the relationship between the federal government and the entity as it may not be completely reflected by the legal form of the relationship.
28. Control does not necessarily mean the federal government has responsibility for the management of the day-to-day operations of an entity. It is the federal government’s authority to determine the policies governing those activities that indicates control.
29. Determining whether control exists requires the application of professional judgment. The federal government achieves its objectives through a wide range of entities which individually will fall somewhere along a continuum. At one end of the continuum, it will be clear that an entity does not have

¹¹ For example, the federal government may hold more equity in preferred stock than all other stockholders but the preferred stock may be non-voting.

¹² Ownership interests 50% or less should be accounted for in accordance with the appropriate accounting standards per the GAAP hierarchy. However, the entity should still be assessed against the control and the misleading to exclude inclusion principles.

¹³ The expected benefit or risk of loss may be financial or non-financial. For example, a non-financial benefit would be the federal government benefits from a service being provided on its behalf.

the power to act independently and is controlled by the federal government—such as an Executive Department. At the other end, the entity will have the power to act independently and, while the federal government may have a level of influence, it will be clear that it does not have control—such as a state government.

Indicators of Control

30. As discussed in the following paragraphs, there are indicators that should be considered in determining whether the federal government controls an entity. As noted above, consideration needs to be given to the nature of the relationship between the federal government and the entity and much judgment applied to determine whether control exists.
31. Certain indicators¹⁴ provide persuasive evidence that control exists. These indicators provide strong evidence of control, however; the absence of one or more of these specific indicators does not lead to a presumption that control is not present. Typically, meeting any one of these indicators would mean control is present. These indicators are when the federal government has the authority to:
 - a. Unilaterally appoint or remove a majority of the governing board members of another entity;
 - b. Direct the governing body on the financial and operating policies of the entity;
 - c. Unilaterally dissolve the entity thereby having access to the assets and responsibility for the obligations; or
 - d. Establish or amend the fundamental purpose and mission of the entity, which may include authorizing the entity to exercise sovereign power of the federal government and requiring the entity to carry out federal missions and objectives.
32. Other indicators provide evidence that control exists, but must be considered in the aggregate and often require the application of professional judgment in assessing. These indicators are when the federal government has the ability to:

¹⁴ The indicators noted in par. 31 and 32 provide support for both the power and/or benefit part of the control definition. As noted in par. 26 a federal reporting entity should meet both the power and benefit elements for determining whether control exists.

-
- a. Provide significant input into the appointment of members of the governing body of the entity or being involved in the appointment or removal of a significant number of members;
 - b. Access entity's assets or direct the ongoing use of those assets;
 - c. Appoint or remove key executives or personnel;
 - d. Approve the budgets or business plans for the entity;
 - e. Require audits;
 - f. Veto, overrule, or modify governing board decisions or otherwise significantly influence normal operations;
 - g. Finance the deficits of and provide financial support to or settle liabilities;
 - h. Direct the entity to work with the government to provide services to taxpayers which may include determining the outcome or disposition of matters affecting the recipients of services;
 - i. Establish, rescind, or amend management policies;
 - j. Establish limits or restrictions on borrowing and investments of the entity; or
 - k. Restrict the capacity to generate revenue of the entity, especially the sources of revenue.

Situations Where Control Does Not Exist

- 33. Because of the uniqueness of the federal government, control would not be inferred from:
 - a. The authority to exercise regulatory powers over an entity; or
 - b. Economic dependency of the entity on the federal government.
- 34. The federal government has the power to regulate many entities by use of its sovereign and legislative powers. For example, the federal government has the power to regulate the behavior of entities by imposing conditions or sanctions on their operations. However, the governing bodies of the regulated entities make decisions within the regulatory framework. Regulatory powers do not constitute control for purposes of this Statement because the federal government's interest in these entities extends only to the regulatory aspects of the operations.
- 35. Certain entities may be economically dependent on the federal government but ultimately retain discretion as to whether to accept funding

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

Misleading to Exclude Principle

36. There may be instances when an organization does not meet the inclusion principles in this Statement (ie. It is not included in the schedule of *Federal Programs by Agency and Account*, there is not majority ownership, or it may be difficult to provide sufficient evidence it meets the control principle) yet the government-wide financial report would be misleading or incomplete if the entity were excluded.¹⁵
37. This Statement requires inclusion of entities in the government-wide report if it would be misleading to exclude them.

Organizations--Core Government Entities and Non-core Entities

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

Core government entities

39. Core (or general) government entities generally provide federal goods and services on a non-market basis.¹⁶ Such entities are financed primarily

¹⁵ Although situations such as this would be considered rare, this Statement provides for situations that may arise.

¹⁶ Goods and services are provided on a non-market basis when they are provided free of charge or at charges that bear little relationship to the cost of goods or services.

through taxes, fees, and other non-exchange revenues as evidenced by inclusion in the budget. Significant risks and rewards fall to the taxpayer for core government entities.

40. Accountability for core government entities rests with the President and the Congress. Their governance structure is vertically integrated with elected officials as evidenced by the chain of command and manner of decision making. Vertical integration may include the establishment of organizational authorities, development and approval of budgets, and the appointment of organizational leaders by the Congress and the President or their agents.
41. Entities listed in the budget and for which management has not asserted the entity is a non-federal entity receiving federal assistance (see par. 21-22) are presumed to qualify as core government entities while greater judgment will be needed to classify other entities.

Non-core entities

42. In order to fulfill public policy objectives, the federal government may have relationships with organizations that have a greater degree of autonomy than core government entities. Such entities are included for accountability purposes but are considered “non-core entities.”
43. Non-core entities may maintain a separate legal identity, have a governance structure that vests greater decision making authorities in a governing body to insulate the entity from political influence, and/or allow for relative financial independence.
44. Non-core entities may provide core federal government goods and services but are more likely to provide goods and services on a market basis.¹⁷ Non-core entities receive limited or no taxpayer support. Accountability rests with the Congress and the President, but they have less direct involvement in decision making than is true in core government entities. Limited risks and rewards fall to the taxpayers.
45. Non-core entities include but are not limited to: quasi governmental and/or financially independent entities, receiverships and conservatorships, and federal government intervention actions. In some cases, the relationship with the federal government is not expected to be permanent. The non-

¹⁷ Goods and services are provided on a market basis when prices are determined in a competitive marketplace between willing buyers and sellers.

core entity types are presented to assist in identifying entities that are non-core entities.

Quasi Governmental and/or Financially Independent Entities

46. Quasi Governmental and/or Financially Independent Entities are hybrid entities where accountability and transparency of these unique organizations are important yet they differ from core entities when assessing the governance and/or the financial (risk and rewards) arrangements.
47. Governance differences typically lead to greater independence. Characteristics may include the following:
 - a. Longer appointments of key executives or governing boards allow these appointees a degree of independence from the Congress and the President.
 - b. Delegated operational authority to provide a service or execute a program in a manner similar to private business enterprises.
 - c. May possess private sector legal characteristics.
 - d. May be voluntarily affiliated with the federal government and share purposes to implement government policies.
48. Financial differences typically lead to greater fiscal autonomy. Characteristics may include the following:
 - a. Primary funding is derived from a source other than through appropriations.
 - b. Delegated financial authority to provide a service or execute a program in a manner similar to private business enterprises.
 - c. Sells goods and/or services to individuals outside of the government reporting entity as its principal activity.
 - d. Intended to, in the normal course of its operations, maintain its operations and meet its liabilities from revenues received from sources outside of the government reporting entity.
49. Examples of Quasi Governmental and/or Financially Independent Entities may include Federally Funded Research and Development Centers (FFRDCs). However, details may differ among FFRDCs and some may potentially be core entities and therefore flexibility is necessary for

determining the most meaningful presentation. The accompanying Illustrative Guide offers examples that may be useful in application.

