



February 9, 2012

Memorandum

To: Members of the Board

From: Melissa Loughan, Assistant Director

Wendy M. Payne

Through: Wendy M. Payne, Executive Director

Subj: Federal Reporting Entity- **Tab D--Component Reporting Entity**¹

MEETING OBJECTIVES

- To consider two approaches to identifying organizations that should be included in the financial reports of component reporting entities.

BRIEFING MATERIAL

The transmittal memorandum includes a summary of the approaches for the Board's consideration for moving forward on the component reporting entity phase. As presented, the approaches provide draft language that could be placed in the Draft Exposure Draft. Discussion of options begins on page 3 under Staff Analysis and Recommendations. Note that staff is seeking input on which approach is preferred. At future meetings, staff will seek board input on the details embodied in the draft.

A full list of Questions for the Board appears on page 13. Attachment A provides a flow chart for Option A.

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

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

During the December meeting, the Board discussed how the “in the Budget” inclusion principle could be applied at the component level as well as the notion of the complete economic entity at the component level. From the discussion, the Board agreed:

- The basis for conclusions should discuss the reasons for the limitation that “the statements should be read with the realization that they are for a component of the U.S. Government, a sovereign entity.”
- The exclusion or exception for federal financial assistance should also apply at the component entity level.
- Staff should not attempt to develop additional principles for instances where an organization identified in the budget should not be considered part of the larger organization. The vote was 5-4 so it was close enough that, if one of the members that voted to develop criteria comes up with some wording that satisfies the others, the board can revisit.

NEXT STEPS

Once the Board agrees on the approach, staff will continue drafting the component section of the ED and determine issues related to the component entity phase. The goal is to have a complete draft exposure draft by August 2012.

MEMBER FEEDBACK

If you require additional information or wish to suggest another alternative not considered in the staff proposal, please contact staff as soon as possible. In most cases, staff would be able to respond to your request for information and prepare to discuss your suggestions with the Board, as needed, in advance of the meeting. If you have any questions or comments prior to the meeting, please contact me by telephone at 202-512-5976 or by e-mail at loughanm@fasab.gov with a cc to paynew@fasab.gov.

STAFF ANALYSIS AND RECOMMENDATIONS

As discussed at previous meetings, it was concluded that the same objectives apply to both government-wide and component reporting entities, and that all costs and liabilities reported in the government-wide financial statements must be attributable to a component reporting entity. In addition, there appeared to be a general principle that all costs and liabilities must be reported at the component level before flowing into the consolidated statements. Naturally there appeared agreement, the information presented in government-wide financial statements is aggregated and in less detail than in component entity financial statements. So, certain non-core entities may meet materiality thresholds in component entity reports while not in the government-wide. Therefore, disclosures are likely to be more detailed in component entity reports.

Based on discussions at the December 2011 meeting, staff concluded the overall framework for the component reporting entity standards should be generally consistent with those established for the government-wide—based on organization and accountability. Staff believes there are two options for accomplishing this depending on the desired perspective.

OPTION A-- Administratively assigned approach. The government-wide reporting entity's GPFFR includes all organizations for which the Congress and the President are accountable based on principles established in this Statement. The government-wide reporting entity is the only federal reporting entity that is an independent economic entity.² Disaggregation of the government-wide reporting entity into component reporting entities supports accountability and should result in each component reporting entity including in its GPFFR all core and non-core entities administratively assigned to it. In addition, each non-core entity should be reported in the GPFFR of the core entity with which it has the most comprehensive relationship. (A flow chart depicting this approach is provided as Attachment A.)

OPTION B-- Revised inclusion principles approach. The principles for defining what organizations should be included in the component entity reports should be consistent with those established for the government-wide. Principles and attributes established for core and non-core entities would generally be the same, but have been restated so that they can be applied by the component entity. Consistent application of the principles would allow the Congress and the President to hold component entity management accountable for implementation of public policy decisions, show the risks inherent in component entity operations, and enhance accountability to the public.

² SFFAC 2, par. 38.

Proposed Language

A. Administratively assigned approach

1. The government-wide reporting entity is the only federal reporting entity that is an independent economic entity³ and the inclusion principles are expressed from the perspective of the federal government. However, GPFFR for the government-wide reporting entity represent a consolidation of component reporting entity GPFFRs. Therefore, component reporting entities must identify and include in their GPFFR all core and non-core entities for which they are accountable so that both the component reporting entity and government-wide GPFFR are complete. Each component reporting entity is accountable for:
 - a) all core and non-core entities administratively assigned to it, and
 - b) non-core entities with which it has the most comprehensive relationship relative to other component reporting entities.

