



Federal Accounting Standards Advisory Board

April 15, 2010

Memorandum

To: Members of the Board

From: Melissa Loughan, Assistant Director

Wendy M. Payne

Through: Wendy M. Payne, Executive Director

Subj: Update on other Standard Setters' Entity Projects—**Federal Entity Tab C1**¹

As you are aware, staff monitors the activities of the other standard setters, especially those projects that relate to our current projects. Staff believes recent exposure drafts issued may be relevant to the Federal Entity project and provides this summary and key points for your consideration.

The Governmental Accounting Standards Board (GASB) issued an Exposure Draft (ED) of a proposed Statement, *The Financial Reporting Entity, an amendment of GASB Statements No. 14 and No. 34*. The ED may be downloaded from the GASB's website at www.gasb.org/exp with written comments due by June 30, 2010. GASB has also requested volunteers to field test the proposal. The proposed Statement is intended to improve financial reporting of component units, which are legally separate organizations that state and local governments include in their financial reports. Key points include the following:

- It would modify the existing criteria for inclusion of organizations that are “fiscally dependent” on a government by adding a requirement that the potential component unit and the primary government also have a financial benefit or burden relationship.
- In cases where the government determines it would be misleading to exclude an organization that does not meet the financial accountability concept from its financial reports, the proposed Statement would clarify the manner in which that determination should be made.
- The proposed Statement would amend the criteria for “blending,” or the reporting of component units as if they were part of the primary government. For component units that are currently blended based on the “substantively the same governing body” criterion, it would additionally require that (1) the primary government and the component unit have a financial benefit or burden relationship or (2) management of the primary government have operational responsibility for activities of the component unit.
- The blending provisions would be amended to clarify that funds of a blended component unit have the same characteristics and the same reporting options as a fund of the primary government.

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.

- Additional reporting guidance would be provided for blending a component unit if the primary government is a business-type activity that uses a single column presentation.
- It would clarify the reporting of equity interests in legally separate organizations by requiring the primary government to report its equity interest in a component unit as an asset, with the asset being eliminated in the blending process if the component unit meets the blending criteria. In addition, the Exposure Draft would extend equity interest guidance beyond simply stock to also address partnerships and joint ventures. The proposal harmonizes reporting requirements for component units, joint ventures, and organizations with similar characteristics.

The FASB and the IASB recently issued an Exposure Draft, *Conceptual Framework for Financial Reporting: The Reporting Entity* on March 11, 2010 with written comments requested by July 16, 2010. The ED may be downloaded from the FASB's website at <http://www.fasb.org>. The proposed Statement is a Concepts Statement and follows a Discussion paper issued in May 2008, *Preliminary Views--Conceptual Framework for Financial Reporting: The Reporting Entity*. Key points of the proposal include the following:

- A reporting entity is a circumscribed area of economic activities whose financial information has the potential to be useful to existing and potential equity investors, lenders, and other creditors who cannot directly obtain the information they need in making decisions about providing resources to the entity and in assessing whether the management and the governing board of that entity have made efficient and effective use of the resources provided.
- An entity controls another entity when it has the power to direct the activities of that other entity to generate benefits for (or limit losses to) itself. If an entity that controls one or more entities prepares financial reports, it should present consolidated financial statements.
- A portion of an entity could qualify as a reporting entity if the economic activities of that portion can be distinguished objectively from the rest of the entity and financial information about that portion of the entity has the potential to be useful in making decisions about providing resources to that portion of the entity.
- A reporting entity has three features:
 - a. Economic activities of an entity are being conducted, have been conducted, or will be conducted
 - b. Those economic activities can be objectively distinguished from those of other entities and from the economic environment in which the entity exists
 - c. Financial information about the economic activities of that entity has the potential to be useful in making decisions about providing resources to the entity and in assessing whether the management and the governing board have made efficient and effective use of the resources provided.
 (These features are necessary but not always sufficient to identify a reporting entity.)
- Two or more entities may share the power to direct the activities of another entity to generate benefits for (or limit losses to) themselves. In this case, none of the entities that share the power to direct the activities of this other entity individually controls this other entity. Accordingly, none of these entities would present information about itself and this other entity on a consolidated basis.
- If one entity has significant influence over another entity, it does not control that other entity. The entity's ability to influence the activities of another entity without actually being able to direct those activities does not constitute power over that other entity.

If you have any questions or comments, please contact me by telephone at 202-512-5976 or by e-mail at loughanm@fasab.gov.

