



April 8, 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 D¹**

MEETING OBJECTIVES

- To approve draft guidance regarding factors to consider for non-core accountable entity presentation and disclosure

The primary objective for the April Board meeting is to determine if the Board approves the draft guidance regarding factors to consider for non-core accountable entity presentation and disclosures for those that are not consolidated. Specific questions related to this objective are included on page 4 and 6 of the Staff memo. Additional objectives (time permitting) include obtaining the Board's feedback on the following:

- Basis of Accounting
- Revised Flowchart
- Format and detail of the proposed Illustration guide. (Staff has included a sample of the type to be included in the guide.)
- Comments on other sections of the ED.

BRIEFING MATERIAL

- ***Staff Issue Paper (beginning at page 3 of this memo)***
- ***Attachment 1— Flowchart***
- ***Attachment 2— Draft Exposure Draft***
- ***Attachment 3—Illustration Guide sample***

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

BACKGROUND

As you may recall at the February 2011 meeting, the Board approved staff's distinction between core (general) government entity and non-core accountable entity. The Board also agreed with the general notion that entities in the budget are core entities that should be consolidated.

For the April Board meeting the Board requested staff to develop factors and criteria to assist in determining information that should be presented for non-core entities.

NEXT STEPS

After receiving the Board's feedback on the factors and proposed disclosures for non-core accountable entities, staff anticipates contacting representatives from the Federal Reserve. Based on the proposed requirements and anticipated revisions and/or rescissions to SFFAC 2², staff would like to obtain their input on the proposal before it is exposed for comment. Based on the comments received, a decision will be made if it would be necessary to invite representatives to a Board meeting.

Staff will also continue developing additional examples for the Illustration guide.

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.

² This is an open item—once the proposed statement is near final, staff must determine what sections of SFFAC 2 need to be amended or rescinded. For example, paragraph 47 of SFFAC 2 related to the Federal Reserve System may need to be amended or rescinded.

**Staff Paper- Federal Entity
April 2011 Board Meeting**

**Non-Core (Accountable) Entities
Factors to Consider for Presentation and Disclosure**

Flexibility in presentation of non-core (accountable) entities is provided because the range of non-core entities is broad and may require different presentation or disclosures to meet the reporting objectives.

Consolidation may not be the best alternative for meeting the basic qualitative characteristics of information in financial reports for non-core entities. Furthermore, it is less clear that consolidation provides the most relevant, understandable, or consistent measure when asked the following questions:

- Does consolidation obscure the boundaries of the risks and rewards intended to be assumed?
- Are assets that are not available for purposes other than the specific business operation commingled or added to federal assets?
- Are liabilities not fully guaranteed by the federal government added to the federal government liabilities?
- Should gross costs of the organization be added to federal governmental costs?
- Should gross revenues of the organization be added to federal government revenues?

Alternatively-- presenting summary financial statements, condensed financial information, key indicators, or risk assumed information in the notes may present pertinent financial information for entities as entities separate from core government. Any transactions or balances with the entities displayed on the various sets of financial statements (if presented) are not eliminated. This presentation allows readers to assess risks/rewards; performance and stewardship readily for non-consolidated entities as well as other information that can be analyzed readily. It also provides flexibility to the preparer.

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. For example there may be certain instances when consolidation may undermine the ability to provide the most meaningful presentation because it may obscure results and make it difficult to separately identify amounts for selected organizations. On the other hand, there may be instances where consolidation may be less costly than a separate disclosure.

Therefore, preparers may need a list of factors or guidance to assist in making this determination. Materiality is an overarching consideration in financial reporting. Preparers should consider both qualitative and quantitative materiality in determining non-core entity presentation and disclosure. Beyond materiality, factors that may assist in determining the nature and extent of appropriate non-core (accountable) entity presentation and disclosures include:

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

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

Cost/Benefit of compiling the information- In certain cases, consolidation may be less costly than a separate disclosure and the preparer may elect to consolidate non-core entities along with core entities. Also, the level of detail presented through disclosure may vary based on cost/benefit considerations.

Organization views/perspective- How the organization 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 Congress may influence the amount of information disclosed.

Complexity of the relationship- The more complex relationships would involve more detail to ensure the relationship is understood by the readers.

Extent to which the information interests, or may be expected to interest, a wide audience - Due to the sensitivity, materiality of the transactions or even perhaps a notable news headline, or other reasons, interested parties may expect some type of disclosures regarding the organization or the relationship with the federal government.

Extent to which there are not alternative sources of reliable information- An objective of general purpose federal financial reporting is to meet the needs of users who may have limited access to information or statements and lack the ability to demand the desired information.

QUESTION FOR THE BOARD: Does the Board approve the factors above? See par. 59 for placement in the ED.

See the following page for proposed disclosures.

