



October 14, 2011

Memorandum

To: Members of the Board

From: Melissa L. Loughan, Assistant Director

Wendy M. Payne

Through: Wendy M. Payne, Executive Director

Subj: Federal Entity- **Tab B —Government-wide – Additional Materials**¹

MEETING OBJECTIVES

- To consider Board member's proposed language.

The purpose of this memo is to transmit Mr. Steinberg's wording for intervention activities.

BRIEFING MATERIAL

- See proposed language attached.
- Appendix 1 (Relevant Excerpts from December 2010 Meeting & Minutes)

BACKGROUND

As detailed in the August minutes, it was agreed that Mr. Steinberg would develop a specific proposal for intervention activities for discussion at the October meeting. His view is that intervention activities should not be considered non-core entities because this implies they are federal entities.

Staff believes the current structure of the exposure draft is:

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.

1. Identify organizations to be included in the government-wide General Purpose Federal Financial Reports (GPFFR)
2. Determine which organizations are core entities and which are non-core entities
3. Require consolidation of core entities and prevent consolidation of non-core
4. Information about non-core entities must be disclosed in the government-wide GPFFR and non-core entities are not subject to the GAAP hierarchy in SFFAS

In August, staff presented revisions intended to clarify that non-core entities are included in GPFFR rather than being included in the entity. The purpose section of the ED (see par. 1 to 3) describes this succinctly and care has been taken throughout the document to avoid stating that non-core entities are included in the federal entity. The document explains why non-core entities should be included in GPFFR.

Staff believes the document could be further clarified by (1) revising the title (presently “Government-wide and Component Reporting Entities”) to a more descriptive option such as “Identifying Organizations to Include in Federal Financial Reports and Related Disclosure Requirements”² and (2) acknowledging in the executive summary and basis for conclusions the continuum among non-core entities such that some may be viewed as federal entities while some may not. Staff does not believe that the boundaries of the ‘federal entity’ can be established clearly with out crafting an exception to the inclusion principles. The Board previously considered an exception approach and Appendix 1 documents that discussion.

NEXT STEPS

Mr. Steinberg’s proposal will be discussed at the October meeting. In addition, Mr. Steinberg has indicated a desire to discuss the clarity of the exposure draft regarding whether entities are federal or non-federal.

² Staff has been reviewing title options and planned to present options at the next meeting. We will present other alternatives at the next meeting that align with the revised structure.

SPECIFIC WORDING TO AVOID CONSIDERING INTERVENTION ENTITIES AS PART OF THE FEDERAL ENTITY.

The primary purposes of the standard is to define the Federal entity. Although the financial disclosures for intervention entities might be the same as or similar to the financial disclosures for non-core entities, the intervention entities are not part of the Federal government and should not be designated as another type of non-core entity. Rather they should be identified as what they are, namely intervention entities, and the necessary disclosures defined

Therefore, I would

1. Change pages 25-26 as follows:

- the sub-section titled “Federal Government Intervention Actions” would be changed from a sub-section of Organizations-Core Government Entities and Non-Core Entities to a separate section titled “Federal Government Intervention Entities”; and
- paragraphs 52-55 would read:

52. The Federal government, with its broad responsibility to provide for the common defense and promote general welfare, occasionally intervenes in a privately owned entity whose failure could have an adverse impact on the nation’s economy, commerce, or national security. As a condition of the intervention, the Federal government frequently obtains a certain level of ownership interests and/or some of the indicators of control presented in paragraphs 26-32.

53. Although there may be no specific time limit associated with the intervention, they are not intended to be permanent. Strategic planning documents are unlikely to include objectives to routinely initiate such interventions or to permanently operate the activities for which the Federal government intervened. Rather the Federal government expects to end its interest and relinquish or cede control as soon as practicable.

54. The existence of ownership instance or indicators of control in these instances of intervention does not make the intervention entity part of the Federal government or any of the components that are part of the Federal government. Disclosures of the relationship(s) with the intervention entity and any actual or potential material costs, liabilities, exposures, or benefits are still necessary. They are addressed in paragraph 65.