Identifying Entities Administratively Assigned to or Having the Most Comprehensive Relationship with a Component Reporting Entity.

2. Administrative assignments to component entities are typically made in policy documents such as budget documents, laws, regulations, or strategic plans. Administrative assignments can be identified by evaluating one or more of the following:
 - a. Scope of the Budget and Budget Approval Process
 - b. Accountability Established Within a Component Entity
 - c. Other Significant Relationships / Misleading to Exclude

Scope of the Budget & Budget Approval Process

3. Core and non-core entities subject to the budget approval and oversight process of the component reporting entity head should be included in the component reporting entity GPFFR. Each component reporting entity should include all core and non-core reporting entities:
 - a. listed within its section of the *Budget of the United States Government: Analytical Perspectives- Supplemental Materials*

³ SFFAC 2, par. 38.

schedule *Federal Programs by Agency and Account* unless they are non-federal organizations receiving federal financial assistance⁴ or

- b. included in its Congressional Budget Justification.

Accountability Established Within a Component Entity

- 4. All core and non-core entities for which a component reporting entity has been assigned accountability responsibilities should be included in its GPFFR. Indicators that accountability was established in the component reporting entity include:
 - a. Statutes or regulations establishing an organization state that it is assigned to or part of a larger federal organization.⁵
 - b. An organization is included in the component reporting entity's official organization chart.
 - c. The component reporting entity acquires and/or monitors⁶ ownership⁷ interests in organizations where there are ongoing responsibilities such as:
 - (1) monitoring activities and/or reporting on outcomes,
 - (2) monitoring the value of the ownership interest,
 - (3) coordinating and/or conveying input on strategic plans,
 - (4) providing appropriated funds to the organization and requesting funding for future years, or
 - (5) administering any federal grants or contracts awarded to the organization.
 - d. A controlled organization⁸ was established by the component reporting entity or to support the mission of the component reporting entity, and a continuing relationship exists. Examples of continuing relationships include:
 - (1) approving bylaws including any amendments,
 - (2) being represented on the governing board (e.g., as an ex-officio member),
 - (3) appointing members of the governing board,
 - (4) coordinating and/or conveying input on strategic plans,

⁴ See par. 19.

⁵ For example, the United States Census Bureau (officially the Bureau of the Census, as defined in Title [13 U.S.C. § 11](#)) is part of the US Department of Commerce.

⁶ Such responsibilities may be assigned to a program office or the office of inspector general.

⁷ An owned organization may be a component reporting entity itself but also must be reported by another component reporting entity if management responsibilities are assigned to that entity.

⁸ Where control exists at the government-wide level based on paragraphs 22-31.

- (5) monitoring organizational performance,
 - (6) approving budgets, operating plans, or contracts with others,
 - (7) establishing and executing cooperative agreements with the organization,
 - (8) administering federal grants to or contracts with the organization, or
 - (9) testifying before Congress regarding entity performance and objectives.
5. If more than one component reporting entity is assigned responsibilities as described above, the owned or controlled organization should be included in the GPFFR of the component reporting entity with which it has the most comprehensive relationship.
 6. Each non-core entity should be reported in the GPFFR of a core component reporting entity. A non-core entity should be reported by the core entity with which it has the most comprehensive relationship based on factors discussed above regarding administrative assignments. If the component reporting entity having the most comprehensive relationship with the non-core entity cannot be determined, the non-core entity should be reported by the component reporting entity with which its mission most closely aligns.

Misleading to Exclude

7. There may be instances where an organization is not administratively assigned to the component reporting entity based on the principles 'Scope of the Budget and Budget Approval Process' and 'Accountability Established Within a Component Entity' yet the component reporting entity GPFFR would be misleading or incomplete if the organization were excluded. For example, two organizations with the same mission may establish joint strategic plans and cooperate in executing programs to the extent that it would be misleading to separately report on their activities. Where component reporting entities' GPFFRs would be misleading if an organization were excluded, the organization may be included.

