



March 9, 2007

Memorandum

To: Members of the Board
Wendy M. Comes

Through: Wendy M. Comes, Executive Director

From: Melissa L. Loughan

Subj: **Federal Entity Project --Tab D¹**

At the January 2007 Meeting, the Board approved the Federal Entity Project plan and directed staff to move forward on the project. The Federal Entity project is phase 5 of the overall Conceptual Framework Project. In the Federal Entity Project plan, staff identified several issue areas that would be addressed in the project. The attached staff paper discusses the first issue area—Definition of entity/ reporting entity. In assessing how entity / reporting entity should be defined for federal financial reporting purposes, staff considered the following questions:

- Does FASAB already define entity / reporting entity?
- Should there be a distinction between Entity and Reporting Entity?
- Is there a relationship between the reporting entity concept and the objectives of federal financial reporting? If so, should this be articulated?
- How do U.S. standard-setters and National and International standard-setters define Entity /Reporting Entity?
- Would a definition be best articulated in Concepts or Standards?

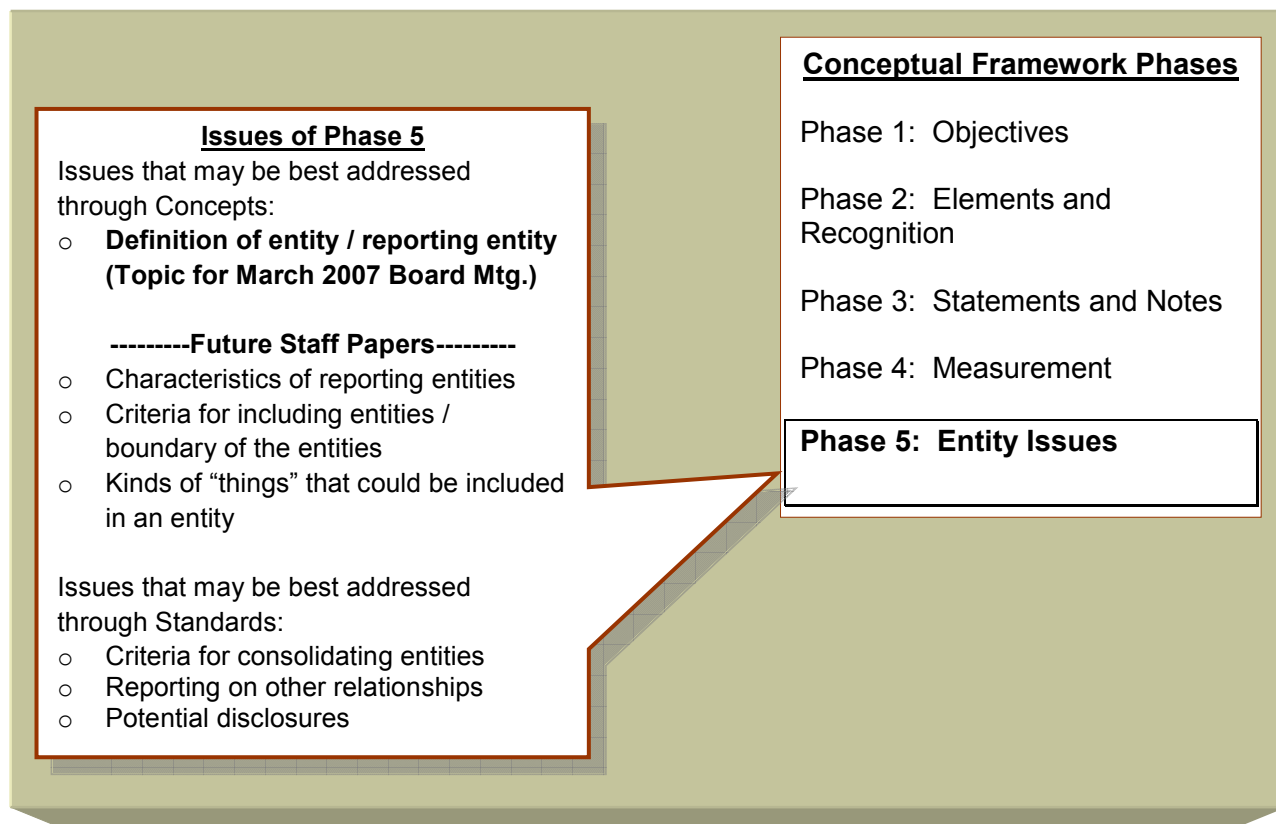
As noted above, this paper will focus on the first issue area –Definition of entity / reporting entity. This paper will **not** consider the characteristics of entities, boundaries of entities, notion of control, etc. These topics will be discussed in future staff papers. This paper is a first in a series of papers to consider several different aspects of the

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.

federal entity concept. Staff anticipates Board discussions will naturally include these areas but they are **not** covered in this paper. Staff encourages all discussion because it will be helpful as staff moves forward on those topics.