2. Add a title on page 31 “Disclosures for Interventions”, followed by the following paragraph.

65. The following disclosures would be appropriate for intervention entities:

- a. The name and description of the intervention entity(ies).

b. The primary reason for the intervention(s) and a brief description of the Federal government's plans during the intervention period and for eventually disposing of the entity(ies).

c. The nature of, and any changes during the period, in the risks associated with the intervention or the intervention entity(ies)' financial condition..

d. The potential financial impact, whether gains or losses, resulting from the Federal government's involvement with the intervention entity, including how that gain or loss would result; and the amount that best represents the Federal government's maximum exposure to gain or loss and how that amount is determined.

Other conforming changes would be:

1. Page 23, Paragraph 45. Delete the words "Federal government intervention actions."

2. Page 27, paragraph 61. Add "and for the intervention entities" after "core governmental entities."

3. Page 29, paragraph 65c. Delete

4. Page 41, paragraph A41, last two lines. Delete "Federal government intervention actions."

5. Page 42. The title "Federal Government Intervention Actions" should be at a level equal to the title "Non-core Entities."

6. Pages 42-44, paragraphs A47-54. Rewrite the BfC to support the position taken in the standard.

7. Page 49, paragraph A72. 9th line. Delete "either core or non-core entities."

Appendix 1

This Appendix includes relevant excerpts from the December 2010 meeting as staff believes this should be considered in conjunction with Mr. Steinberg’s proposal. Staff notes interventions are considered non-core per earlier Board decisions to approve non-core language and the overall two-step approach. Staff initially proposed to exclude interventions and the Board did not approve that approach because the Board had issue with noting exceptions to the standard and preferred this approach. At this time, that is when staff developed the core and non-core entity attributes used to distinguish among the organizations that are included

As you may recall, in December 2010 staff presented the Board with two charts /options for consideration:

Government-wide Reporting Entity					Related Party Disclosures
CONSOLIDATED ENTITIES	Exceptions				
	<p>INTERVENTIONS</p> <p>Intervention in exceptional circumstances, such as an economic crisis situation or military occupation—may last for more than several years, but it is not intended to be permanent.</p>	<p>CONSERVATOR/ RECEIVORSHIP</p> <p>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</p>	<p>QUASI-GOVT FINANCIAL INDEPEND.</p> <p>Governance differences lead to greater independence Financial differences lead to greater fiscal autonomy</p>	<p>JOINTLY FUNDED MUSEUMS & OTHERS</p> <p>dependent upon or supported by contributions or charity, although they may receive some funding from the federal government</p>	

Government-wide Reporting Entity		Related Party Disclosures
CONSOLIDATED ENTITIES	<p>Temporary Exceptions</p> <p>Intention is not to make it permanent.</p>	

As the minutes detail, the Board noted concern with using exceptions in a principals based standard and requested staff to develop the language that is was approved for core and non-core entities.

Excerpt from December 2010 Minutes

Mr. Showalter explained he has a difficult time calling the exceptions related parties. He added this would be a total different meaning of what a related party means to most readers. He added that he also doesn't like the word exception, so he likes Mr. Steinberg's suggestion to come up with a new term to describe these entities. Mr. Dacey agreed it would be redefining related parties, and he is okay with coming up with a new term if the Board wants to—but he doesn't want to call them federal entities.

Mr. Jackson explained that exceptions aren't principles based. He believes the buckets should be criteria based. Chairman Allen explained that it appears similar to what Mr. Steinberg suggested and what staff has been working towards.

Chairman Allen explained it would be helpful to understand the Board's stance on the two versions as it appeared the Board approved the new approach.

Mr. Granof voted for the Narrow version. [Explanatory note: The 'narrow version' refers to the narrower related party category and is an endorsement of the first chart above.]

Mr. Jackson voted for the Narrow version.