50. Additional examples of Quasi Governmental and/or Financially Independent Entities may include museums, performing arts organizations and universities, and venture capital funds. The accompanying Illustrative Guide offers examples that may be useful in application.

Receiverships and Conservatorships¹⁸

51. There are certain federal entities whose mission may include taking control or ownership of failed financial institutions such as banks with no goal to maintain control or ownership. For example, certain federally-created entities may act as a receiver to liquidate failing financial institutions or as a conservator to guide such institutions back to safe and sound conditions.¹⁹ Organizations controlled or owned by such federal entities would be non-core entities.

Federal Government Intervention Actions

52. The federal government with its broad responsibility may often intervene for the well being of the country, but those actions are not expected to be permanent. The federal government's intervention in exceptional circumstances, such as an economic crisis situation or military occupation is not intended to be permanent.
53. Although there is no specific time limit, the federal government's intention is not to make such interventions permanent. Typically federal government intervention actions in these instances are not routine activities and strategic planning documents are unlikely to include objectives to routinely initiate such interventions or to permanently operate entities acquired through past interventions.
54. Examples of intervention actions include:
- a. Temporary control-- the federal government seizes control of an established entity but expects to relinquish or cede control.

¹⁸ This differs slightly from federal interventions because receivership activities are considered part of the normal activities and mission of the federal reporting entities that perform them and the duration is typically shorter.

¹⁹ For example, the Federal Deposit Insurance Corporation (FDIC) is an independent agency created by the Congress with the mission "to maintain stability and public confidence in the nation's financial system by: insuring deposits; examining and supervising financial institutions for safety and soundness and consumer protection; and, managing receiverships."

- b. Temporary ownership--the federal government acquires an ownership interest of an entity but expects to end its interest as soon as practicable.
- 55. Temporary situations that exist at fiscal year-end must be assessed to confirm they are not expected to be permanent.

Related Parties

- 56. In addition, the federal government may be able to exercise significant influence over certain entities. Such parties are referred to as "related parties." See Related Party discussion beginning at par. XX for definition, disclosures and additional information. NOTE: The issue of significant influence will be addressed when the Board next considers Related Parties.

Government-wide GPFFR Consolidation and Disclosure

Core government entities

- 57. The Statement provides for consolidation²⁰ of core government entities' financial statements to facilitate an assessment of the financial position of the federal government and the cost of operations financed by taxpayers. Consolidation aggregates the individual financial statements of entities comprising a reporting entity and results in presentation of information for a single economic entity representing core taxpayer supported activities, resources, and obligations where accountability rests with the Congress and the President.
- 58. Core government entities should apply SFFAS 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*.
- 59. SFFAS 34 recognizes that a limited number of federal entities prepare and publish financial reports pursuant to the accounting and reporting standards issued by the Financial Accounting Standards Board (FASB). SFFAS 34 provides that general purpose federal financial reports

²⁰ Consolidation is a method of accounting that combines the accounts of those entities line by line on a uniform basis of accounting and eliminates balances and transactions among the entities. For selected financial statements such as the statement of budgetary resources, a combined financial statement which does not eliminate balances and transactions among the entities is acceptable.

prepared in conformity with accounting standards issued by the FASB also may be regarded as in conformity with GAAP. The consolidated government-wide entity should consolidate component entity financial statements for core government entities prepared in accordance with SFFAS 34 without conversion for any differences in accounting policies among the entities. The following disclosures are required where the amounts prepared pursuant to FASB standards are material to the line item and there is a difference between FASAB and FASB accounting principles or standards:

- a. descriptions of the different accounting policies and methods applied and the related amounts included in the line item for each policy and method
- b. identities of component entities that prepared financial statements pursuant to FASB standards as permitted by SFFAS 34, paragraphs 9 – 11 and contributed significantly to the separately reported line item

Non-core entities

60. Maintaining a distinction between the finances of core government entities and non-core entities will more effectively meet federal financial reporting objectives. Such a distinction allows core government entity financial statements to reveal the costs to taxpayers as well as how such entities have impacted the net position of the core government. However, federal financial reporting objectives can not be met without further information regarding such entities.
61. For those organizations not classified as core government entities, this Statement provides for judgment by the preparer in determining the appropriate disclosures based on the factors and principles provided herein.
62. Non-core entities need not be grouped by type and no distinction is made by type for purposes of determining the appropriate presentation or disclosure. These types of entities and any other types of entities identified as non-core should provide disclosures consistent with Disclosures for Non-core Entities as detailed in par. 64 to **Error! Reference source not found.** below after considering the factors listed in par. 63.

Factors in Determining Non-Core Entity Disclosures

63. Materiality is an overarching consideration in financial reporting. Preparers should consider both qualitative and quantitative materiality in determining non-core entity disclosures. Beyond materiality, the following factors²¹ should be considered in making judgments about the extent of appropriate non-core entity disclosures:
- ***Relevance to reporting objectives of reporting entity*** - Significance of the non-core entity in light of the reporting objectives. This would include the significance of the balances and/or information regarding results of operations and financial position to meeting the operating performance and stewardship reporting objectives.
 - ***Nature of the potential benefits or risks/exposures associated with the relationship***- Information is needed to provide an understanding of the potential financial impact, including financial-related exposures to potential gain and risk of loss to the core entity resulting from the entity's operations.
 - ***Organization views/perspective***- How the non-core itself accounts for or reports on its relationship with the federal government. For example, whether the organization views itself as an extension of the federal government or operationally independent of the President and the Congress may influence the amount of information disclosed.
 - ***Complexity of the relationship***- The more complex relationships would involve more detailed disclosures to ensure the relationship is understood by the readers.
 - ***Extent to which the information interests, or may be expected to interest, a wide audience*** - Due to the sensitivity, materiality of the transactions, media attention, or other reasons, interested parties may expect some type of disclosures regarding the organization or the relationship with the federal government.
 - ***Extent to which there are not alternative sources of reliable information***- An objective of general purpose federal financial reporting is to meet the needs of users who may have limited access to

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

information or statements and lack the ability to demand the desired information.

Disclosures²² for Non-core Entities

64. Both qualitative and quantitative factors should be considered in determining whether a non-core entity should be presented separately due to its significance or aggregated²³ with other non-core entities. For each significant entity and aggregation of entities disclose information to meet the following objectives:
- a. **Relationship:** The nature of the federal government's relationship with the non-core entity.
 - b. **Relevant Activity:** Nature and magnitude of relevant activity during the period and balances at the end of the period.
 - c. **Future exposures:** A description and, if possible, quantification, of the federal government's exposure to gains and losses from the future operations of the non-core entity.
65. Examples of information²⁴ that may meet the above objectives and provide the necessary understanding of the non-core entity's relationship, activities, and future exposures specific to the federal government include but are not limited to:
- a. The name and description of the non-core entity
 - b. The nature of the relationship between the federal government and the non-core entity including any control or influence over the non-core entity and/or the percentage of ownership interest and voting rights, including key statutory or other legal authorities relating to potential financial impacts
 - c. For intervention actions, the primary reasons for the intervention and a brief description of the federal government's plan relative to operating

²² These may include disclosures required by other standards.

