Federal Accounting Standards Advisory Board

August 13, 2010

Memorandum

To: Members of the Board

From: Melissa Loughan, Assistant Director

Wendy M. Payne

Through: Wendy M. Payne, Executive Director

Subj: **Federal Entity-TAB H** [1]

MEETING OBJECTIVE

The primary objective for the August Board meeting is to discuss issue areas related to the federal entity project and staff recommendations that will enable staff to continue finalizing a Draft ED. Staff will seek Board member's comments on the questions listed in the Staff Issue Paper.

BRIEFING MATERIAL

This transmittal memorandum includes a Staff Issue Paper presenting issues and recommendations. Questions for the Board are specifically on pages 8, 13, 15, 16, and 19. The following issues will be discussed at the August meeting:

- ***Issue 1- Wrap up of Conclusive Principle Open Items***
- ***Issue 2- Approach for Considering the Indicative Principles for INCLUSION***
- ***Issue 3- Indicative Principles Comparison to SFFAC 2 Criteria***
- ***Issue 4: Indicative Principle—Majority Ownership (Board decided at the June Board meeting to address Minority Interest in the Proposed Statement)***

[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.

The Draft ED is located at **Attachment 2** for your reference and to allow issues and draft language to be considered in the context of the Draft ED. However, the main focus of the session will be on the issues and questions in the Staff Issue Paper.

BACKGROUND

At the June 2010 meeting, the Board discussed the following issue areas and staff recommendations related to the federal entity project:

- *Clarification that financing accounts for any entity should be considered in the conclusive principle*
- *Entities partially in the budget (Museums and Performing Arts Organizations)*
- *Project Scope Expanded to Include Consolidation Issues Related to Entities with a Different Source of GAAP and Different Year Ends*
- *Introduction to the Indicative Principles*
- *Tone of Indicative Principles ("includes" or "may include")*
- *Clarification of 1st Indicative Principle- Legal status of entities*
- *Clarification of 2nd Indicative Principle- Majority Ownership*

While additional detail of the deliberations can be found in the minutes, the Board agreed to the following:

The conclusive principle still has a few open issues related to financing accounts and entities that receive subsidies. The Board agreed specific reporting requirements for Museums and Performing Art Organizations could be addressed in the Exceptions and/or Reporting Requirements section. The Board agreed to expand the project scope to include consolidation issues related to entities with a different source of GAAP and different year ends. The Board requested staff to develop options for the Board's consideration on approaches to considering the indicative principles. The Board agreed Minority Interests should be addressed within the ownership principle in the Statement.

The Board will be considering these and additional issues as staff work toward finalizing the Draft ED.

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If you have any questions or comments or would like to provide feedback prior to the meeting, please contact me by telephone at 202-512-5976 or by e-mail at loughanm@fasab.gov.

Staff Issue Paper

Issue 1: Wrap up of Conclusive Principle Open Items

The draft text as of the June meeting provided:

> Government-wide Reporting Entity Conclusive Principle and Criteria
>
> 17. An entity listed in the *Budget of the United States Government: Analytical Perspectives- Supplemental Materials* schedule *Federal Programs by Agency and Account*[7] is within the boundaries of the government-wide reporting entity.
>
> 18. However, entities listed in the *Federal Programs by Agency and Account* schedule that only receive a subsidy or other federal financial assistance[8] would not be considered within the boundaries of the government-wide reporting entity based on the conclusive principle. Instead, the entity, like other entities the federal government has a relationship with, would be assessed against the indicative principles to determine if it is within the boundaries of the U.S. government reporting entity.
>
> 19. If an entity meets the conclusive principle, no further assessment against the indicative principles is required; it is considered within the boundaries of the government-wide reporting entity.
>
> [7]Entities should include any financing accounts associated with the organization although they may not be specifically included in the schedule.
> [8]As defined by the Single Audit Act Amendments of 1996 which is assistance that **non-Federal** entities receive or administer in the form of grants, loans, loan guarantees, property, cooperative agreements, interest subsidies, insurance, food commodities, direct appropriations, or other assistance. [emphasis added]
>
> Source: June 2010 Tab C Briefing Material