Mr. Steinberg voted for the Narrow version.

Mr. Reger asked what the vote means. Chairman Allen explained that means we would focus on that version. Based on that, he agreed with the Narrow version.

Ms. Kearney voted for the Narrow version because it offered more structure and guidance to the preparer, with the caveat that it needs additional buckets.

Mr. Dacey voted for the Narrow version, with the caveat that he is concerned that the exceptions are not federal entities.

Mr. Schumacher voted for the Narrow version, but agreed with Mr. Jackson in that instead of creating exceptions the focus should be on criteria for the buckets.

Mr. Showalter voted for the Narrow version.

Therefore the Board agreed unanimously for the Narrow approach.

Mr. Steinberg suggested the conservatorship/receivership bucket be split as the two are considered very different. Ms. Payne asked if the suggestion was based on the expected outcome for disclosure. Mr. Dacey explained that it wasn't necessary to split them, in fact both could be seen as interventions.

Mr. Granof explained he believes the first 30 paragraphs of the proposal are the most important as they detail what is in the federal entity and that is what the Board should be focusing on. Mr. Granof explained the Board should be discussing what the government-wide reporting entity is.

Chairman Allen suggested that the Board walk through the proposed standard for Board member comments, starting on par. 16. Mr. Granof explained he had some issue trying to diagram it as it seemed like it still needed to meet control and/or ownership. Staff noted par. 16 states if it is the budget then it is consolidated, the following paragraph provides entities receiving federal assistance (there are few) then it should be assessed against the other two principles. Staff will work on the wording of par. 17 for clarity, perhaps a footnote will suffice. Staff also noted there is a plan to include a flowchart in the exposure draft.

Mr. Jackson noted that majority ownership would bring in entities such as AIG and GM and there is some concern with that. Chairman Allen explained there are still the exceptions, but one must still have principles that capture the entities to begin with. Mr. Steinberg agreed he would be nervous to say that in the beginning, so there should be something said up front regarding the temporary nature. Staff explained in earlier versions of the proposal there were paragraphs included in the majority ownership and control section that referenced the exceptions (for temporary and interventions) but the Board suggested that a blanket statement be made at the beginning of the document versus being repeated throughout the proposal. Staff explained it could be put back or footnoted if the Board prefers. Mr. Dacey suggested including more discussion in par. 15.

Mr. Jackson noted concern with saying the exceptions are part of the federal government. He believes the federal government often takes action—to protect the general public, but that doesn't make these entities part of the federal government. Mr. Jackson suggested that par. 29 should be expanded to include intervention actions as these are natural functions of the government and they shouldn't be considered control to trigger consolidation. He explained this paragraph could be expanded to include these activities so they are not considered for consolidation. He added that these entities are not considered part of the federal government and he believes the interventions should be included here versus as exceptions. He explained the federal government did what it had to do, but that doesn't make the entities part of the federal government and the proposal needs to be reshaped to reflect this. Mr. Jackson also believes par. 29 may need to be revised slightly as it appears control does exist, but these entities shouldn't be included in the federal entity.

Mr. Steinberg explained that isn't the purpose of par. 29, as it relates specifically to control. Mr. Jackson explained he understood and it can be revised and could be characterized differently. He agreed with some of Mr. Dacey's points that the interventions are not part of the federal government, though he has not determined his final stance on other entities like the FFRDCs and museums.

Ms. Payne explained the term government-wide reporting entity does not assert the entity should follow FASAB standards rather than FASB. Staff asserts the exception entities should not be consolidated, the reason for putting them under the government-wide reporting entity is for accountability. The federal entity is to be accountable because it owns it or controls it and that is the purpose for putting them under the government-wide reporting entity—accountability—not to mandate FASAB standards or consolidation. Ms. Payne commented that once there is a better understanding of the core or consolidated government, perhaps this will be clearer. Ms. Payne suggested the narrative could be improved with categories of core government, accountable or affiliated entities, and related parties.