²³ Aggregation may be based on non-core entity type, class, investment, or a particular event deemed significant by the preparer. The goal would be concise, meaningful and transparent disclosures.

²⁴ No individual example is itself a required disclosure nor are they required in the aggregate. Therefore, the examples are not alternatives or substitutes one for another. Instead, a disclosure that provides an understanding of the one of the objectives should be provided.

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- or disposing of the entity (including timeframes) and/or a statement that the intervention is not expected to be permanent
- d. A description and summary of assets, liabilities, revenues, expenses, gains, and losses recognized in the financial statements of the core government entity as a consequence of transactions with or interests in the non-core entity and the basis for determining the amounts reported
 - e. Summary financial statements, condensed financial information for the non-core entity (e.g. assets, liabilities, fund balances, total expenditures and sources of revenues), or key indicators. For example, if the federal government's risk of exposure is significant, then a set of summary financial statements may be appropriate, whereas if the exposures are limited then key indicators of financial impacts with selected financial info (net position and net results) might be appropriate.
 - f. A general reference to non-core entity financial statements and how they can be obtained
 - g. Key terms of contractual agreements regarding potential financial impacts (including those terms of the arrangements to provide financial support and liquidity, including events or circumstances that could expose the federal government to a loss)
 - h. The nature of, and changes in, the risks associated with the control or involvement with the entity during the period or other indicators of financial health or changes in financial health
 - i. The amount that best represents the federal government's maximum exposure to gain or loss from its involvement with the non-core entity, including how the maximum exposure to gain or loss is determined. If this cannot be quantified, that fact should be disclosed.
 - j. Other information that would provide an understanding of the potential financial impact, including financial-related exposures to potential gain and risk of loss to the government-wide reporting entity, resulting from the non-core entity

Basis of Accounting for Non-core entities²⁵

- 66. Non-core entities disclosed in the government-wide report should be reported on accrual based standards provided in generally accepted accounting principles for its specific type of entity. This includes generally accepted accounting principles for any domain (FASAB, Governmental Accounting Standards Board, or Financial Accounting Standards Board).
- 67. Although a common fiscal year-end is encouraged, it is not mandatory and the cost and benefits of establishing a common fiscal year-end may be considered. If non-core entities have a different fiscal year-end than the core government-wide entity, financial information included for non-core entities should be for the year ended within the core government entity's year end, while being timely and accurate.
- 68. Any significant changes in information occurring from the non-core entity's financial statement date to the core government entity's year end should be disclosed.

Related Party Government-wide Reporting Entity**Related Party Disclosures for Government-wide Reporting Entity**

Part II of Proposed Standard**Component Reporting Entities**

²⁵ Core government entities should apply the GAAP hierarchy established in SFFAS 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*.

Effect on Existing Concepts

Effective Date

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

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

Appendix A: Basis for Conclusions

This appendix discusses some factors considered significant by Board members in reaching the conclusions in this Statement. It includes the reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others. The standards enunciated in this Statement—not the material in this appendix—should govern the accounting for specific transactions, events, or conditions.

Introduction

- A1. Identifying the organizations to be included in the government-wide general purpose federal financial reports (GPFFR) is very important. Most would agree that GPFFR communicate information to users concerned or interested in the reporting entity. While SFFAC 2 provides criteria for determining if an organization should be included, questions have continued.
- A2. The federal government and its relationships with other organizations have become increasingly complex. Consequently, the GPFFR should be broad enough to include the varied organizations for which the President and Congress are accountable. Therefore, the primary reason for developing standards for the government-wide GPFFR is to ensure that users will be provided with complete financial information about the entity and its involvements.

Project History /Task Force

- A3. In 2008, the Board formed a Federal Entity Task Force. The objective of the task force was: “The Federal Entity Task Force will assist in developing the proposed standards on the boundaries of the reporting entity and specific criteria for determining whether an organization should be included.”
- A4. The Federal Entity Task Force met several times over the course of the project and also exchanged numerous ideas and recommendations electronically. The task force views and recommendations were presented to the Board for their consideration and most often were approved.

Organizational Approach to Defining Boundaries

- A5. The federal government is complex and therefore it may be difficult defining the boundary of the GPFFR. It is unique because of its constitutionally established

powers and often its motivations and functions are different than other organizations.

- A6. An organizationally based approach to defining boundaries provides accountability. Focusing on organizations helps to identify who is accountable for what. In addition, an organizational approach provides meaningful financial statements by aligning boundaries with defined organizations and there would likely be users of organizationally based GPFFR. However, as the federal government must report on many different types of relationships with varied purposes due to complex governance structures and finances, there must be differences in presentation of financial information for different relationships.
- A7. 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."
- A8. 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.
- A9. This Statement provides that decisions about reporting boundaries be taken in two steps – first, determine what organizations are to be included in the reports and second, identify the means to present relevant information about organizations.
- A10. Three principles for including organizations in the government-wide GPFFR are established: *In the Budget*, *Majority Ownership Interest*, and *Control with Expected Benefits or Risk of Loss*. Next, a distinction is to be made between core government entities and non-core entities for those organizations to be included. The distinction between core government and non-core entities will determine how financial information is presented in the GPFFR. Core government entity financial statements are to be consolidated and non-core entity financial information is to be disclosed.

- A11. 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 financial information about the government. There is a focus on the needs of current and potential users of federal financial information; accountability and users' information needs are the foundation of governmental financial reporting. In each of the four federal financial reporting objectives articulated in SFFAC 1 there are several references to user information needs and accountability. Therefore, the notion of accountability should be of importance when considering the boundaries of GPFFR.
- A12. Professional judgment is required in the application of the standards proposed in this Statement. This Statement presents a principles-based approach to determining which organizations should be included²⁶ in the government-wide GPFFR because of the wide and varying relationships of the federal government. The Board considered several alternative approaches to identifying organizations for which elected officials – the Congress and the President – were accountable. The principles for inclusion proposed herein establish accountability for organizations (1) funded through the budgetary process, (2) where a majority ownership interest is held, or (3) controlled with an expectation of benefits or risk of loss. Each of these principles for inclusion is discussed below.

Principles for Inclusion in the Government-wide GPFFR

In the Budget

- A13. Identification of an organization in the President's Budget is the clearest evidence that an entity should be included in the government-wide report. Absent budgetary actions – originating with the President's Budget and leading to appropriations – federal organizations would be unable to continue operations. Financial reporting objectives – budgetary integrity, operating performance, stewardship and systems and controls – could not be met if organizations identified in the budget were not included in the financial reports. Therefore, the most efficient means to identify organizations for inclusion is by their participation in the budget process as evidenced in the *Budget of the*

²⁶ Note that this Statement does not specify which organizations must prepare and issue financial statements.

United States Government: Analytical Perspectives- Supplemental Materials schedule *Federal Programs by Agency and Account*.