Exhibit 1 relates the topic of this paper (Definition of entity/ reporting entity) and future papers (that will be addressed in Phase 5) to the overall conceptual framework project.

Exhibit 1--Relationship of Phase 5 to the Overall Conceptual Framework Project



As noted above, this paper is a first in a series of papers to consider several different aspects of the federal entity concept. Staff plans to devote the next several Board meetings to issue papers that will address the following:

- Characteristics of a Reporting Entity
- Boundaries of a Reporting Entity
- Kinds of "things" that could be included in an entity—the types of transactions, events and entities that may be encompassed within a reporting entity, ie, other entities, activities, guarantees, functions, etc.

As noted in the Federal Entity Project Plan, ultimately this project may result in both a proposed concept and one or more proposed standards. The resulting concept and standards would rescind the sections of SFFAC 2² relating to entity. Based on staff's preliminary determinations in this issue paper, staff believes it would be appropriate to develop a Concepts Statement on Entity. The future issue papers noted above, along with this paper, relate to the conceptual areas that would be included in a proposed concepts statement.

Staff's approach is to complete issue papers identified above and then proceed with drafting a proposed Concepts Statement. Although each area will be considered at separate meetings along with the issue paper, staff believes the topics are related and should be discussed before drafting portions of a proposed Concepts Statement. Staff believes that it may be difficult to make any hard or permanent decisions regarding the definition of entity / reporting entity at this point. Staff believes the conceptual issue areas of the federal entity concept (noted above) will need to be explored. Meaning, the Board may have preliminary thoughts on the Definition of Entity and Reporting Entity, but it would be subject to change as other topic areas are fully developed.

The goal for the March Board meeting is to seek the Board's input on the following:

- Does the Board agree with the staff analysis and recommendation?
- Are there other issues or considerations related to the definition of entity/ reporting entity that the Board would like staff to research?
- Does the Board agree with the staff's approach (which is consistent with the Federal Entity Project Plan) to discuss the conceptual issue papers and explore those areas prior to making certain decisions on the definitions?
- Are there any other potential issue areas that should be covered in the beginning or conceptual part of the Federal Entity Project?

Please feel free to contact me at 202-512-5976 or by email at loughanm@fasab.gov to discuss any comments or questions you may have.

² Phase 3, Statement and Notes of the Conceptual Framework Project would address the remainder of SFFAC 2 related to the Display of Financial Information. Ultimately, the completion of Phase 3 and Phase 5 would rescind SFFAC 2 in its entirety.

Federal Entity

ISSUE 1: Definition of Entity / Reporting Entity³

PURPOSE: The purpose of this paper is to consider how entity / reporting entity should be defined for federal financial reporting purposes.

SCOPE: Definition of Entity / Reporting Entity

In assessing how reporting entity should be defined for federal financial reporting purposes, staff considered the following questions:

- Does FASAB already define entity / reporting entity?
- Should there be a distinction between Entity and Reporting Entity?
- Is there a relationship between the reporting entity concept and the objectives of federal financial reporting? If so, should this be articulated?
- How do U.S. standard-setters and National and International standard-setters define Entity /Reporting Entity?
- Would a definition be best articulated in Concepts or Standards?

Does FASAB already define entity / reporting entity?

There are many “entity” terms used in FASAB’s literature—entity, reporting entity, federal reporting entity, component entity, component reporting entity, Federal Government entity. For example, SFFAC 1 and other standards use the term “entity” generically to refer, depending on the context, to the U.S. Government as a whole, organizational component units of the Government, e.g., an agency, or to other kinds of potential reporting units such as programs.

The Original Pronouncements Consolidated Glossary includes the following definition:

Entity: A unit within the federal government, such as a department, agency, bureau, or program, for which a set of financial statements would be prepared. Entity also encompasses a group of related or unrelated commercial functions, revolving funds, trust funds, and/or other accounts for which financial statements will be prepared in accordance with OMB annual guidance on Form and Content of Financial Statements.

SFFAC 2 par. 2 states “the statement specifies the types of entities for which there ought to be financial reports (hereinafter called reporting entities).…” In addition, SFFAC 2 par. 29 provides “reporting entities are entities that issue general purpose financial statements to communicate financial and related information about the entity.”

³ Issue 1 is from the Federal Entity Project Plan approved by the Board at the January 2007 Board Meeting.

Based on the existing FASAB language, it appears the definitions are generically defined⁴ as follows:

'entity' is as a unit within the government for which financial statements are prepared, and

'reporting entity' is an entity that issues general purpose financial statements (as noted above, SFFAC 2 also provides three criteria that make an entity a reporting entity).