Specific Disclosures for Non-core Accountable Entities include the following for each significant³ entity that is not consolidated:

1. Nature of the federal government's relationship, including the name and description of the entity. Such information also would include as appropriate:
 - a. The nature of any control over the entity and/or the percentage of ownership interest and voting rights
 - b. For intervention actions, the primary reasons for the intervention and a brief description of the government's plan⁴ relative to operating or disposing of the entity (including timeframes) and/or a statement that the intervention is not expected to be permanent
2. For any core government entity transactions with the non-consolidated non-core entities (which are accounted for 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.
3. The amount that best represents the federal government's maximum exposure to gain or loss from that involvement, including how the maximum exposure to gain or loss is determined. If this cannot be quantified, that should be disclosed.
4. Information that would provide an understanding of the potential financial impact, including financial-related exposures to potential gain and risk of loss to the government-wide reporting entity resulting from the entity. Examples include:
 - a. Summary financial statements, condensed financial information for the entity (e.g. assets, liabilities, fund balances, total expenditures and sources of revenues), key indicators, or risk assumed information. For example, if the federal government's risk of exposure is 100% then a set of summary financial statements may be appropriate, whereas if the exposures are limited then an explanation of the amount of support offered (risk assumed) with selected financial info (net position and net results) might be appropriate.
 - b. If applicable, other pertinent information to the understanding of the relationship such as:
 - key terms of contractual agreements (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);
 - the nature of, and changes in, the risks associated with the control or involvement with the entity; and
 - key statutory or other legal authorities.

³ Determining significant entities should be based on both qualitative and quantitative materiality considerations. Information about other entities not deemed material and similar type entities may be aggregated, where appropriate.

⁴ 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.

**QUESTION FOR THE BOARD: Does the Board approve the Disclosures above?
See par. 60-63 for placement in the ED.**

BASIS OF ACCOUNTING

During the June 2010 meeting, the Board agreed to expand the scope of the project to include issues related to entities with a different source of GAAP and different year ends.

BASIS OF ACCOUNTING FOR CORE ENTITIES*

1. 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*.

*The issue of addressing different year ends for core entities is an open item. Staff would like to seek the input of the task force and others on this matter.

BASIS OF ACCOUNTING FOR NON-CORE ACCOUNTABLE ENTITIES

2. Non-core accountable entities included⁵ in the government-wide report should be reported on accrual based standards provided in generally accepted accounting principles. This includes generally accepted accounting principles for any domain (FASAB, Governmental Accounting Standards Board, or Financial Accounting Standards Board).
3. Non-core accountable entities may have a different fiscal year-end than the core government-wide entity. Although a common fiscal year-end is encouraged, it is not mandatory. Therefore, the cost and benefits of establishing a common fiscal year-end should be considered.
4. Financial information included for non-core accountable entities should be for the year ended closest to the core government entity's year end, while being timely and accurate. For example, if the non-core accountable entity's fiscal year end is within the first quarter following the federal government's year end, it may be acceptable to include information for that year. Alternatively, if the non-core entity's year end is one month prior it may be more appropriate to include financial information for that year end.

⁵ Included means consolidated or disclosed. Disclosures may include presentation of summary financial information.

QUESTION FOR THE BOARD: Does the Board approve the language for the Basis of Accounting? See pars. 46 for core and 64- 66 non-core for placement in the ED.

FLOWCHART

Staff included a revised Flowchart at **Attachment 2**. Staff believes the high level flow chart provides a good summary of the steps involved in the process, especially when considered with the paragraph numbers referenced in the proposed standard.

Staff believes the Flowchart is an integral part to understanding the ED and should be included.

QUESTION FOR THE BOARD: Does the Board wish to offer comments or have any questions about the Flowchart?

ILLUSTRATION GUIDE

As previously agreed, staff plans to develop an Illustration Guide, with examples of entities (similar to the Appendix in GASB 14) that would accompany the exposure draft. The Illustration Guide will be a combination of known examples and possible made up entities for ease of demonstrating certain key points, but will utilize fictitious names as facts and circumstances may change after the guide is issued. Also, even within the individual forms of entities (such as a quasi official agency) circumstances may vary.

Included at **Attachment 3** are samples of the type of examples to be included in the Illustration guide. Staff is requesting Board member feedback on the format and detail of the proposed examples for Illustrative guide. Note that a placeholder has been provided to indicate where analysis against the requirements in the standard would be presented. The analysis will be prepared after further progress on the factors and disclosures for non-core accountable entities.

Once the entire draft guide is complete, staff will share it with the Task Force for their comments.