- A14. Although the legislative and judicial branches (and most organizations within those branches) are not currently required to prepare financial statements, based on this principle (*In the Budget*) those organizations would be included in the government-wide report.²⁷
- A15. Organizations should include any financing accounts associated with the organization although such accounts may not be specifically identified in the schedule. For example, the *Federal Programs by Agency and Account* may not identify associated financing accounts, such as federal credit reform financing accounts, but those accounts should be included in GPFFR for the organization. In addition, other GAAP principles would apply, such as SFFAS 2, *Accounting for Direct Loans and Loan Guarantees*, and SFFAS 5, *Accounting for Liabilities of the Federal Government*, and help identify the elements and required disclosures for each organization.
- A16. The *Federal Programs by Agency and Account* schedule also sometimes names specific recipients of federal financial assistance. SFFAC 2, *Entity and Display*, acknowledged that the *Federal Programs by Agency and Account* schedule sometimes names an entity to receive a “subsidy” and states “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.” Thus, “subsidy” is the term used in SFFAC 2 to distinguish such “non-federal” organizations from the intended “federal” organizations.
- A17. While the provision in SFFAC 2 was correct, the Board is proposing standards, and believes terms used in this Statement should be defined. The Board considered ways to define “subsidy” but concluded it was more appropriate to define “federal financial assistance.” The proposed language ensures organizations receiving assistance as defined by the Single Audit Act Amendments of 1996²⁸ and specifically listed under an appropriation in the *Federal Programs by Agency and Account* schedule are not automatically included in the government-wide GPFFR. Instead, to confirm that specifically

²⁷ As the source of GAAP for federal reporting entities, FASAB GAAP would be the appropriate accounting standards for these entities to adopt if they prepare GAAP-based financial statements.

²⁸ ‘Federal financial assistance’ is assistance that non-federal entities receive or administer in the form of grants, loans, loan guarantees, property, cooperative agreements, interest subsidies, insurance, food commodities, direct appropriations, or other assistance.

identified recipients are “non-federal entities,” such organizations should be assessed against the Majority Ownership Interest and Control with Expected Benefits or Risk of Loss principles before being excluded from the government-wide GPFFR.

Organizations partially in the budget

- A18. The Board deliberated the issue of certain organizations being partially in the budget (i.e., some of their operations or accounts are not in the President’s Budget), such as a museum receiving substantial donor support. The Board determined the organization should be included in the government-wide report based on the in the budget principle. The Board further decided that how such organizations would be presented would be based on whether the organization met the attributes of a core or non-core entity, as discussed later in the Statement. Therefore, the language in the principle (for *in the budget*) is silent regarding organizations partially funded by non-budgetary sources.
- A19. While the principle In the Budget is the most efficient means to identify organizations for inclusion, there may be other organizations that should be included in the government-wide GPFFR and there are additional principles to be considered for organizations not identified in the Budget. The budget principle represents a starting point in analysis but does not mean that organizations not addressed in the budget should be excluded. Because the budget’s purposes differ from financial reporting objectives in many respects (such as the forward looking focus of the budget and decisions on the allocation of resource flows), it is possible that organizations or activities might be excluded from the budget for reasons that do not justify exclusion from financial reports. The other inclusion principles are necessary to ensure completeness in the context of the federal financial reporting objectives.

Majority Ownership Interest

- A20. When the federal government holds a majority ownership in an entity it should be included in the government-wide report. As described in the Statement, majority ownership interest exists with over 50% of the votes or the net residual assets of an entity.
- A21. The Board determined that minority ownership interests (less than 50%) should be acknowledged within the Statement by simply saying such interests should be accounted for in accordance with GAAP. This question was deliberated

because it was uncertain how broad the scope of the “entity” standard should be. The Board agreed attempting to address minority interests in such a narrow scope through the entity project may be less effective than allowing the GAAP hierarchy to fill any void. It was agreed the Statement would contain a footnote that states ownership interests 50% or less should be accounted for in accordance with the appropriate accounting standards per the GAAP hierarchy.

Control with Expected Benefits or Risk of Loss

- A22. When the federal government controls an organization with the expectation of benefit or risk of loss, the organization should be included in the government-wide GPFFR. As detailed in the Statement, control involves the power to govern the financial and/or operating policies with expected benefits or risk of loss as a result of those actions. Both the power and benefit/loss aspects of the control definition should be present to justify inclusion of the entity in the government-wide GPFFR.
- A23. For example, the Statement provides situations where control does not exist—in the instance of the federal government exercising its rights of regulatory powers over an organization. In these cases, the federal government is unable to exercise that power for its own benefit. Therefore, including such an organization in the government-wide report would misrepresent the financial position and results of operation of the government. This would not support achievement of the objectives of financial reporting.
- A24. For financial reporting purposes, assessment of control is made at the reporting date and based on current legislation, rather than legislation that may or may not be enacted in the future.
- A25. Determining control requires judgment, and the Statement provides indicators to assist in making determinations. The first set of indicators is “persuasive” as the federal government has the authority to control and any one of the listed items would mean control is present. The second set of indicators is more permissive when the federal government has the ability to control and the set of indicators is considered in the aggregate.
- A26. Because the government does not usually seek only financial benefits, the expected *benefit* associated with control does not have to be a financial benefit. Instead, it may be non-financial. For example, it may be in the form of a service provided on the federal government’s behalf or the ability to direct the work of the other entity to deliver goods and services.

Misleading to Exclude Principle

- A27. The Statement includes a general provision requiring inclusion of an organization if it would be misleading to exclude it. Certain members believed this may be problematic because no criteria are offered. However the Board ultimately agreed the principle would help ensure that the proposed Statement could accommodate rare situations that may arise in the future. This is consistent with provisions of SFFAC 2.
- A28. The Board also believes it is similar to what the Governmental Accounting Standards Board provides in GASB 14, *The Reporting Entity*. It provides for those unique situations where the preparer and auditor agree something should be included that was not captured by the existing standards.
- A29. The Board also believes this principle would be used in situations agreed to by the preparer and auditor; judgment would be required in this area. Therefore, the Board believes these types of situations would be difficult to anticipate and developing criteria challenging.

Organizations--Core Government Entities and Non-core Entities

- A30. Differences in purposes and governance structures require differences in presentation of financial information. Decisions about federal financial reports for an entity are taken in two steps – first, determining what organizations are to be included in the reports (Inclusion Principles above) and second, identifying the means to present relevant information about organizations.
- A31. To assist in making decisions about presentation, a distinction is made between core (or general) government entities and non-core entities. This assessment is based on the degree to which the following characteristics are met: the entity is taxpayer supported, is governed by the Congress and the President, imposes or may impose risks and rewards on the taxpayer, and/or provides core federal government goods and services on a non-market basis.

Core (or general) government entities

- A32. Core government entities generally provide federal goods and services on a non-market basis. That is, prices are not established solely through market

transactions where supply and demand determine price. Goods and services provided on a non-market basis may be free of charge or provided at prices that are either not economically significant or bear little relationship to the cost of the good or services.

- A33. Core government entities are financed through taxes, fees and other non-exchange revenue as evidenced by inclusion in the budget. Significant risks and rewards fall to the taxpayer for core government entities. Inclusion in the budget is the clearest evidence that an entity is “federal.”
- A34. The budget is a political document serving many purposes. The 1967 *Report of the President’s Commission on Budget Concepts* indicates that “the budget must serve simultaneously as an aid in decisions about both the efficient allocation of resources among competing claims and economic stabilization and growth.” On the topic of coverage of the budget, the Commission recommended that “the budget should, as a general rule, be comprehensive of the full range of Federal activities” and included specific recommendations on matters then considered controversial.
- A35. Therefore, the most efficient means to identify “federal” entities is through their participation in the budget process as evidenced by inclusion in the budget. Entities listed in the budget that are not receiving federal financial assistance are presumed to qualify as core government entities. A decision by the Office of Management and Budget or the Congress to include an entity in the budget could be viewed to settle the matter of an entity being “federal.” Inclusion in the budget means that allocation of resources to its activities is determined through federal legislation – making the entity itself financially accountable to Congress and the President.
- A36. Accountability for core government entities rests with the President and the Congress, and their approved appointed organizational leaders.
- A37. The assessment whether an entity meets the attributes for a core government entity is based on the assessment of all the attributes and the degree to which each is met. As such, not all attributes are required to be met; classification is based on the assessment as a whole. For example, the post office may compete against others, therefore it provides goods and services on a market basis. However, if it primarily meets the other characteristics then it is a core government entity.