Staff believes that although the existing concepts contain the above definitions, they appear to be very generic. Further, it may be difficult to understand if there is a difference between the definition of an entity and a reporting entity.

SFFAC 2 also discusses three criteria for an entity to be a "reporting entity" SFFAC 2 provides the following:

For any entity to be a reporting entity, as defined by this Statement of Federal Financial Accounting Concepts, it would need to meet all of the following criteria.

- 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.
- The entity's scope is such that its financial statements would provide a meaningful representation of operations and financial condition.
- 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.

As noted above, SFFAC 2 par. 29 discusses three criteria that an entity has to meet to be a "reporting entity." Therefore, it appears SFFAC 2's consideration of the criteria that must be met is the determining factor to be a reporting entity—but is this part of the definition? If these criteria are considered part of the definition, it appears the criteria are quite limiting. Staff notes that SFFAC 2 states "it would need to meet all of the following criteria." Staff does not agree with the wording of SFFAC 2 and does not believe the criteria should be considered part of the definition. Additionally, staff does not agree that all the criteria listed must be met to be a reporting entity. However, staff believes there are certain qualities, criteria, or characteristics and perhaps user needs that result in reporting entities.⁵ These will be discussed in a future staff paper.

An issue that will be explored further as we progress through the conceptual part of the entity project is determining the definition of a reporting entity versus the characteristics of a reporting entity. The two issues are related and easily overlap when describing them.

⁴ The definitions appear in Concepts Statements and the *Introduction* to Standards, therefore, neither term is defined in an authoritative section of a Standard.

⁵ These qualities, criteria, or characteristics will be addressed in a future staff paper.

Staff notes the *Exposure Draft: Definition and Recognition of Elements of Accrual-Basis Financial Statements*, contains a discussion on the Entity Concept. Although the focus is on 'component entities', staff believes it is relevant for the Board's consideration of how the 'entity' term can be used in different contexts.⁶ The discussion is as follows:

Entity Concept

10. All elements defined in this Concepts Statement are defined in relation to the U.S. Government ("federal government" or "government"). That is, an item that meets the relevant definition is an asset, liability, net position, revenue, or expense of the federal government. The item is recognized in the consolidated financial statements of the federal government, provided it is measurable, except when it is eliminated in the consolidation process, as discussed in paragraphs 14 and 15.

11. The federal government is composed of component entities that **control**, manage, or are otherwise accountable for the government's assets and may be authorized to incur liabilities. Component entities include departments, independent agencies, and government corporations, as well as their agencies, bureaus, offices, administrations, corporations, and other organizational units. An item that meets the definition of an element of the federal government is also an element of a component entity. It is recognized in the component entity's accrual-basis financial statements provided it is measurable.

12. Sometimes a question may arise as to which component entity should report a particular item. Typically, a review of the authorizing legislation establishing a government program or activity, the appropriations act funding it, and related federal laws, regulations or other executive issuances clearly identifies one component entity as having a comprehensive relationship to the program or activity. That is, the component entity is responsible and accountable for receiving, controlling, managing, and utilizing government assets or incurring liabilities on behalf of the government in performing operations related to the program or activity. When a component entity has such a comprehensive relationship, the assets and other elements involved should be reported by that component entity.

13. When no component entity has a comprehensive relationship to a government program or activity, the assets and other elements involved should be reported by the component entity most responsible for managing them. For example, if one component entity has acquired and has some control over a government asset but another component entity presently manages and utilizes the asset as part of its routine operations, the second component entity should report the asset. In other circumstances, a component entity's management responsibilities may be limited to, for example, collecting monies owed to the federal government and depositing them in the U.S. Treasury. Although the component entity has no authority or responsibility to retain or use the monies collected, it should report the assets and other elements involved in the collection activity.

⁶ See GASB excerpt on the chart "*How do U.S. standard-setters and National and International standard-setters define Entity / Reporting Entity?*" The excerpt from the GASB Proposed Concepts Statement *Elements of Financial Statements*, details how GASB utilizes the terms Governmental Unit, Reporting Entity, and Reporting Unit to distinguish how the entity concept is used in different contexts.

14. Some items recognized in the accrual-basis financial statements of component entities are not recognized in the consolidated financial statements of the federal government because they are eliminated in the consolidation process. For example, component entities may exchange services for a fee and recognize the resulting intra-governmental receivables, payables, and related elements in their financial statements. However, intra-governmental items offset each other when the government is viewed as a whole and are eliminated in preparing the government's consolidated financial statements.