Mr. Steinberg explained regarding control, it should be clear that it must be to exercise control. Mr. Steinberg also suggested that par. 28b that reads “Establish or amend the entity’s fundamental purpose and mission, 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” should be considered persuasive evidence. Chairman Allen agreed and noted he had the same point. Staff explained this particular indicator was elaborated upon and that based upon the additions it probably should be moved up and if the Board agrees, staff will do so. There were no objections.

Mr. Showalter noted concern with the wording of paragraph 26 in conjunction with 27 and 28. Staff explained that 27 were more persuasive while 28 is viewed in the aggregate to provide evidence. Mr. Showalter explained the standard should be specific in whether one or all needs to be in 27. Staff noted the language in paragraph 26 states the absence of one of the indicators does not lead to a presumption that control is not present (so this allowed for judgment), but agreed it needed to be clearer and staff would revise while still allowing flexibility.

FASAB counsel, Mr. Dymond commented that control includes both power to govern the financial and/or operating policies of another entity with expected benefits and/or risk of loss and asked if the indicators should be considered if they didn’t include both. Staff noted the indicators are included to assist preparers in their assessment. Staff believes it is possible to present indicators that may meet only a portion of the definition of control because the indicators are considered in the aggregate in determining if the entity meets the definition of control. Staff explained strictly showing one side for a particular indicator (benefit/risk) and another indicator (power) to meet the definition of control is acceptable in par. 28 because they are considered in the aggregate.

~~~~BREAK~~~~

After the break, Chairman Allen asked staff for the key questions staff would like to resolve in the remainder of the session. Staff wanted to confirm that the Board agreed with Mr. Steinberg’s suggestion to define relationships and come up with attributes for the terms core/primary government and affiliated/associated government. Mr. Showalter commented it may assist with coming up with criteria for each of the categories as the Board had discussed. Chairman Allen noted based on several nods at the table the Board appeared in agreement with staff developing options for the Board’s consideration.

Staffs also asked for feedback on Mr. Dacey’s point regarding the exceptions are not considered part of the federal entity and instead are related parties. Chairman Allen explained he may be 180 degrees opposite on this issue but it may not matter at this point. He added that he sees value in having the core government as discussed, but there is also this other responsible / accountable group and a related party. Mr. Dacey explained his point is that the exceptions or responsible / accountable group is not a federal entity. Mr. Reger added that by definition they can’t be a federal entity. Mr. Steinberg added that although some may not be considered federal, there may be some that are federal—such as certain corporations and museums. He agreed there may be a middle bucket, but there needs to be some flexibility that allows for some that may be federal and some that aren’t. He explained the next task will be to come up with characteristics and criteria for each of the buckets versus the reporting for the buckets.

FASAB Counsel, Mr. Dymond asked if the issue of reporting requirements and whether something is a federal entity for purposes of GAAP, is a distinction that is causing problem or confusion.

Mr. Dacey noted concern if the standard suggests a particular entity is a federal entity; it may lead some to interpret this as saying that they need to follow FASAB. Ms. Payne understood his sensitivity, but noted there is a standard that allows entities to go to FASB GAAP. Mr. Dacey explained he viewed it as a separate issue considering this is a federal entity standard; and therefore required more sensitivity. Chairman Allen suggested the issue be addressed in the wording that is used.

Mr. Showalter explained that the Board is in agreement it is part of the reporting entity, but it is not a federal entity. Chairman Allen directed staff to work on ensuring the language characterizes it as such so it will address Mr. Dacey's concern.<sup>3</sup> Mr. Dacey agreed.

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<sup>3</sup> The proposal doesn't require any entity to prepare statements. [Par. 7 states "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 entities should be included in the federal reporting entity. The Statement provides principles on determining what should be included in the government-wide reporting entity and in each component reporting entity's financial statement and ensures adequate disclosure or alternate presentation of those not included. The Statement also provides information about and required disclosures for related parties.] Staff will continue working to ensure the language addresses member's concerns.