Non-core entities

- A38. On the opposite end of the spectrum and with varying degrees in between are non-core entities. The use of professional judgment will be required when assessing the non-core entities as there is a much broader spectrum of entities along the continuum with varying degrees of relationships with the federal government.
- A39. Non-core entities receive limited or no taxpayer support. Non-core entities, in contrast to core entities, are often structured so there is a clear barrier or limit on taxpayer financing of the entity. This is an effort to shield the taxpayer from risk.
- A40. In addition, another contrast with core entities is that with non-core entities, accountability ultimately rests with the President and Congress, but there is much less direct involvement in decision making. Greater decision making may rest with a governing board or there may be situations where non-core entities may have a separate legal identity.
- A41. The Statement provides categories of non-core entities primarily as a way to help identify non-core entities. However, the Statement does not require presentation by any specific class or category and allows flexibility in presenting information about non-core entities. Non-core entities include but are not limited to: quasi governmental and/or financially independent entities, receiverships and conservatorships, and federal government intervention actions.

Quasi Governmental and/or Financially Independent Entities

- A42. The Statement describes *Quasi Governmental and/or Financially Independent Entities* as those non-core entities where governance and/or financial differences lead to greater independence. The Statement provides both governance and financial characteristics that would indicate this type of non-core entity.
- A43. These characteristics are considered along with the other non-core attributes presented in the standard. However, as noted the disclosures for a non-core entity are the same regardless of which category the entity may fit in. Categories are simply included to aid in identifying non-core entities.
- A44. Quasi Governmental and/or Financially Independent Entities may include a Federally Funded Research and Development Center (FFRDC). However, details may differ among FFRDCs and some may potentially be core entities

and therefore flexibility is necessary for determining the most meaningful presentation. The accompanying Illustrative Guide offers examples that may be useful in application.

- A45. Additional potential examples of Quasi Governmental and/or Financially Independent Entities include museums, performing arts organizations and universities, and venture capital funds. The accompanying Illustrative Guide offers examples that may be useful in application.

Receiverships and Conservatorships

- A46. The Statement describes *Receiverships and Conservatorships* as non-core entities as those failed financial institutions and banks the federal government may take control or ownership with no goal to maintain the relationship.

Federal Government Intervention Actions

- A47. The Statement describes *Federal Government Intervention Actions* as non-core entity involvements resulting from the federal government's intervention actions that are not expected to be permanent. SFFAC 1 acknowledges the unique nature of federal government activity and its broad responsibilities. Par. 50 explains "The federal government is unique, when compared with any other entity in the country, because it is the vehicle through which the citizens of the United States exercise their sovereign power. The federal government has the power through law, regulation, and taxation to exercise ultimate control over many facets of the national economy and society..." SFFAC 1 describes the federal government's responsibility for the general welfare of the nation in par. 53-54 as "a broad responsibility that involves multiple goals."
- A48. With these broad responsibilities, the federal government may be required to take certain actions or intervene in certain situations that are deemed necessary. Examples may include actions to provide stability to the financial markets or military occupation of another country.²⁹ These types of federal government interventions are considered rare.³⁰

²⁹ After the signing of the Japanese Instrument of Surrender in 1945, Japan was supervised for 6 years by the Allied (primarily American) forces and subject to military control, with General MacArthur at the head of the Occupation administration. (Takemae, Eiji 2002 p. xxvi and Wikipedia http://en.wikipedia.org/wiki/Occupation_of_Japan)

³⁰ The current financial crisis is considered to be the most severe since the Great Depression. (White Paper on Changes to Financial Regulations)

- A49. Currently SFFAC 2 provides an exception for situations where the indicative criteria are met temporarily. Specifically, par. 45 of SFFAC 2 states “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 are more than fleeting.”
- A50. However, there may be instances where the federal government intervention is longer than one year due to the extreme factors of the national crisis. In these instances, the focus continues to be on governance and protection, rather than maximizing profits or the federal government entering new lines of business. Further, although the actions may be longer than one year, the interventions are not expected to be permanent.
- A51. Historically the federal government has been involved in few commercial enterprises on an equity basis or shared ownership basis.³¹ As a sovereign entity, the federal government does not act to maximize profits. However, there may be instances when the federal government may act in these capacities for the general well-being of the nation. Challenges may force the federal government to take extraordinary measures, such as actions to provide stability to financial markets or to revive the financial system. In doing so, the federal government may intervene and act in capacities to protect taxpayers which may ultimately lead to taking control of organizations or acquiring some form of ownership.
- A52. Consider the recent economic crisis, it is an example of a federal government intervention action—by September 2008, the U.S. financial markets were in crisis.³² The Treasury Secretary, Chairman of the Federal Reserve, and the Securities and Exchange Commission developed a relief program in response to the deepening financial crisis. In his testimony to Congress, then Treasury Secretary Paulson urged action to “avoid a continuing series of financial institution failures and frozen credit markets that threaten American family’s financial well-being, the viability of business both small and large, and the very health of our economy.”
- A53. As a result, the Emergency Economic Stabilization Act of 2008 (EESA) was passed that provided Treasury broad authorities to protect and recapitalize the financial system. EESA was designed to allow Treasury efforts to restore market confidence and improve overall market functioning. Specifically, the objectives of EESA were to be met by providing authority and facilities that the Treasury Secretary could use to restore liquidity and stability to the financial system, and ensuring the authority and facilities are used in a manner to

³¹ CRS Report for Congress RL30533, *The Quasi Government: Hybrid Organizations with Both Government and Private Sector Legal Characteristics*

³² SIGTARP: Initial Report to the Congress

protect home values, college funds, retirement accounts and savings; preserve home ownership and; maximize overall returns to the taxpayers.³³ EESA created the Troubled Asset Relief Program (TARP) which authorized Treasury to purchase or insure troubled assets as a way to promote stability in the financial markets.

- A54. As many of the stabilization activities unfolded, it was evident that many would last longer than one year. However, the federal government's intent in intervening in these unique situations was appeared to be to protect the general interest of the taxpayers and welfare of the nation. The federal government intervention actions reflect a unique role of government as protector and not proprietor. That is, the government is taking possession to protect the general interest and welfare of the people rather than to derive profit through ownership. For example, the sole purpose for many of the actions relative to the economic stabilization is to bring stability to the markets rather than to become owners.

Government-wide Reporting Entity Consolidation and Disclosure

- A55. As noted above, decisions about the government-wide GPFFR are taken in two steps – first, determining what organizations are to be included in the reports and second, identifying the means to present relevant information about organizations. The final determination of the presentation of financial information through consolidation or disclosure is based upon the results of two assessments—first if the organization is included and second, if those included organizations are classified as core government or non-core entities.
- A56. The **High Level Flowchart** at Appendix B to this ED is a useful tool in applying the principles established as it steps through this process. It is helpful in the assessment and applying the standards in order, including paragraph references to the ED and major decision points.