15. Appropriations are another example of items reported in the accrual-basis financial statements of component entities but not in the consolidated financial statements of the federal government. For the component entities, appropriations are inflows of resources against which the component entity may incur obligations in support of authorized activities. Assuming compliance with the relevant definitions of elements and the recognition criteria, a component entity would recognize appropriations as increases in assets and revenues and would recognize the use of appropriations as increases in expenses and decreases in fund balance with Treasury. However, from the perspective of the government as a whole, an appropriation is not a resource flow to the federal government or from the government to a component entity. Rather, it is a budgetary amount that constitutes legal authority for a component entity to incur obligations for specified purposes during specified time periods, and for the U.S. Treasury to liquidate the resulting obligations of the component entity. The actual liquidation will be from cash and other assets of the U.S. Treasury resulting from the inflow of resources from taxes and other financing sources. Therefore, appropriations recognized by component entities are eliminated in the process of consolidation and are not reported in the consolidated financial statements of the federal government.

16. The definitions of elements may refer to *another entity* or *other entities*. For the federal government, these terms describe entities external to the government, such as foreign, state, and local governments, business enterprises, not-for-profit organizations, and individuals. For a component entity, the terms *another entity* and *other entities* include other component entities of the government as well as entities external to the government.

Should there be a distinction between Entity and Reporting Entity?

In its most general sense, an entity could be considered as something with a separate and distinct existence, and reporting entity could be considered an entity that reports.

From the *Merriam Webster Dictionary (on-line)*, entity is defined⁷ as follows:

- Entity- **1 a** : BEING, EXISTENCE; *especially* : independent, separate, or self-contained existence **b** : the existence of a thing as contrasted with its attributes
- 2** : something that has separate and distinct existence and objective or conceptual reality
- 3** : an organization (as a business or governmental unit) that has an identity separate from those of its members

⁷ <http://www.m-w.com/dictionary/entity>

Using this general definition, the following could be examples of what might be considered an entity:

- Government as a whole
- Components of the Government such as Departments, Agencies, Bureaus, Administrations, Offices, etc.
- Legal entities, such as companies, partnerships, trusts, and other organizations, etc.
- Economic entities
- Trust funds, special funds, revolving funds, etc.
- Programs, Organizations, Activities, Functions, Projects, etc.
- Boards, Commissions, Committees, etc.

Continuing with a simple definition, some may argue that “reporting” is simply an adjective. Meaning, it may be used to refer to the entity or distinguish the particular entity that is reporting. Using this approach, the simple definition does not exclude any particular entity from being a reporting entity. A reporting entity would be an entity that issues (reports) general purpose financial statements—which is very similar to what is in FASAB’s existing concepts statements.

However, SFFAC 2 par. 29 provides the following:

“As stated, reporting entities are entities that issue general purpose financial statements to communicate financial and related information about the entity. For any entity to be a reporting entity, as defined by this Statement of Federal Financial Accounting Concepts, it would need to meet all of the following criteria.”

Based on this language, it appears the Board did want a distinction between ‘entity’ and ‘reporting entity.’ SFFAC 2 implies that reporting entities come from a wider pool of entities. Further, SFFAC 2 describes certain criteria for an entity to be a reporting entity, which would lead one to believe that if an entity does not meet the criteria, it would not be considered a reporting entity. Therefore, not all entities are reporting entities.

Staff believes there should be a distinction between entity and reporting entity. Staff believes that reporting entities are drawn from a wider pool of entities. Reporting entities can be individual entities, groups of entities, and combinations of entities and portions of other entities and other things.⁸ Staff believes that there are certain qualities, criteria or characteristics and perhaps user needs that result in reporting entities.

⁸ Other “things” that could be included in an entity—the types of transactions, events and entities that may be encompassed within a reporting entity, ie, other entities, activities, guarantees, functions, etc—will be addressed in a future staff paper.

Is there a relationship between the reporting entity concept and the objectives of federal financial reporting? If so, should this be articulated?

The objectives of federal financial reporting, as detailed and discussed in SFFAC 1 are as follows:

Objective 1--Budgetary Integrity

Federal financial reporting should assist in fulfilling the government's duty to be publicly accountable for monies raised through taxes and other means and for their expenditure in accordance with the appropriations laws that establish the government's budget for a particular fiscal year and related laws and regulations. *Federal financial reporting should provide information that helps the reader to determine:*

- 1A. How budgetary resources have been obtained and used and whether their acquisition and use were in accordance with the legal authorization.
- 1B. The status of budgetary resources.
- 1C. How information on the use of budgetary resources relates to information on the costs of program operations and whether information on the status of budgetary resources is consistent with other accounting information on assets and liabilities.

Objective 2--Operating Performance

Federal financial reporting should assist report users in evaluating the service efforts, costs, and accomplishments of the reporting entity; the manner in which these efforts and accomplishments have been financed; and the management of the entity's assets and liabilities. *Federal financial reporting should provide information that helps the reader to determine:*

- 2A. The costs of providing specific programs and activities and the composition of, and changes in, these costs.
- 2B. The efforts and accomplishments associated with federal programs and the changes over time and in relation to costs.
- 2C. The efficiency and effectiveness of the government's management of its assets and liabilities.