Misleading to Include

8. There may be instances where administrative assignments based on the above principles would result in misleading presentation. For example, an organization may have been legally established within a larger entity while being authorized to operate independently. While such conditions are expected to be rare, if the component reporting entity GPFFR would be misleading if the organization were included, the organization may be excluded so long as it prepares its own GPFFR and is included in the government-wide GPFFR.

B. Revised inclusion principles approach

1. The principles for defining what organizations should be included in the component reporting entity GPFFR are consistent with those established for the government-wide. The component reporting entity GPFFR should include organizations on a comparable basis across components as well as support identification of organizations to include in the government-wide report.
2. A component reporting entity GPFFR should include all organizations that would allow Congress and the President to hold the agency's head and management (appointed officials) accountable for implementation of public policy decisions, show the risks inherent in component entity operations, and enhance accountability to the public. Consistent with the government-wide inclusion principles but adapted for the component level, the following principles ensure accountability at the component reporting entity level
 - a. In the Budget
 - b. Majority Ownership Interest
 - c. Control with expected benefits or risk of loss

In the Budget

3. An organization with an account or 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 component reporting entity GPFFR with which it is listed unless it is a non-federal organization receiving federal financial assistance.⁹ However, any listed non-federal organizations receiving federal financial assistance should be assessed against the next two principles (*Ownership* and *Control*) to determine if they should be included in the component reporting entity GPFFR.

Majority Ownership Interest

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

4. As discussed in par. 20-21 of the government-wide standards, an ownership interest¹⁰ is a legal claim on the net residual assets of an organization and majority ownership interest exists with over 50% of the voting rights or net residual assets¹¹ of an organization.¹²
5. Because ownership interests¹³ in the federal government may not be explicit to a particular component reporting entity, some aspects of ownership responsibilities may be assigned or delegated to component reporting entities. It is therefore necessary for component reporting entities to consider not only those organizations that it holds a majority ownership in but also those that it has ownership interest management responsibilities for where the federal government holds a majority ownership. For example, there may be an organization owned by the federal government for which a component reporting entity performs ownership interest management responsibilities on behalf of the federal government¹⁴ because they have the most comprehensive relationship with the organization or activity.
6. Indicators that should be considered in determining whether the component reporting entity has ownership interest management responsibilities may include:
 - a. Monitoring the value of the ownership interest
 - b. Evaluating organizational performance and reporting on outcomes
 - c. Coordinating and/or conveying input on strategic plans
 - d. Providing appropriated funds to the organization and requesting funding for future years
 - e. Administering any federal grants or contracts
 - f. Being represented on the governing board
7. If more than one component reporting entity performs such ownership interest management responsibilities, the owned organization should be included in the component reporting entity with which it has the most comprehensive relationship.

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, 2011*.

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 An owned organization is likely to be a component reporting entity itself but also must be reported by another component reporting entity if management responsibilities are assigned to that entity.

¹⁴ The component reporting entity may do this because it has been assigned this function by the Administration or it is most closely related to that organization.

Control with Expected Benefits or Risk of Loss

8. As discussed in par. 22 from the government-wide standards, control with expected benefits or risk of loss is the power to impose will on and/or govern the financial and/or operating policies of another organization with the potential to obtain financial resources or non-financial¹⁵ benefits or be obligated to provide financial support or assume financial obligations.
9. Each component reporting entity exercises authorities assigned to it through laws to carry out its responsibilities. Because the ultimate authority rests with elected officials, some aspects of control over organizations may not be delegated to component reporting entities. It is therefore necessary for the component reporting entity to consider both its authorities and the authorities of the Congress and the President when assessing whether control exists.
10. For example, in some cases, control was established in the legislation creating an organization by setting boundaries regarding its operations rather than by vesting a larger component reporting entity with defining such boundaries. Nonetheless, the benefits and/or risk of loss generated by the organization can be associated with a particular component reporting entity. For example, an organization may be chartered to operate independently but its operations are solely to support (benefit) the mission of a component reporting entity.
11. As discussed in the following paragraphs, there are indicators that should be considered in determining whether the component reporting entity controls an organization for the purposes of financial reporting. As noted above, consideration needs to be given to the nature of the relationship between the federal government and the organization and judgment applied to determine whether such control exists.
12. Certain indicators provide persuasive evidence that control exists. These indicators provide strong evidence of control, so meeting any one would typically mean control is present. However; the absence of any does not lead to a presumption that control is not present. These indicators are when the component reporting entity or the federal government have the authority to:
 - a. Establish or amend the fundamental purpose and mission of the organization, which may include authorizing the organization to exercise sovereign power of the federal government and requiring the organization to carry out federal missions and objectives.