Core government entities

- A57. The Statement provides that core government entities apply SFFAS 34, The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board.

³³ EESA Act of 2008, P.L. 110-343

In addition, it provides for the consolidation of core government entities so taxpayers and citizens may assess the financial position and the cost of operations of the federal government. Consolidation of the taxpayer supported activities, resources, and obligations where accountability rests with the Congress and the President ensures that the reporting objectives of SFFAC 1 are met.

Consolidation of FASB-based and FASAB-based Information

- A58. The Board has considered the potential ramifications when some federal entities follow GAAP for nongovernmental entities promulgated by the private sector Financial Accounting Standards Board (FASB GAAP) and their information is consolidated with information based on FASAB standards. For example, federal government corporations, the U.S. Postal Service, certain component entities of the U.S. Department of the Treasury, and some smaller entities in the executive and legislative branches have historically applied FASB GAAP and continue to do so. SFFAS 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*, recognizes that “general purpose financial reports prepared in conformity with accounting standards issued by the FASB also may be regarded as in conformity with GAAP for those entities that have in the past issued such reports.” SFFAS 34 also provides that a federal entity preparing audited financial statements for the first time may adopt FASB standards in the rare case that the needs of its primary users would be best met through the application of FASB standards. The acceptance of these practices raises the question of whether the information prepared under FASB standards may be consolidated with information prepared under FASAB standards in consolidated reports prepared by other component entities and in the consolidated government-wide entity.
- A59. The Board has considered such issues on several occasions and provided concepts as follows:
- The reporting entities of which the components [preparing reports under FASB or regulatory accounting standards] are a part can issue consolidated, consolidating, or combining statements that include the components’ financial information prepared in accordance with the other accounting standards. They need to be sensitive, however, to differences resulting from applying different accounting standards that could be material to the users of the reporting entity’s financial statements. If these differences are material, the standards recommended by FASAB and issued by OMB and GAO should be applied. The components would need to provide any additional disclosures recommended by FASAB and included in the OMB issued standards that would not be required by the

other standards.³⁴ (SFFAC 2, Entity and Display, par. 78 (excerpt from section on “Financial Reporting For An Organizational Entity”))

- A60. The Board determined in SFFAS 34 that FASB-based statements are acceptable in certain circumstances. While there are significant differences between FASB and FASAB standards, both standards result in accrual basis information and disclosures that aid users in understanding the information. Given the decisions made in SFFAS 34, members do not believe requiring a conversion of FASB-based information to FASAB-based information for consolidated financial reports of larger entities is justifiable.
- A61. Users may be confused by the presentation of different amounts for the same component in the consolidated financial reports of larger entities; particularly when both amounts would be in accordance with GAAP for federal entities per SFFAS 34. In addition, conversion imposes a cost and it is not clear that the cost is justifiable based on benefits to the user. This Statement proposes that amounts derived for component entities in compliance with SFFAS 34 be consolidated without adjustment. However, if this leads to consolidation in a single line item of amounts measured differently due to differences between FASB and FASAB standards, then disclosure of the different accounting policies and the related amounts should be required. Such disclosures will aid the reader in understanding the information provided.

Non-core entities

- A62. Based on deliberations, the Board determined consolidation of non-core entities would not result in information meeting the basic qualitative characteristics of information in financial reports because it does not provide the most relevant, understandable, or consistent information. For example, for non-core entities the Board believes consolidation may obscure the boundaries of the risks and rewards intended to be assumed. Further, assets that are not available for purposes other than the specific business operation might be commingled with federal assets and liabilities not fully guaranteed by the federal government might be added to federal liabilities.
- A63. SFFAC 1 par. 49 states “...Federal accounting and financial reporting are shaped by, and need to respond to, the unique characteristics and environment

³⁴ In October 1999, FASAB was recognized as the Rule 203 standards-setting body for the federal government.

of the federal government.” SFFAC 1 par. 105 further explains “reports must accurately reflect the distinctive nature of the federal government and must provide information useful to the people, their elected representatives, and federal executives...” SFFAC 1 also provides the qualitative characteristics of information in financial reports, by identifying these basic characteristics: understandability, reliability, relevance, timeliness, consistency, and comparability.³⁵

- A64. Flexibility in disclosures for non-core entities is provided because the range of non-core entities is broad and may require different disclosures to meet the reporting objectives. Providing this flexibility allows the preparer to present information judged most necessary to meet reporting objectives while also providing an understanding of the potential effect of the relationship on the core entity’s financial statements.
- A65. One approach is to consider the goal to ensure that basic financial statements measure and communicate the risks and rewards assumed by the citizens.³⁶ Citizens have an interest in the risks and rewards assumed, but it is less clear that full consolidation provides the most relevant, understandable, or consistent measures.
- A66. Par. 161 of SFFAC 1 discusses relevance as “...To be relevant, a logical relationship must exist between the information provided and the purpose for which it is needed. Information is relevant if it is capable of making a difference in a user’s assessment of a problem, condition, or event. Relevance depends on the types of financial information needed by the various users to make decisions and to assess accountability.” SFFAC 1 also provides that the concept of consistency in financial reporting extends to the determination of the financial reporting entity.³⁷

Factors in Determining Non-Core Entity Disclosures

- A67. Because of the flexibility needed regarding disclosures, preparers may need a list of factors or guidance to assist in determining what disclosures to include. Materiality is an overarching consideration in financial reporting. Preparers should consider both qualitative and quantitative materiality in determining non-

³⁵ SFFAC 1, par. 156

³⁶ SFFAC 1, par. 99-102 describes the users need information to assess the effect of the government’s activities on its financial condition and that of the nation, which includes information on the federal government’s exposures and risks.

³⁷ SFFAC 1, par. 163

core entity presentation and disclosure. Beyond materiality, the factors provided in the Statement assist in determining the nature and extent of appropriate non-core entity disclosures to be provided.

- A68. The factors are to be considered in the aggregate; no individual weight should be assigned or interpreted. Therefore, the assessment of the appropriate disclosures should be made after considering all the factors.

Disclosures for Non-Core Entities

- A69. The Board recognizes that although the Statement provides flexibility with non-core entity disclosures, there is a wide variety of information listed as examples that may be disclosed to meet the objectives intended. Care should be taken to ensure the objectives are met, without producing unintended consequences. Preparers should keep in mind there are associated costs and potential audit implications with any information included in general purpose reports. Incorporating by reference or including summary financial statements or summary financial information may result in an auditor being required to gain audit assurance on that information and thereby result in additional audit costs.

Basis of Accounting for Non-core entities

- A70. The Board believes non-core entity disclosures in the government-wide GPFFR should be based on accrual based standards specific to the type entity and minimize additional costs on the non-core entity. Therefore, there will be instances where non-core entities disclosures are based on different year-ends. The Board agreed that a non-core entity reporting period ending within the fiscal year of the core entity is acceptable for disclosing information in the notes. The Board performed outreach on this issue to the audit community and to the federal entity task force. Generally, the feedback supported this approach.
- A71. However, due to the fact there could be a large time lag, there should be a provision for disclosing significant changes in information (whether financial condition or other information) occurring from the audited financial statements to the reporting entity's fiscal year end. The Board notes this would only be necessary if a non-core entity summarized financial statements or summarized financial information were presented. Otherwise normal transactions would be captured throughout the year so this would be a somewhat narrowed focus.