Objective 3--Stewardship

Federal financial reporting should assist report users in assessing the impact on the country of the government's operations and investments for the period and how, as a result, the government's and the nation's financial condition has changed and may change in the future. *Federal financial reporting should provide information that helps the reader to determine:*

- 3A. Whether the government's financial position improved or deteriorated over the period.
- 3B. Whether future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due.
- 3C. Whether government operations have contributed to the nation's current and future well-being.

Objective 4--Systems and Control

Federal financial reporting should assist report users in understanding whether financial management systems and internal accounting and administrative controls are adequate to ensure that:

- 4A. Transactions are executed in accordance with budgetary and financial laws and other requirements, consistent with the purposes authorized, and are recorded in accordance with federal accounting standards;
- 4B. Assets are properly safeguarded to deter fraud, waste, and abuse; and
- 4C. Performance measurement information is adequately supported.

The Objectives phase of the overall Concepts Project related to the evaluation of the reporting objectives as presented in Statement of Federal Financial Accounting Concepts (SFFAC) 1, *Objectives of Federal Financial Reporting*. Evaluation of the reporting objectives focused on (1) clarifying the broad federal financial reporting objectives by determining if they are still valid and appropriate and whether additional objectives are necessary and (2) defining FASAB's strategic directions by clarifying its near-term role in achieving those broad objectives as the nature of the Board's involvement may vary for each objective. The Board agreed to maintain the current broad objectives of federal financial reporting in SFFAC 1.⁹

SFFAC 1 provides that the "objectives are designed to guide the Board in developing accounting standards to enhance the financial information reported by the federal government to (1) demonstrate its accountability to internal and external users of federal financial reports, (2) provide useful information to internal and external users of federal financial reports, and (3) help internal users of financial information improve the government's management."¹⁰ Further, the objectives "reflect many of the needs expressed by current and potential users of federal financial information."¹¹

In addition to the reporting objectives, SFFAC 1 discusses accountability and users' information needs as the foundation of Governmental financial reporting. Specifically, par. 71 states "It may be said that "accountability" and its corollary, "decision usefulness," comprise the two fundamental values of governmental accounting and financial reporting. They provide the foundation for the objectives of federal financial reporting." Further, par. 71 adds "The assertion of accountability therefore leads to identifying, first, those to whom government is accountable and, second, the information needed to maintain and demonstrate that accountability."

SFFAC 1 explains that the federal government has a special responsibility to report on its actions and the results of those actions. SFFAC 1 contains a lengthy discussion about the information needs of both internal and external users. It explains that reports should provide information useful to the citizens, their elected representatives, federal executives, and program managers because it is an essential part of accountability in government.

Considering the Board determined that the federal financial reporting objectives are still valid and appropriate in the Objectives Phase of the Conceptual Framework Project, it is important that those be considered in the Federal Entity Phase.

SFFAC 1 is very clear that the objectives were designed to help ensure the accountability of the federal government and to better inform decisions influenced by the financial information about the government. There is a focus on the needs of current and potential users of federal financial information. As noted, SFFAC 1 discusses

⁹ FASAB's *Strategic Directions Report: Clarifying FASAB's Near-Term Role in Achieving the Objectives of Federal Financial Reporting*, November 2006

¹⁰ SFFAC 1, par. 3

¹¹ SFFAC 1, par. 4

accountability and users' information needs as the foundation of Governmental financial reporting

It appears the overriding objective of federal financial reporting is accountability and user needs. In fact, in each of the four objectives there are several references to user information and accountability. Therefore, notion of accountability and users' information needs should be discussed in the reporting entity concept. As noted above, FASAB SFFAC 2 discusses three criteria for an entity to be a "reporting entity." Although, criteria and characteristics will be discussed in a future staff paper, it should be pointed out that one of the criteria of SFFAC 2 is "There are likely to be users of the financial statements who are interested in and could use the information in the statements to assist them in making resource allocation and other decisions and holding the entity accountable for its deployment and use of resources." Therefore, it appears the previous Board did want this linkage conveyed.

How do U.S. standard-setters and National and International standard-setters define Entity / Reporting Entity?