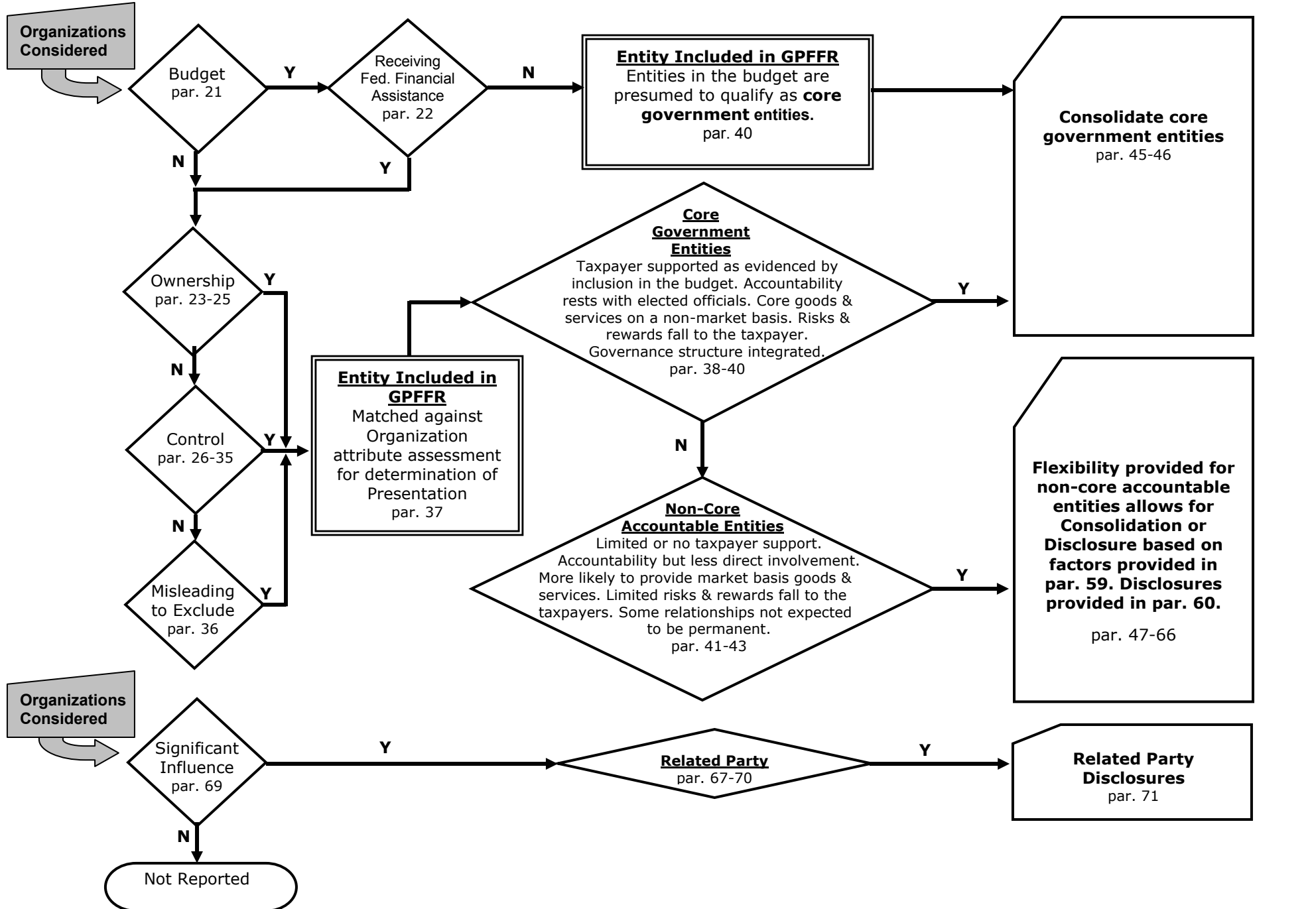
QUESTION FOR THE BOARD: Does the Board wish to offer feedback on format of the Illustration Guide examples provided or wish to offer staff input on the guide?

HIGH LEVEL FLOW CHART

Inclusion Principles

Organization Type

Presentation



Introduction

Purpose

1. The federal government's relationships with other entities have become increasingly complex. Public policy decisions can be carried out in a variety of ways and involve increasingly complex organizations and relationships. To meet federal financial reporting objectives, it is important to develop principles 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 President's accountability for those organizations. In addition, component reporting entity reports should allow Congress and the President to hold management accountable for implementation of public policy decisions. Although Statement of Federal Financial Accounting Concepts (SFFAC) 2, *Entity and Display*, addresses identifying reporting entities and criteria for including components in a reporting entity, questions have continued in this area that resulted in the need for a standard.¹
3. This Statement provides principles to guide preparers of general purpose federal financial reports² (GPFFR) in determining what organizations are required to be included in a federal reporting entity and what information should be presented. This will ensure that users of GPFFR are provided with complete 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.

¹ SFFAC 2 is a Concepts Statement and is considered Other Accounting Literature in the hierarchy of generally accepted accounting principles (GAAP) and therefore it is level d in the GAAP hierarchy.