¹⁵ For example, a non-financial benefit would be the federal government benefits from a service being provided to it or on its behalf.

- b. Unilaterally appoint or remove a majority of the governing board members of another organization;
 - c. Direct the governing body on the financial and operating policies of the organization; or
 - d. Unilaterally dissolve the organization thereby having access to the assets and responsibility for the obligations.
13. 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 – through the responsibilities assigned to the component reporting entity - has the ability to:
- a. Provide significant input into the appointment of members of the governing body of the organization or being involved in the appointment or removal of a significant number of members;
 - b. Access the organization'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 organization;
 - 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 organization 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 organization; or
 - k. Restrict the capacity to generate revenue of the organization, especially the sources of revenue.
14. The guidance in the government-wide control section at par. 23-31 should be applied by the component reporting entity, considering both its own

- authorities and those of the government as a whole, for any organizations with which the component reporting entity has a comprehensive relationship.
15. The component reporting entity should first identify organizations that it has a comprehensive relationship with and then test those organizations against the government-wide control indicators to assess whether it should be included in the component reporting entity GPFFR.
 16. The following are indicators of a comprehensive or continuing relationship
 - a. approving bylaws including any amendments,
 - b. representation on the governing board (e.g., as an ex-officio member),
 - c. appointing members of the governing board,
 - d. coordinating and/or conveying input on strategic plans,
 - e. monitoring organizational performance,
 - f. approving budgets, operating plans, or contracts with others,
 - g. establishing and executing cooperative agreements with the organization
 17. If it is not clear which, if any, component reporting entity should include a controlled organization in its GPFFR, the controlled organization should be included in the component reporting entity with which it has the most comprehensive relationship.

Misleading to Exclude Principle

18. 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 component entity GPFFR would be misleading or incomplete if the organization were excluded.¹⁶
19. This Statement requires inclusion of organizations in the component entity GPFFR if it would be misleading to exclude them.

¹⁶ Although situations such as this would be considered rare, this Statement provides for situations that may arise.

Question 1 for the Board:

Does the Board have any questions or suggestions regarding the Proposed Language for Option A or B?

Staff Recommendation:

Staff believes both options presented would result in component reporting entity standards that are based on organization and accountability -- generally consistent with those established for the government-wide. However, there may be certain pros and cons for each of the two options depending on the desired perspective.

Some may prefer the manner in which Option B (Revised Inclusion Principles) is similar to the government-wide standards. However, while drafting Option B, staff noted there was still a need to address issues that might only be solved by an administrative assignment approach or with language similar to what was proposed in Option A regarding that an organization “should be included in the component reporting entity with which it has the most comprehensive relationship.” These are the types of issues that ultimately must be addressed at the component reporting entity level. Staff also believes the inclusion principles, especially the control indicators are somewhat difficult to apply at the component level as component entities may believe control doesn’t exist exclusively at that level.

Staff believes Option A (Administratively Assigned Approach) may provide a more realistic view of how component reporting entities become accountable for organizations and how component entity boundaries are likely to be determined. Administrative assignments to component entities are typically made in policy documents such as budget documents, laws, regulations, or strategic plans. Ultimately, component reporting entities would identify and include in their GPFFR all core and non-core entities for which they are accountable so that both the component reporting entity and government-wide GPFFR would be complete.

Although some may raise concerns with the magnitude of effort for either approach, staff believes with additional guidance—perhaps a coordinated effort from the central agencies—there could be processes in place to ensure the component reporting entities are performing the necessary procedures to capture the material organizations from their perspectives and also for consideration at the government-wide level. Because option A does not create a second set of inclusion principles – which may imply greater differences than intended – staff believes it is a more effective approach to developing the necessary procedures.

Therefore, staff recommends Option A (Assigned Approach).

Question 2 for the Board:

Does the Board agree with the Staff Recommendation?

Questions for the Board

- 1. Does the Board have any questions or suggestions regarding the Proposed Language for Option A or B?**
- 2. Does the Board agree with the Staff Recommendation?**

Attachment A-HIGH LEVEL FLOW CHART