Document	Definition
<p>FASAB Statement of Federal Financial Accounting Concepts No. 2, <i>Entity and Display</i></p> <p>Original Pronouncements Consolidated Glossary</p>	<p>SFFAC 2 par. 29 states:</p> <p>As stated, reporting entities are entities that issue general purpose financial statements to communicate financial and related information about the entity. For any entity to be a reporting entity, as defined by this Statement of Federal Financial Accounting Concepts, it would need to meet all of the following criteria.</p> <ul style="list-style-type: none"> • 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. • The entity’s scope is such that its financial statements would provide a meaningful representation of operations and financial condition. • 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. <p>As noted above, SFFAC 2 par. 29 discusses three criteria that an entity has to meet to be a reporting entity.¹²</p> <p>Entity: A unit within the federal government, such as a department, agency, bureau, or program, for which a set of financial statements would be prepared. Entity also encompasses a group of related or unrelated commercial functions, revolving funds, trust funds, and/or other accounts for which financial statements will be prepared in accordance with OMB annual guidance on Form and Content of Financial Statements.</p>

¹² Staff believes that there are certain qualities, criteria or characteristics and perhaps user needs that result in reporting entities, which will be discussed in a future staff papers, the purpose of this paper is to discuss the definition of entity / reporting entity.

Document	Definition
<p data-bbox="191 306 487 436">GASB Statement No. 14, <i>The Financial Reporting Entity</i></p> <p data-bbox="191 1377 500 1476">Proposed Concepts Statement, <i>Elements of Financial Statements</i></p>	<p data-bbox="548 239 1398 638">Financial Reporting Entity (from Glossary)—A primary government, organizations for which the primary government is financially accountable, and other organizations for which the nature and significance of their relationship with the primary government are such that exclusion would cause the reporting entity’s financial statements to be misleading or incomplete. The nucleus of a financial reporting entity usually is a primary government. However, a governmental organization other than a primary government (such as a component unit, a joint venture, a jointly governed organization, or other stand-alone government) serves as the nucleus for its own reporting entity when it issues separate financial statements.</p> <p data-bbox="548 676 1419 974">In addition, GASB includes the section “The Financial Reporting Entity Concept” in GASB 14. Par. 10-11 of this section discusses the concept underlying the definition of the financial reporting entity is accountability. Specifically, it discusses that elected officials are accountable to their constituents and one of the objectives of financial reporting is to provide users of financial statements with a basis for assessing the accountability of those officials, the definition of financial reporting entity should be based on accountability.</p> <p data-bbox="548 1012 1414 1176">Par. 12 of GASB 14 provides the definition of Financial Reporting Entity, which includes the primary government, component units, and other organizations. GASB 14 also has additional discussion and definitions for primary government, component units, and other organizations.</p> <p data-bbox="548 1276 1425 1709">3. The entity to which the definitions are to be applied is a governmental unit (a separate legal entity, which is an organization created, for example, as a body corporate or a body corporate and politic). A reporting entity may include more than one governmental unit, and a governmental unit may consist of one or more reporting units. Control over resources and obligations to sacrifice resources, which are inherent characteristics of elements of financial statements, are manifested only at the governmental unit level. When financial statements are prepared for a reporting unit (for example, a fund, a segment, or other subset of a legally separate entity), the elements of the reporting unit are the elements of the governmental unit that have been assigned to that reporting unit for control, management, or financial reporting purposes.</p>

Document	Definition
<p>FASB / IASB Joint Conceptual Framework Project</p>	<p>Neither of the Board’s existing frameworks contains a robust reporting entity concept, but an implicit reporting entity concept exists. For example, the FASB framework does not contain a definition for reporting entity.</p> <p>The Board’s are currently working on a joint conceptual framework project¹³ that includes a phase on the reporting entity. The Boards have tentatively decided that the conceptual framework should describe what constitutes an entity for the purposes of financial reporting but should not define it. The Boards have tentatively decided that the reporting entity concept should not specify which entities should be required to prepare general purpose external financial reports (GPEFR). Rather, an entity that chooses, or is required (by legislation), to prepare GPEFR would be a reporting entity.¹⁴</p>
<p>International Public Sector Accounting Standards Board (IPSASB)</p> <p>IPSAS 1, <i>Presentation of Financial Statements</i></p>	<p>IPSASB provides a definition for economic entity as follows: 8. The term “economic entity” is used in this Standard to define, for financial reporting purposes, a group of entities comprising the controlling entity and any controlled entities. 9. Other terms sometimes used to refer to an economic entity include “administrative entity,” “financial entity,” “consolidated entity” and “group.”</p> <p>Staff notes that although economic entity is the only term that is defined, IPSASB refers to ‘reporting entity’ and ‘entity’ throughout the standards. It appears the terms are used generically—entity is used to refer to components (of the economic entity, or one that is being controlled, etc.) and reporting entity is used to distinguish a particular entity that is reporting.</p> <p>IPSASB also discusses the importance of the objectives in the public sector are to provide information useful for decision-making, and to demonstrate the accountability of the entity as follows: 15. Financial statements are a structured representation of the financial position and financial performance of an entity. The objectives of general purpose financial statements are to provide information about the financial position, financial performance and cash flows of an entity that is useful to a wide range of users in making and evaluating decisions about the allocation of resources. Specifically, the objectives of general purpose financial reporting in the public sector should be to provide information useful for decision-making, and to demonstrate the accountability of the entity for the resources entrusted to it.</p>

¹³ The FASB/IASB Joint Conceptual Framework Project, Phase D *Reporting Entity* will examine, refine, and clearly articulate the implicit reporting entity concept that exists.