² The term general purpose federal financial report is used throughout this Statement as a generic term to refer to the report that contains the entity's financial statements that are prepared pursuant to generally accepted accounting principles. In the federal government, the report for the U.S. government 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 or the Agency Financial Report.

Effective Date

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

Proposed Standards**Scope**

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 federal reporting entity. The Statement also provides principles on determining what organizations should be included in government-wide report and into each component reporting entity's financial report. 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. SFFAC 2 explains for the entity to be a reporting entity,³ it would need to meet all of the following criteria:
 - a. There is a management responsible for controlling and deploying resources, producing outputs and outcomes, executing the budget or a portion thereof (assuming that the entity is included in the budget), and held accountable for the entity's performance.
 - b. The entity's scope is such that its financial statements would provide a meaningful representation of operations and financial condition.
 - c. There are likely to be users of the financial statements who are interested in and could use the information in the statements to help them make resource allocation and other decisions and hold the entity accountable for its deployment and use of resources.

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

10. **Government-wide Reporting Entity** The government-wide reporting entity includes all entities existing within the federal government, which includes all component reporting entities within the executive, legislative, and judicial branches as well as other organizations for which the Congress and 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 entity⁴ 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 entity⁵) 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 Reporting Entities

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

⁴ The larger reporting entity could be the government-wide reporting entity or another component reporting entity.

⁵ Often financial reports that present aggregations of information for organizations such as an administration or a bureau are more useful than reports at the higher component level. Such reports can provide a better understanding of the financial results and status of the many individual organizations and programs constituting a department or major agency.

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.

resources to produce outputs and outcomes. Each organization operates under an established governance structure intended to meet an established public policy objective. Governance structures allow for varying degrees of autonomy in relation to the Congress and 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 budgetary integrity, operating performance, and stewardship reporting objectives established in SFFAC 1. In such cases, disclosures about the organization rather than financial information consolidated across all organizations may better meet these objectives.
16. Thus, decisions about federal financial reports for an entity are taken in two steps – first, determining what organizations are to be included in the reports and second, identifying the means to present relevant information about organizations.
17. This Statement first establishes the principles for including organizations (see Principles for Inclusion in the Government-wide Report) then a distinction will be made between core government entities and non-core accountable entities (see Core Government Entities and Non-core Accountable Entities which describes these types of entities) for those organizations. Lastly, the presentation of financial information based on those decisions is addressed (see Government-wide Reporting Entity Consolidation and Disclosure).

Principles for Inclusion in the Government-wide Report

18. The following paragraphs set forth principles for inclusion of an organization in Government-wide federal financial reports.
19. Clearly defining which entities should be included in the government-wide reporting entity ensures that the financial reports contain all the information essential for fair presentation of the 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 permits inclusion of entities if it would be misleading to exclude them (see par. 36).

⁸ Included means consolidated or disclosed. Disclosures may include presentation of summary financial information.

20. An organization meeting any of the three principles below is included in the government-wide GPFFR:
 - a. In the Budget;
 - b. Majority Ownership Interest; or
 - c. Control with expected benefits or risk of loss.

In the Budget

21. An entity listed in the *Budget of the United States Government: Analytical Perspectives- Supplemental Materials* schedule *Federal Programs by Agency and Account* should be included in the government-wide reporting entity.
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 should be conducted to confirm the entity is not an organization for which Congress and the President should be held 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 reporting entity for the purpose of meeting accountability goals.

Majority Ownership Interest

23. The federal government may acquire 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 equivalent percentage interest in voting rights, but not always. In the federal government there may be instances of ownership interest with voting rights or ownership interest without voting rights.
25. Majority ownership interest exists with over 50% of the votes or the net residual assets¹¹ of an entity. When the federal government holds a

⁹ As defined by the Single Audit Act Amendments of 1996 which 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*.

majority ownership in an entity it should be included in the government-wide reporting entity.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 should be included in the government-wide reporting entity. 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 the power to act independently and is controlled by the federal government. 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.

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.

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.

Indicators of Control

30. As discussed in the following paragraphs, there are indicators that should be considered in determining whether the federal government controls an entity. As noted above, much judgment and consideration needs to be given to the nature of the relationship between the federal government and the entity in order to determine whether control exists.
31. Certain 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. 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. Govern or direct the governing body on the financial and operating policies of the entity;
 - c. Unilaterally dissolve the entity thereby having access to the assets and responsibility for the obligations; or
 - d. Establish or amend the fundamental purpose and mission of the entity, which may include authorizing the entity to exercise sovereign power of the federal government and requiring the entity to carry out federal missions and objectives.
32. Other indicators provide evidence that control exists, but must be considered in the aggregate and often require the application of professional judgment in assessing. These indicators are when the federal government has the ability to:
- a. Provide significant input into the appointment of members of the governing body of the entity or being involved in the appointment or removal of a significant number of members;
 - b. Access entity's assets or direct the ongoing use of those assets, or has ongoing responsibility for losses;
 - c. Appoint or remove key executives or personnel;
 - d. Approve the budgets or business plans for the entity and right to require audits;
 - e. Veto, overrule, or modify governing board decisions or otherwise significantly influence normal operations;

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.