At the meeting, members expressed various concerns about the text and staff is not certain that the concerns were resolved. As a reminder, the purpose of the conclusive principle is to capture entities that are 'clearly' federal. Staff believes inclusion in the "President's Budget" is the clearest evidence that an entity is "federal." Absent budgetary actions – originating with the President's Budget and leading to appropriations – federal agencies would be unable to continue operations. Therefore, the most efficient means to identify "federal" agencies is through their participation in the budget process as evidenced by inclusion in the President's Budget.

The two open issues are (a) whether the standards ought to clarify that financing accounts are included in the entity even though they are not listed in the President's

Budget and (b) how to address the cases in which the President's Budget specifically mentions an entity that is not a federal entity but does receive a federal subsidy.

Issue 1a – Financing Accounts

With respect to the issue of financing accounts being included in the entity, staff believes that the issue would be resolved by the requirements of SFFAS 2, *Accounting for Direct Loans and Loan Guarantees,* and SFFAS 5, *Accounting for Liabilities of the Federal Government.* These standards require that entities account for the assets and liabilities related to loans and loan guarantees. The financing accounts hold entity borrowings to finance cash flows associated with loans and loan guarantees subject to the Federal Credit Reform Act of 1990. (See Box 1 for a discussion of such accounts.)

Some members expressed concern that the standards could be interpreted to mean that only "accounts" listed in the *Federal Programs by Agency and Account* schedule would be within the boundaries of the federal entity. The schedule (which was 529 pages long for the FY 2011 budget) presents appropriation requests by various categories within an entity. For example, some listed items are funds, others may be object classes (e.g., salaries), or programs. Pages from the schedule presenting US AID's FY2011 request are shown in Attachment 1 to provide an example of the various categories of funding listed.

Staff believes it's relevant to note the definition the Board approved for Federal Reporting Entity at the April Board meeting. The approved definition is consistent with that in SFFAC 2. It is included here for reference:

Box 1 - Small Business Administration – FY2009 Agency Financial Report (Note 1)

Budgets and Budgetary Accounting for Loan Programs

SBA's loan disbursements are financed by appropriations for long-term loan subsidy cost and borrowings from the Treasury for the remaining non-subsidized portion of the loans. The Congress may provide one year, multi-year or no year appropriations to cover the estimated long-term costs of the loan programs. The non-subsidized portion of each loan disbursement, financed initially under permanent indefinite authority to borrow funds from the Treasury, is repaid from collections of loan fees, repayments and default recoveries. The Congress limits the dollar amount of obligations that can be made for direct loans and loan guaranties in its annual appropriation bill.

A permanent indefinite authority is available to fund any reestimated increase of subsidy costs that occurs after the year in which a loan is disbursed. Reestimated reductions of subsidy costs are returned to the Treasury and are unavailable to the SBA. As required by the Federal Credit Reform Act of 1990, the SBA uses budgetary "program accounts" to account for appropriations in its credit programs and nonbudgetary "financing accounts" to account for credit program cash flow. Estimates and reestimates of credit program subsidy expenses are recorded in SBA's program accounts. Financing accounts are used to account for the Treasury borrowings and the collection of loan fees, repayments, default recoveries and disbursement of loans.

Source: SBA, FY2009 AFR, Page 28

Federal Reporting Entity The term "federal reporting entity," which refers to both the government-wide reporting entity and component reporting entities is an organization that issues a General Purpose Federal Financial Report (GPFFR) because either there is a statutory or administrative requirement to prepare the GPFFR or it chooses to prepare one. SFFAC 2 explains for the entity to be a reporting entity,[2] it would need to meet all of the following criteria:

a. There is a management responsible for controlling and deploying resources, producing outputs and outcomes, executing the budget or a portion thereof (assuming that the entity is included in the budget), and held accountable for the entity's performance.