¹⁴ Summary based on IASB website, September 2006 Meeting Summary and Observer Notes

Document	Definition
<p>Australia Accounting Standards Review Board</p> <p>Statement of Accounting Concepts SAC 1 “<i>Definition of the Reporting Entity</i>”</p>	<p>Par. 40 states “Reporting Entities are all entities (including economic entities) in respect of which it is reasonable to expect the existence of users dependent on general purpose financial reports for information which will be useful to them for making and evaluating decisions about the allocation of scarce resources.”</p> <p>Par. 6 defines entity and economic entity for the purposes of SAC 1 as follows: “entity” means any legal, administrative, or fiduciary arrangement, organizational structure or other party (including a person) having the capacity to deploy scarce resources in order to achieve objectives “economic entity” means a group of entities comprising a controlling entity and one or more controlled entities operating together to achieve objectives consistent with those of the controlling entity</p>
<p>United Kingdom Accounting Standards Board</p> <p>Statement of Principles for Financial Reporting, Chapter 2- <i>The Reporting Entity</i></p>	<p>Chapter 2 provides the following principle “An entity should prepare and publish financial statements if there is a legitimate demand for the information that its financial statements would provide and it is a cohesive economic unit.”</p> <p>Par. 2.2 provides “For the preparation of financial statements to be justified in any particular case, there needs to be a legitimate demand for the information that the financial statements would provide. This means, that the information provided by the financial statements will need to be useful and the benefits to be provided by doing the financial statements will need to exceed the cost of doing so.”</p> <p>Par. 2.3 adds “...if the information provided by the financial statements is to be useful, the entity that is subject of the financial statements (the reporting entity) needs to be a cohesive economic unit. This ensures accountability—the reporting entity is held to account for all things it can control...”</p>
<p>New Zealand</p> <p>Statement of Concepts for General Purpose Financial Reporting</p>	<p>Par. 2.1 provides “A reporting entity exists where it is reasonable to expect the existence of users dependent on general purpose financial reports for information which will be useful to them...”</p>

Many of the standard setters (Australia, New Zealand, and the UK) adopted a user information needs focus by relating the definition of reporting entity to their objectives of financial reporting and explicitly referring to user needs and accountability. In addition, GASB and IPSASB indirectly bring the objectives into the reporting entity concept. For example, “*The Financial Reporting Entity Concept*” in GASB 14 discusses accountability as one of the objectives of financial reporting is to provide users of financial statements

with a basis for assessing the accountability of officials, and the definition of financial reporting entity should be based on accountability.

GASB defines Financial Reporting Entity (versus entity or reporting entity) which is different when compared to the other standard setters. GASB's model has additional discussion and definitions for primary government, component units, and other organizations, which are part of the financial reporting entity. Additionally, GASB's Proposed Concepts Statement, *Elements of Financial Statements*, Scope section includes a discussion of the terms 'Governmental Unit', 'Reporting Entity', and 'Reporting Unit'. It details how GASB utilizes the terms to distinguish how the entity concept is used in different contexts as it would be confusing to use the same term when different meanings are intended.

Still others, such as the FASB, IASB, and IPSASB have not explicitly defined the terms. The FASB and IASB currently have an active project on entity and have tentatively decided that the reporting entity concept should not specify which entities should be required to prepare general purpose external financial reports (GPEFR). Rather, an entity that chooses, or is required (by legislation), to prepare GPEFR would be a reporting entity.¹⁵ IPSASB is in the early stages of its Conceptual Framework project that includes a phase related to the concept and characteristics of a reporting entity.

As for FASAB, SFFAC 2 par. 29 states "reporting entities are entities that issue general purpose financial statements to communicate financial and related information about the entity." FASAB appears to have a general definition for both entity and reporting entity. However, SFFAC 2 also discusses three criteria for an entity to be a "reporting entity". Although, these will be discussed in a future staff paper, it should be pointed out that one of the criteria is "There are likely to be users of the financial statements who are interested in and could use the information in the statements to assist them in making resource allocation and other decisions and holding the entity accountable for its deployment and use of resources." Therefore, it appears SFFAC 2's consideration of the criteria that must be met is the determining factor to be a reporting entity—but is this part of the definition?

An issue that will be explored further as we progress through the conceptual part of the entity project is determining the definition of a reporting entity versus the characteristics of a reporting entity. The two issues are related and easily overlap when describing them.