- f. Finance the deficits of and provide financial support to or settle liabilities;
- g. Direct the entity to work with the government to achieve services to taxpayers which may include determining the outcome or disposition of matters affecting the recipients of services that the federal government provides;
- h. Establish, rescind, or amend management policies;
- i. Establish limits or restrictions on borrowing and investments of the entity; or
- j. 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 standard (ie. It is not included in the Federal Programs by

Agency and Account 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

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

37. The principles above were used to assess what organizations to include in reports. To assist in making decisions about presentations, a distinction will be made between core (or general) government entities and non-core accountable entities. This assessment is based on the degree to which the 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.
38. Core (or general) government entities generally provide core federal goods and services on a non-market basis, and are financed primarily through taxes and other non-exchange revenues. Their governance structure is vertically integrated as evidenced by the establishment of organizational authorities and budgets by the Congress and the President, and the appointment of organizational leaders through the political process.
39. Core government entities receive taxpayer support to deliver goods and services on a non-market basis. Accountability for core government entities rests with the President and Congress (elected officials.) Substantially all the risks and rewards fall to the taxpayer for core government entities.
40. Entities listed in the budget (as described at par. 21-22) are presumed to qualify as core government entities while greater judgment will be needed to classify other entities.
41. Federal officials may rely on organizations that have a greater degree of autonomy than core government entities to fulfill public policy objectives. Such entities may maintain a separate legal identity, have a governance structure that vests greater decision making authorities in a governing body to insulate the entity from political influence, and/or allow for relative financial independence.
42. Maintaining a distinction between the finances of such entities and core government entities will more effectively meet federal financial reporting objectives. Such a distinction would allow core government entity financial statements to reveal the costs to taxpayers as well as how such entities

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

have impacted the net position of the core government. However, federal financial reporting objectives can not be met without further information regarding such entities. Therefore, these entities are included for accountability purposes but are considered “non-core accountable entities.”

43. Non-core accountable entities may provide core federal government goods and services but are more likely to provide goods and services on a market basis. Non-core accountable entities receive limited or no taxpayer support. Accountability rests with the Congress and the President, but they have less direct involvement in decision making than is true in core government entities. Limited risks and rewards fall to the taxpayers. In some cases, the relationship with the federal government is not expected to be permanent.
44. In addition to organizations for which the Congress and the President are accountable, the federal government may be able to exercise significant influence over certain entities. Such parties are referred to as “related parties.” Related parties *may* provide core federal government services but are more likely to provide market based services. Related Parties do not receive taxpayer support directly but may engage in transactions with the federal government. Accountability does not rest with the Congress or the President. Risks and rewards do not explicitly fall to the taxpayer. See Related Party discussion beginning at par. 67 for definition, disclosures and additional information.

Government-wide Reporting Entity Consolidation and Disclosure

Core government entities

45. The Statement provides for consolidation¹⁶ of core government entities 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.
46. Core government entities should apply the GAAP hierarchy established in SFFAS 34, *The Hierarchy of Generally Accepted Accounting Principles*,

¹⁶ 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.

Including the Application of Standards Issued by the Financial Accounting Standards Board.

Non-core accountable entities

47. For those organizations not classified as core government entities, the Statement provides for flexibility and allows judgment by the preparer to determine whether consolidation or disclosure would provide the most meaningful presentation¹⁷ for non-core accountable entities that meet the government-wide principles for inclusion.
48. This Statement identifies the following types of non-core entities: quasi governmental and/or financially independent entities, receiverships and conservatorships, and federal governmental intervention actions. These types are presented to assist in identifying entities that are non-core accountable entities. Non-core entities need not be grouped by type and no distinction is made by type for purposes of determining the appropriate presentation or disclosure. These types of entities and any other types of entities identified as non-core should provide disclosures consistent with Disclosures for Non-core Accountable Entities as detailed in par. 60 to 63 below after considering the factors listed in par. 59.

Quasi Governmental and/or Financially Independent Entities¹⁸

49. Quasi Governmental and/or Financially Independent Entities are hybrid entities where accountability and transparency of these unique organizations are important yet they differ in key areas. These entities differ when assessing the governance and/or financial (risk and rewards) areas.
50. Governance differences typically lead to greater independence. Characteristics may include the following:
 - a. Longer appointments, not dominated by the Congress or the President.
 - b. Delegated operational authority to carry on a business in a manner similar to private business enterprises.
 - c. May possess private sector legal characteristics or be voluntarily affiliated with purposes to implement government policies.