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

c. There are likely to be users of the financial statements who are interested in and could use the information in the statements to help them make resource allocation and other decisions and hold the entity accountable for its deployment and use of resources.

Paragraphs 29-38 SFFAC 2 states that an "account" is insufficient to be an entity for GPFFR purposes. SFFAC 2 focuses on "organizations" as entities. This rationale applies regardless of whether the "accounts" are budgetary accounts, off-budget (e.g., financing) accounts, or non-budgetary accounts.

In addition to the footnote presented in at the June meeting, additional options are:

1 – remain silent and allow GAAP to govern what is included for an entity (Note: GAAP would also include the definition for federal reporting entity in this standard so GAAP is not completely silent per se when considering SFFAC 2 language that is also incorporated in the definition.)

2 – add text indicating that entity accounting is not limited to transactions in "budgetary accounts" and that the entity reporting is governed by applicable accounting principles (delete the footnote and add text as shown in the staff recommendation below)

<u>Issue 1b -- Subsidies</u>

The *Federal Programs by Agency and Account* schedule also names specific recipients of subsidies in some cases. For example, the following entities or groups of entities are named:

[2] SFFAC 2, par. 29-38, provides a discussion on Identifying the Reporting Entity for General Purpose Financial Reporting.

1. District of Columbia*
2. Howard University
3. Gallaudet University
4. National Technical Institute for the Deaf
5. American Printing House for the Blind
6. Assistance for the Independent States of the Former Soviet Union (included to show various ways federal financial assistance for outside entities may appear in the schedule)

> SFFAC 2, *Entity and Display* par. 42
>
> Appearance in the Federal budget section currently entitled "Federal Programs by Agency and Account" is a conclusive criterion. Any organization, program, or budget account, including off-budget accounts and government corporations, included in that section should be considered part of the U.S. Federal Government, as well as part of the organization with which it appears. This does not mean, however, that an appropriation that finances a subsidy to a non-Federal entity would, by itself, require the recipient to be included in the financial statements of the organization or program that expends the appropriation.

NOTE: Staff has not reviewed the entire schedule to determine how widespread this practice is. We do not believe it is widespread. In addition, staff has not assessed the above entities against the indicative criteria to confirm that they are not otherwise "federal" entities. These examples are for illustrative purposes.

* Applies to the District of Columbia for some kinds of appropriations accounts because the District is listed for more than appropriations made to the Department of the Treasury for payment to the District. For example, the appropriation for the District of Columbia Courts is not a subsidy, but is instead an appropriation directly out of the US Treasury as well as the appropriation for the District's Public Defender Service.

SFFAC 2, Entity and Display, acknowledges that the Federal Programs by Agency and Account schedule sometimes names an entity to receive a "subsidy" and states "This does not mean, however, that an appropriation that finances a subsidy to a non-Federal entity would, by itself, require the recipient to be included in the financial statements of the organization or program that expends the appropriation." Thus, "subsidy" is the term used in SFFAC 2 to distinguish such "non-federal" entities from the intended "federal" entities. Since the Board is developing standards, the view was that terms (rules) used in the document should be defined.

The Board has been considering ways to define "subsidy" and provide clarity regarding the exception. At the last meeting, FASAB general counsel noted that the challenge in defining subsidy and applying paragraph 42 of SFFAC 2 is the definition is circular. The definition asks the user to determine if an entity is "federal" or "non-federal" for purposes of determining whether it received a "subsidy" and, therefore whether it is a "federal reporting entity" or not. Therefore it requires confirmation that the entity in question is "non-federal" but appearance in the budget is the conclusive test that an entity is "federal" – placing these two conditions in conflict.