Federal Reserve System

A72. SFFAC 2 identified certain entities or types of entities (the Federal Reserve System, Government Sponsored Enterprises and Bailout Entities) that could be included in the government-wide reporting entity based on the established concepts but that should not be included.³⁸ This Statement establishes principles to ensure users of GPFFR are provided comprehensive financial information while recognizing the complexity of the federal government and its relationships with varied organizations. The new principles can be applied to the entities previously excluded and conclusions reached to include the entities—either as core or non-core entities—or to continue to exclude the entities. SFFAC 2 is being amended to ensure that concepts provide a framework for standards-setting but do not themselves establish standards by listing specific exclusions.

“Quasi Governmental and/or Financially Independent Entity”

[NOTE: The following is a preliminary staff draft for discussion purposes. Consultation with general counsel and other experts may result in changes if the Board selects this option.]

A73. An example of a Quasi Governmental and/or Financially Independent Entity would be the Federal Reserve System (the Board of Governors of the Federal Reserve System and the Federal Reserve Banks).³⁹ An analysis of the present facts shows the Federal Reserve System meets the inclusion principles (discussed above); specifically, it meets the principle of control with expected benefit or loss. For example, the Federal Reserve System derives its authority from the U.S. Congress. Further, the members of the Board of Governors are appointed by the President and confirmed by the Senate for 14-year terms. In addition, the Chairman and Vice Chairman of the Board of Governors are also appointed by the President and confirmed by the Senate for four-year terms. The Board of Governors supervises and regulates the operations of the Federal Reserve Banks.⁴⁰ As for the expected benefit or loss, the Board of

³⁸ SFFAC 2, *Entity and Display*, par. 47-50.

³⁹ The Federal Reserve System often referred to as the Federal Reserve or simply “the Fed” is the central bank of the United States. It is a federal system, composed of a central, governmental agency—the Board of Governors—in Washington, D.C., and twelve regional Federal Reserve Banks.

⁴⁰ The summary information about the Federal Reserve is based on the FAQs at the Federal Reserve website at <http://www.federalreserve.gov/faqs>.

Governors requires the Reserve Banks to remit their net earnings after providing for their expenses, dividends, and capital to the U.S. Treasury.⁴¹

- A74. The Federal Reserve System is subject to oversight by Congress, which periodically reviews its activities and can alter its responsibilities by statute. Also, the Federal Reserve System must work within the framework of the overall objectives of economic and financial policy established by the government. Congress chartered the Federal Reserve Banks for a public purpose and they are operated in the public interest rather than for profit or to benefit any private group. The Reserve Banks are the operating arms of the central banking system, and they combine both public and private elements in their makeup and organization.⁴²
- A75. While chartered and overseen by elected officials, the Federal Reserve System is considered an independent central bank because its decisions do not have to be ratified by the President or anyone else in the executive or legislative branch of government. It does not receive funding appropriated by Congress, and the terms of the members of the Board of Governors span multiple presidential and congressional terms. Once appointed, Governors may not be removed from office for their policy views. The lengthy terms and staggered appointments are intended to contribute to the insulation of the Federal Reserve System as a whole--from day-to-day political pressures to which it might otherwise be subject.⁴³ Therefore, the Federal Reserve System can be most accurately described as "independent within the government."
- A76. The Federal Reserve System presently has the attributes of a non-core entity described in the Statement and many of the characteristics of the Quasi Governmental and/or Financially Independent Entity. Specifically, the Federal Reserve System is not listed in the schedule of accounts in the President's Budget (although certain information is included in an appendix to be transparent regarding activities). While the governance structure provides for a Board that is appointed, those appointments are for much longer periods than is customary for core entities. Further, the Federal Reserve System structure appears to offer a degree of independence in fact and appearance. Therefore, based on present circumstances, the Federal Reserve System should be included in the government-wide report and disclosures consistent with the non-core entity provisions in the Statement should be provided.

⁴¹ Approximately 95% of the Reserve Banks' net earnings have been paid to the Treasury since the Federal System began operations in 1914. (Staff working on reference)

⁴² Ibid

⁴³ The summary information about the Federal Reserve is based on the FAQs at the Federal Reserve website at <http://www.federalreserve.gov/faqs>.

Appendix B: Illustrations-FLOWCHART

Appendix C: Abbreviations

CFR	Consolidated Financial Report
DOL	U.S. Department of Labor
ED	Exposure Draft
FASAB	Federal Accounting Standards Advisory Board
FASB	Financial Accounting Standards Board
GAAP	Generally Accepted Accounting Principles
GPFFR	General Purpose Federal Financial Reports
OAI	Other Accompanying Information
OMB	Office of Management and Budget
RSI	Required Supplementary Information
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards
U.S.	United States

Appendix D: Glossary

FASAB Board Members

Tom L. Allen, Chair

Debra J. Bond

Robert F. Dacey

Michael H. Granof

Norwood J. Jackson, Jr.

Mark Reger

Alan H. Schumacher

D. Scott Showalter

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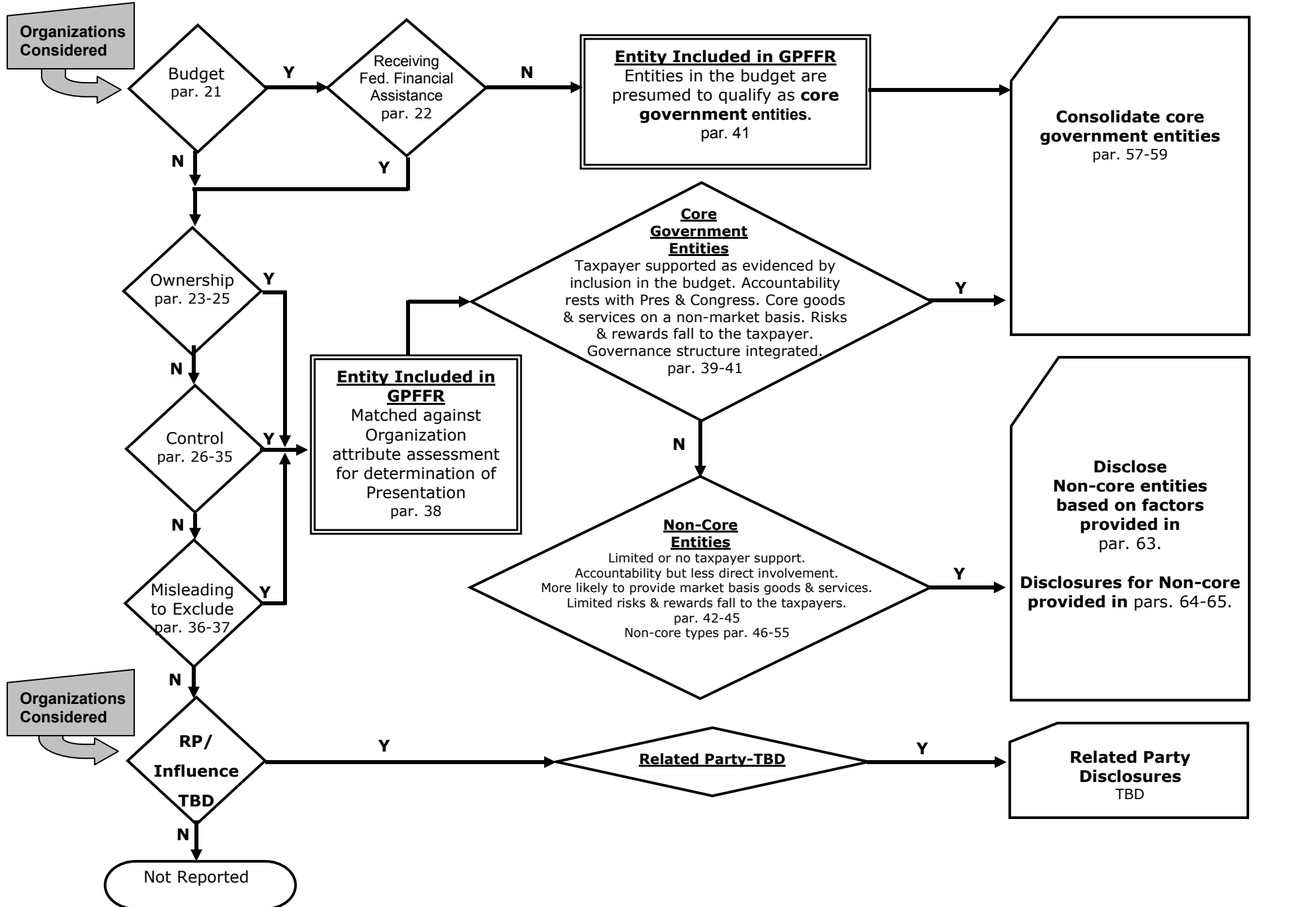
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HIGH LEVEL FLOW CHART