¹⁷ For example there may be certain instances when consolidation may undermine the ability to provide the most meaningful presentation because it may obscure results and make it difficult to separate the activities or certain entities and activities.

¹⁸ Quasi Governmental /Financially Independent Entities is used to describe the entities, none of the terms should be viewed exclusively, for example Congress establishes independent agencies (such as NASA) that are simply not under an established department.

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51. 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 carry on business 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.
52. Examples 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.
53. Additional examples of Quasi Governmental and/or Financially Independent Entities may include museums, performing arts organizations and universities, venture capital funds, OTHER GENERIC. The accompanying Illustrative Guide offers examples that may be useful in application.

Receiverships and Conservatorships¹⁹

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

Federal Government Intervention Actions

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

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

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

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

56. 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.
57. Examples of intervention actions are:
 - a. Temporary control-- the federal government seizes control of an established entity but expects to relinquish or cede control.
 - b. Temporary ownership--the federal government acquires an ownership interest of an entity but expects to end its interests as soon as practicable.
58. Temporary situations that exist at fiscal year-end must be assessed to confirm they are not expected to be permanent.
59. Materiality is an overarching consideration in financial reporting. Preparers should consider both qualitative and quantitative materiality in determining non-core entity presentation and disclosure. Beyond materiality the following factors²¹ should be considered in making judgments about presentation and disclosure including the extent of appropriate non-core (accountable) entity disclosures:
 - **Relevance to reporting objectives** - Significance of the entity in light of the reporting objectives. This would include the significance of the balances and/or information regarding results of operations and financial position to meeting the operating performance and stewardship reporting objectives.
 - **Nature of the potential benefits or risks/exposures associated with the relationship**- Information is needed to provide an understanding of the potential financial impact, including financial-related exposures to potential gain and risk of loss to the core entity resulting from the entity's operations.
 - **Cost/Benefit of compiling the information**- In certain cases, consolidation may be less costly than a separate disclosure and the preparer may elect to consolidate non-core entities along with core entities. Also, the level of detail presented through disclosure may vary based on cost/benefit considerations.

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

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

Disclosures for Non-core Accountable Entities include the following for each significant²² entity that is not consolidated:

60. Nature of the federal government's relationship, including the name and description of the entity. Such information also would include as appropriate:
 - a. The nature of any control over the entity and/or the percentage of ownership interest and voting rights
 - b. For intervention actions, the primary reasons for the intervention and a brief description of the government's plan²³ relative to operating or disposing of the entity (including timeframes) and/or a statement that the intervention is not expected to be permanent
61. For any core government entity transactions with the non-consolidated non-core entities (which are accounted for in accordance with the GAAP hierarchy established in SFFAS 34), a summary of amounts reported in

²² Determining significant entities should be based on both qualitative and quantitative materiality considerations. Information about other entities not deemed material and similar type entities may be aggregated, where appropriate.

²³ 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.

the core government entity financial statements and the basis for determining the amounts reported

62. The amount that best represents the federal government's maximum exposure to gain or loss from that involvement, including how the maximum exposure to gain or loss is determined. If this cannot be quantified, that should be disclosed
63. Information that would provide an understanding of the potential financial impact, including financial-related exposures to potential gain and risk of loss to the government-wide reporting entity resulting from the entity. Examples include:
 - a. Summary financial statements, condensed financial information for the entity (e.g. assets, liabilities, fund balances, total expenditures and sources of revenues), key indicators, or risk assumed information. For example, if the federal government's risk of exposure is 100% then a set of summary financial statements may be appropriate, whereas if the exposures are limited then an explanation of the amount of support offered (risk assumed) with selected financial info (net position and net results) might be appropriate.
 - b. If applicable, other pertinent information to the understanding of the relationship such as:
 - key terms of contractual agreements (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);
 - the nature of, and changes in, the risks associated with the control or involvement with the entity; and
 - key statutory or other legal authorities.

Basis of Accounting for Non-core accountable entities

64. Non-core accountable entities included²⁴ in the government-wide report should be reported on accrual based standards provided in generally accepted accounting principles. This includes generally accepted accounting principles for any domain (FASAB, Governmental Accounting Standards Board, or Financial Accounting Standards Board).
65. Non-core accountable entities may have a different fiscal year-end than the core government-wide entity. Although a common fiscal year-end is

²⁴ Included means consolidated or disclosed. Disclosures may include presentation of summary financial information.

encouraged, it is not mandatory. Therefore, the cost and benefits of establishing a common fiscal year-end should be considered.