Staff believes the Board consensus is to exclude any entities that are mentioned by name in the budget but that otherwise do not share the characteristics of a federal entity.
Options for resolving this include:

1 – refine the "subsidy" text in par. 18 above to develop a definition that does not rely on a "non-federal" entity definition

2 – omit the text and develop an exclusion to be included with the other exclusions following the indicative principles

3 – add text within the conclusive principle acknowledging the issue and describe the principles under which the conclusive principle can be set aside (as shown in the staff recommendation below)

Staff Recommendation- Proposed Text for Conclusive Principle– Issue 1 (a and b)
Government-wide Reporting Entity Conclusive Principle

17. An entity listed in the *Budget of the United States Government: Analytical Perspectives- Supplemental Materials* schedule *Federal Programs by Agency and Account*[7] is within the boundaries of the government-wide reporting entity.

18. Some non-federal entities receiving federal financial assistance[8] are named in the schedule of *Federal Programs by Agency and Account*. If so, a review of the facts and circumstances in each case may result in a conclusion that the named entity is a non-federal entity receiving federal financial assistance. Such an entity would not be considered within the boundaries of the government-wide reporting entity based on the conclusive principle. Instead, the entity, like other entities the federal government has a relationship with, would be assessed against the indicative principles to determine if it is within the boundaries of the U.S. government reporting entity.

19. If an entity meets the conclusive principle, no further assessment against the indicative principles is required; it is considered within the boundaries of the government-wide reporting entity.

[7]While an organization or an account, such as a trust fund, may be identified in the schedule not all of its accounts, transactions, events, and relationships will be identified in the schedule. Once an entity is determined to be a "federal reporting entity", another account, such as a non-budgetary account, may be associated with the entity because it meets the indicative criteria or because it is used to account for an asset (or liability) of the entity under applicable principles. Ultimately, the content of an entity's financial statements is governed by applicable accounting principles and not by whether a specific item, account, transaction, event, or relationship is listed in the schedule. [Note: Slightly different language will be needed in the section addressing component entities.]
[8]As defined by the Single Audit Act Amendments of 1996, federal financial assistance which is assistance that non-Federal entities receive or administer in the form of grants, loans, loan guarantees, property, cooperative agreements, interest subsidies, insurance, food commodities, direct appropriations, or other assistance.

QUESTION for the Board-

Does the Board agree with the staff recommendation for resolving the open issues in the conclusive principle?

Issue 2: Approach for Considering the Indicative Principles for INCLUSION

As you recall, the Board discussed the Introduction to the Indicative Principles presented in the Draft ED and whether meeting one indicative principle was sufficient for inclusion in the boundary of the government-wide reporting entity or alternatively if an entity must meet all indicative principles for inclusion within the boundary of the government-wide reporting entity.

During the June discussion, the Board deliberated how this should be addressed within the Statement. The Board did not reach a decision, but instead requested staff to develop alternatives for further consideration. Staff developed the following four options for the Board's consideration:

<u>OPTION 1--Consider in the Aggregate or Collectively</u>

Staff notes several members supported an approach that would consider the indicative principles in the aggregate as it would offer most flexibility.

> <u>Government-wide Reporting Entity Indicative Principles and Criteria</u>
>
> 20. Entities not meeting the conclusive principle above may still fall within the boundaries of the government-wide reporting entity. However, additional assessment against the following indicative principles is required to ascertain if it is within the boundaries of the government-wide reporting entity:
>
> a. Established by the federal government.
>
> b. In which the federal government has a majority ownership interest.
>
> c. Over which the federal government has the ability to exercise control with expected benefits or risk of loss.
>
> 21. Each indicative principle requires criteria and guidance to assist in application. Further, determinations will require the use of professional judgment and are based on the understanding of the relationship with the entity.
>
> 22. The final assessment of whether the entity is within the boundaries of the government-wide reporting entity is made after considering the entity against all three indicative principles collectively in the aggregate.

23. Financial statement presentation and disclosure requirements are discussed under Government-wide Reporting Entity Presentation and Disclosure Requirements.