Inclusion Principles

Organization Type

Presentation



Appendix 1— Marked Version of Language for Government-wide Issues

Revised Language-- Consolidation of FASB-based Information without Conversion

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

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

The reporting entities of which the components [preparing reports under FASB or regulatory accounting standards] are a part can issue consolidated, consolidating, or combining statements that include the components’ financial information prepared in accordance with the other accounting standards. They need to be sensitive, however, to differences resulting from applying different accounting standards that could be material to the users of the reporting entity’s financial statements. If these differences are material, the standards recommended by FASAB and issued by OMB and GAO should be applied. The components would need to provide any additional disclosures recommended by FASAB and included in the OMB issued standards that would not be required by the other standards.¹ (SFFAC 2, Entity and Display, par. 78 (excerpt from section on “Financial Reporting For An Organizational Entity”))

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

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¹ In October 1999, FASAB was recognized as the Rule 203 standards-setting body for the federal government.

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

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

Government-wide Reporting Entity Consolidation and Disclosure

Core government entities

1. The Statement provides for consolidation² of core government entities' financial statements to facilitate an assessment of the financial position of the federal government and the cost of operations financed by taxpayers. Consolidation aggregates the individual financial statements of entities comprising a reporting entity and results in presentation of information for a single economic entity representing core taxpayer supported activities, resources, and obligations where accountability rests with the Congress and the President.
2. Core government entities should apply SFFAS 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*.
3. SFFAS 34 recognizes that a limited number of federal entities prepare and publish financial reports pursuant to the accounting and reporting standards issued by the Financial Accounting Standards Board (FASB). SFFAS 34 provides that general purpose federal financial reports prepared in conformity with accounting standards issued by the FASB also may be regarded as in conformity with GAAP. The consolidated government-wide entity should consolidate component entity financial statements for core government entities prepared in accordance with SFFAS 34 without conversion for any differences in accounting policies among the entities. The following disclosures are required where the

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

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

⁴ These may include disclosures required by other standards.

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~~amounts prepared pursuant to FASB standards are material to the line item and there is a difference between FASAB and FASB accounting principles or standards;~~

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- a. descriptions of the different accounting policies and methods applied and the related amounts included in the line item for each policy and method
- b. identities of component entities ~~that prepared financial statements pursuant to FASB standards as permitted by SFFAS 34, paragraphs 9 – 11 and contributed significantly to the separately reported line item.~~

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

Staff proposes the following Questions for Respondents:

The Statement would require consolidation of FASAB and FASB based information without conversion for core government entities in accordance with SFFAS 34. This Statement also would require disclosures of the different policies and methods and the related amounts if the FASB amounts are material to the line item and there is a difference in the accounting principles or standards.

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Inserted: where the FASB amounts are material to the line item and there is a difference in the accounting principle

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

Do you agree or disagree with the above referenced requirement?

Please provide the rationale for your answers.

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Revised disclosures for non-core entities

Disclosures⁴ for Non-core Entities

1. Both qualitative and quantitative factors should be considered in determining whether a non-core entity should be presented separately due to its significance or aggregated⁵ with other non-core entities. For each significant entity and aggregation of entities disclose information to meet the following objectives:
 - a. **Relationship:** The nature of the federal government's relationship with the non-core entity.
 - b. **Relevant Activity:** Nature and magnitude of relevant activity during the period and balances at the end of the period.
 - c. **Future exposures:** A description and, if possible, quantification, of the federal government's exposure to gains and losses from the future operations of the non-core entity.
2. Examples of information⁸ that may meet the above objectives and provide the necessary understanding of the non-core entity's relationship, activities, and future exposures specific to the federal government include but are not limited to:
 - a. The name and description of the non-core entity
 - b. The nature of the relationship between the federal government and the non-core entity including any control or influence over the non-core entity and/or the percentage of ownership interest and voting rights, including key statutory or other legal authorities relating to potential financial impacts

⁵ Aggregation may be based on non-core entity type, class, investment, or a particular event deemed significant by the preparer. The goal would be concise, meaningful and transparent disclosures.

⁸ No individual example is itself a required disclosure nor are they required in the aggregate. Therefore, the examples are not alternatives or substitutes one for another. Instead, a disclosure that provides an understanding of the one of the objectives should be provided.

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c. For intervention actions, the primary reasons for the intervention and a brief description of the federal government's plan relative to operating or disposing of the entity (including timeframes) and/or a statement that the intervention is not expected to be permanent

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d. A description and summary assets, liabilities, revenues, expenses, gains, and losses recognized in the financial statements of the core government entity as a consequence of transactions with or interests in the non-core entity and the basis for determining the amounts reported

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

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

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

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h. The nature of, and changes in, the risks associated with the control or involvement with the entity during the period or other indicators of financial health or changes in financial health

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

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j. Other information that would provide an understanding of the potential financial impact, including financial-related exposures to potential gain and risk of loss to the government-wide reporting entity, resulting from the non-core entity

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<#>the nature of, and changes in, the risks associated with the control or involvement with the entity such as changes in bond ratings, publicly-traded share prices, or other indicators of financial health or changes in financial health¶
<#>key statutory or other legal authorities relating to financial impacts¶

The nature of any control over the entity and/or the percentage of ownership interest and voting rights

For intervention actions, the primary reasons for the intervention and a brief description of the government's plan¹ relative to operating or disposing of the entity (including timeframes) and/or a statement that the intervention is not expected to be permanent

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

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

information that would provide an understanding of the potential financial impact, including financial-related exposures to potential gain and risk of loss to the government-wide reporting entity, resulting from the entity.

is flexible and based on the preparer's judgment. It

¹ The plan may include options being considered, plans for ending the intervention, information regarding the length of such arrangement, or plans to change terms of such arrangement.