66. Financial information included for non-core accountable entities should be for the year ended closest to the core government entity's year end, while being timely and accurate. For example, if the non-core accountable entity's fiscal year end is within the first quarter following the federal government's year end, it may be acceptable to include information for that year. Alternatively, if the non-core entity's year end is one month prior it may be more appropriate to include financial information for that year end.

Related Party Government-wide Reporting Entity

67. In addition to organizations for which Congress and the President are accountable, the federal government may be able to exercise significant influence over certain entities. Such parties are referred to as "related parties." Related parties *may* provide core federal government services but are more likely to provide market based services. Related parties do not receive taxpayer support directly but may engage in transactions with the federal government. Accountability for the operating performance and financial position of related parties does not rest with Congress or the President. However, certain information regarding related party relationships may be necessary for accountability purposes. Such information enables users to better understand the financial statements of the government-wide reporting entity because:

(a) Related party relationships might expose the federal government to risks or provide opportunities that would not have existed in the absence of the relationship;

(b) Related party relationships can influence the way in which the federal government operates with other entities in achieving its individual objectives; and

(c) Related parties may enter into transactions that unrelated parties would not enter into, or may agree to transactions on different terms and conditions than those that would normally be available to unrelated parties.

68. **Related Party** parties are considered to be related if the entity was established²⁵ by the federal government, or if the entity can be significantly influenced in making financial and operating decisions, or if the federal government has an ownership interest²⁶ but the entity was not included in the government-wide reporting entity.
69. **Significant influence** is the power to participate in the financial and operating policy decisions of an entity, but not control those policies. Significant influence may also be gained by an ownership interest.
70. Although related party relationships exist among the component entities of the federal government, component entities are subject to the overall direction and operate together to achieve the policies of the federal government and are not subject to the related party disclosure requirements. The government-wide reporting entity is presented on a consolidated basis and the transactions are eliminated to accurately reflect the distinctive nature of the federal government and provide information useful to and understood by the citizens, their elected representatives, federal executives, and program managers.²⁷ However, a component entity should be disclosed as a related party if deemed material when significant transactions are not arms length transactions or when the preparer deems disclosure necessary.

Related Party Disclosures for Government-wide Reporting Entity

71. For any Related Party, the following should be disclosed:
- a. Name and description of the entity;
 - b. Nature of the federal government's relationship with the entity and if applicable, if the entity was being influenced and/or the percentage of ownership interest and voting rights; and
 - c. Other information that would provide an understanding of the potential financial reporting impact, including financial-related exposures to

²⁵ Established by the federal government would exclude geographical political jurisdictions established by the federal government, (e.g., U.S. territories and insular areas, and the District of Columbia) because they have a different status under the U.S. Constitution. It also would not include those whose existence preceded federal recognition, such as many federally chartered corporations that received a congressional charter under Title 36 of the U.S. Code because many of these organizations were incorporated under state law before receiving their congressional charter (e.g., the Boy Scouts of America). For examples of different types of entities established by the federal government and how they were established, see GAO, *Federally Created Entities: An Overview of Key Attributes*, GAO-10-97 (Washington, D.C.: Oct. 2009).

²⁶ Included means consolidated or disclosed. Disclosures may include alternate presentations of summary financial information.

²⁷ Par, 21 of SFFAC 1, *Objectives of Federal Financial Reporting* states that "federal financial reporting helps to fulfill the government's duty to manage programs economically, efficiently, and effectively and to be publicly accountable."

potential gain and risk of loss to the government-wide reporting entity resulting from the relationship.

Part II of Proposed Standard

Component Reporting Entities

Effect on Existing Concepts

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

Effective Date

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

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

Attachment 3—Illustration Guide sample

Examples for Core/Non-core Decisions

Education Research Institute (ERI)

Established through a public law specifying the organization's:

1. status as a tax exempt non-profit
2. purpose and duties
3. governance structure
4. sources of financing
5. reporting requirements

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

The ERI board of directors comprises 15 members. Two members are specific federal officials within the Department of Education. The remaining 13 are appointed by the inspector general (a presidential appointee subject to Senate confirmation who can be removed by the President with Congressional notification) and serve six year terms. One of these 13 appointed members will serve as chairperson. To ensure a bi-partisan effort, no more than seven of the appointees may be from the same political party. The appointees are subject to certain financial disclosure and conflict of interest requirements but are not federal government employees.

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

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

Analysis against Inclusion Principles:

Analysis to determine core/non-core status:

Decisions Regarding Presentation and/or Disclosure:

Attachment 3—Illustration Guide sample

Mediation, Inc.

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

1. status and operating location
2. purpose and duties
3. governance structure
4. sources of financing
5. reporting requirements

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

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

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

Annual audited financial reports are required to be publicly available.

Analysis against Inclusion Principles:

Analysis to determine core/non-core status:

Decisions Regarding Presentation and/or Disclosure:

Attachment 3—Illustration Guide sample

Bicycle America, Inc.