¹⁵ Summary based on IASB website, September 2006 Meeting Summary and Observer Notes

Would a definition be best articulated in Concepts or Standards?

As noted in the Federal Entity Project Plan, a high level issue that will be considered throughout this project is what principles regarding Entity and Consolidation should be in a Concepts Statement versus a Standard. In the project plan, staff proposed that application issues are best accomplished at the standards level while other conceptual issues should remain in a Concepts Statement.

Any definitions for entity and reporting entity would be best suited for a Concepts Statement. As noted in the cover insert or preamble to the *Exposure Draft: Definition and Recognition of Elements of Accrual-Basis Financial Statements*, Concepts Statements “set forth objectives and fundamentals on which financial accounting and reporting standards will be based.” Further the conceptual framework “enhances the consistency of standards and serves the public interest by providing structure and direction to federal financial accounting and reporting.”

Staff Analysis and Recommendation

The purpose of this first issue paper was to determine how entity / reporting entity should be defined for federal financial reporting purposes. Therefore, one would expect the staff recommendation to include a definition for one or both of those terms. However, staff believes that may not be feasible at this point. Staff recommends additional issue papers be considered before making a recommendation.

However, staff would like to provide observations from researching this particular issue area. Based on considering the questions outlined in assessing how entity / reporting entity should be defined for federal financial reporting purposes, staff determined the following:

- Although FASAB’s existing concepts contain definitions for entity and reporting entity, they appear to be very similar. Further, it may be difficult to understand if there is a difference between the definition of an entity and a reporting entity in the existing concepts statement.
- There should be a distinction between entity and reporting entity. Reporting entities are drawn from a wider pool of entities. Reporting entities can be individual entities, groups of entities, and combinations of entities and portions of other entities and other things.¹⁶
- There are certain qualities, criteria, or characteristics and perhaps user needs that result in reporting entities.¹⁷

¹⁶ Other “things” that could be included in an entity—the types of transactions, events and entities that may be encompassed within a reporting entity, ie, other entities, activities, guarantees, functions, etc—will be addressed in a future staff paper.

¹⁷ These qualities, criteria, or characteristics will be addressed in a future staff paper.

- An issue that will be explored further as we progress through the conceptual part of the entity project is determining the definition of a reporting entity versus the characteristics of a reporting entity. The two issues are related and easily overlap when describing them.
- Reporting entities should be defined at a conceptual level by reference to the existence of users who are interested or dependent on financial information for accountability purposes and decision making.
- GASB's model by defining Financial Reporting Entity (versus entity or reporting entity) along with definitions for primary government, component units, and other organizations (which are part of the financial reporting entity) should be explored further and considered. Additionally, GASB's approach in the Proposed Concepts Statement, *Elements of Financial Statements*, by utilizing different terms to distinguish how the entity term is used in different contexts should be considered.

As noted in the Federal Entity Project Plan, ultimately this project may result in both a proposed concept and one or more proposed standards. The resulting concepts and standards would rescind the sections of SFFAC 2¹⁸ relating to entity. Considering this is the first issue paper, staff believes that it may be difficult to make any hard decisions regarding the definitions at this point. Staff believes that the other issue areas of the federal entity concept will need to be explored. Staff plans to devote the next several Board meetings to issue papers that will address the following:

- Characteristics of a Reporting Entity
- Boundaries of a Reporting Entity
- Kinds of “things” that could be included in an entity—the types of transactions, events and entities that may be encompassed within a reporting entity, ie, other entities, activities, guarantees, functions, etc.

Based on staff's preliminary determinations in this issue paper, staff believes it would be appropriate to develop a Concepts Statement on Entity. The future issue papers noted above, along with this paper, relate to the conceptual areas that would be included in a proposed concepts statement. Staff's approach is to complete issue papers identified above, and then proceed with drafting a proposed Concepts Statement. Although each area will be considered at separate meetings along with the issue paper, staff believes the topics are related and should be discussed before drafting portions of a proposed Concepts Statement. Staff believes that it may be difficult to make any hard or permanent decisions regarding the definition of entity / reporting entity at this point.

¹⁸ Phase 3, Statement and Notes of the Conceptual Framework Project would address the remainder of SFFAC 2 related to the Display of Financial Information. Ultimately, the completion of Phase 3 and Phase 5 would rescind SFFAC 2 in its entirety.

Staff believes the conceptual issue areas of the federal entity concept (noted above) will need to be explored. Meaning, the Board may have preliminary thoughts on the Definition of Entity and Reporting Entity, but it would be subject to change as other topic areas are fully developed.

Alternatively, the Board may wish to make a decision on how entity / reporting entity should be defined for federal financial reporting purposes, before considering the other conceptual issue areas.