A nation-wide network of shops and trails was created during the 1960s to encourage greater reliance on bicycles for transportation. Individual jurisdictions invested in the effort to create a coast to coast network and ensure wide access to bicycling. Shares in the venture were held by local bicycles shops in all major cities. In 1989, a financial crisis led to the failure of the Bicycle America. A law was enacted to provide interim funding to prevent the failure of Bicycle America.

The law provided:

1. \$100 million in exchange for preferred stock at 2% interest for 50 years.
2. Voting rights for common shareholders were suspended until the loan is repaid.
3. A governing board was established and continuity provided through election of new members as initial members terms ended.
4. A Presidentially-appointed inspector general was made responsible for oversight.

Analysis against Inclusion Principles:

Analysis to determine core/non-core status:

Decisions Regarding Presentation and/or Disclosure:

Attachment 3—Illustration Guide sample

Federally-funded Research and Development Corporations

Excerpt from a Congressional Research Service report: FRDCs are not-for-profit organizations which are financed on a sole-source basis, exclusively or substantially by an agency of the federal government, which are not subject to Office of Personnel Management regulations. They operate as private non-profit corporations, although they are subject to certain personnel and budgetary controls imposed by Congress and/or their sponsoring agency. Each Center is administered, through a contract with the sponsoring federal agency, by either an industrial firm, a university, or a nonprofit institution. Center personnel are not considered federal employees, but rather employees of the organization that manages and operates the center. FFRDCs were established by the federal government during and immediately following World War II. For various reasons, the federal government was not able to attract the top scientific and technological talent due to lower pay than in the private sector and slow hiring procedures necessary to meet its broad R&D requirements. Because FFRDCs are not allowed to compete for federal or private sector contracts, government officials have often asserted they are free from conflict of interest, and in a better position to protect classified and/or proprietary information.

To establish an FFRDC, an agency must follow the guidelines of the OFPP. According to the National Science Foundation, once the agency implements the OFPP guidelines, the new FFRDC should have the following characteristics: (1) its primary activities should include: basic research, applied research, development, or management of research and development; (2) it is a separate operational unit within the parent organization or is organized as a separately incorporated organization; (3) it performs actual R&D or R&D management either upon direct request of the federal government or under a broad charter from the federal government, but in either case under direct monitoring by the federal government; (4) it receives its major financial support (70% or more) from the federal government, usually from one agency; (5) it has, or is expected to have, a long-term relationship with its sponsoring agency (usually 5 years, with a review of the center's progress conducted by the sponsoring agency during the third year of the agreement); (6) most or all of its facilities are owned by, or are funded under contract with, the federal government, (7) it has an average annual budget (operating and capital equipment) of at least \$500,000; and (8) when renewing the sole-source contract, the sponsoring agency is required to determine if it still needs to sponsor an FFRDC or if the work could be done in a federal facility, or through a traditional private sector contract.

To minimize conflicts of interest, Centers are established as not-for-profit entities that cannot compete with for-profit companies for additional government contracts and are not allowed to produce and market commercial products. As a result, government officials argue that FFRDCs are allowed access to key government officials and highly sensitive data from industry and government sources. Such privileged access enables the Centers to address complex long-term problems with a high degree of objectivity based on their restrictions concerning selling products to the government, or joining forces with those who do, while remaining outside of the government itself. While

Attachment 3—Illustration Guide sample

Centers are not-for-profit entities, they are allowed to charge the government fees above and beyond the cost of carrying out their responsibilities. Some Centers charge fees to cover ordinary and necessary costs of doing business that are not otherwise reimbursable, but that the government recognizes must be incurred. These fees can also be used by an FFRDC to conduct independent research. The FAR acknowledges the legitimacy of such fees.

Source: Congressional Research Service. November 2003.
RS21542 -- *Department of Homeland Security: Issues Concerning the Establishment of Federally Funded Research and Development Centers (FFRDCs)* Michael E. Davey; Specialist in Science and Technology; Resources, Science, and Industry Division (footnotes omitted)

FFRDC 1 – An FFRDC that identifies itself as “federal” and is closely aligned with departmental performance directives.

Analysis against Inclusion Principles:

Analysis to determine core/non-core status:

Decisions Regarding Presentation and/or Disclosure:

FFRDC2 – An FFRDC that does not identify itself as “federal” and operates independently to select research projects within a broad subject area.

Analysis against Inclusion Principles:

Analysis to determine core/non-core status:

Decisions Regarding Presentation and/or Disclosure:

Attachment 3—Illustration Guide sample

Other examples will be developed for the following types of entities:

Entrepreneurial Funds

Interventions

Entity named in the budget but actually receiving federal financial assistance.

Entity created by the federal government but authorized to collect fees subject to approval of its annual budget by appointed federal officials.

Entity received a federal charter.