Support for this approach by members is based on the belief that all factors should be considered collectively and judgment should be used in applying the principles. Members noted that in their experience such judgment will be required. This approach is consistent with SFFAC 2, which may on the surface appear to be a goal of the Statement issued. However, staff believes the goal should be to improve upon this approach since there have been issues with the application of SFFAC 2.

For example, if this option is selected, staff believes some cases currently unresolved will continue to be debatable. Such debates are often swayed by the fact that Congress creates some entities with the intent that they operate “independently.” Staff has found that this intent often leads management to firm conclusions that an entity is “non-federal.” Under this option, no clarity is brought regarding the weight afforded an individual principle and such debates may remain open. Although it would be within a Statement, it may not be much more enforceable than what currently resides in SFFAC 2.

OPTION 2—Meeting ALL Indicative Principles

Staff notes there was indication that certain members supported meeting all indicative principles for inclusion. Based on the discussion at the June meeting, it appeared some members having this view may have shifted to consider the ‘indicative principles in the aggregate” approach, but that was not completely clear from the minutes. Therefore, to ensure all options have been considered, this option is also included.

Government-wide Reporting Entity Indicative Principles and Criteria

20. Entities not meeting the conclusive principle above may still fall within the boundaries of the government-wide reporting entity; however, additional assessment against the indicative principles is required to ascertain if it is within the boundaries of the government-wide reporting entity.

21. The government-wide reporting entity includes entities meeting **all** the following indicative principles, if applicable[3]:

a. Established by the federal government.

b. In which the federal government has a majority ownership interest.

c. Over which the federal government has the ability to exercise control with expected benefits or risk of loss.

[3] For example, there may be instances where a majority ownership may not be applicable.

22. Each indicative principle requires criteria and guidance to assist in application. Further, determinations will require the use of professional judgment and are based on the understanding of the relationship with the entity.

23. Financial statement presentation and disclosure requirements are discussed under <u>Government-wide Reporting Entity Presentation and Disclosure Requirements</u>.

This approach differs from the federal entity task force recommendation as the task force agreed meeting any one of the indicative principles would mean inclusion. (It should be noted that inclusion doesn't necessarily mean an entity is consolidated, it just means it is within the boundaries of the government-wide reporting entity.)

Staff believes this approach would lead to consequences by placing such a stringent requirement that all principles be met for inclusion. Because this is the first step in the process for being within the boundary the stringent requirement may exclude some entities from reporting entirely. For example, entities acquired by the government through economic stabilization efforts would not have been established by the government and would be outside the boundaries.

It seems an approach such as this still leads to an all or nothing conclusion—consolidation or not. It doesn't appear to provide a framework for a middle ground (such as disclosure only) because if an entity doesn't meet all the principles, it is not considered within the boundaries of the government-wide reporting entity. Meeting all the principles suggests a very strong relationship for which consolidation is appropriate.

<u>OPTION 3—Established by federal government combined with other principles</u>

Staff notes there was support by some members for an approach that would couple the first principle with either of the other two indicative principles (control or ownership.) This approach was developed because several members expressed concern whether the first indicative principle (Established by the federal government) should be a principle on its own but members believed it could be combined with the other two indicative principles.

In finalizing this option for consideration, staff made some slight revisions to the narrative so the "established by the federal government" is no longer an indicative principle and is instead included in the language that describes the entity. Staff also added "and carries out federal missions and objectives" to this paragraph (see par. 21 below) that will hopefully address a concern noted by a member.

<u>Government-wide Reporting Entity Indicative Principles and Criteria</u>

20. Entities not meeting the conclusive principle above may still fall within the boundaries of the government-wide reporting entity; however, additional assessment against the indicative principles is required to ascertain if it is within the boundaries of the government-wide reporting entity.

21. The government-wide reporting entity includes entities established by the federal government and carries out federal missions and objectives meeting either of the following:

a. In which the federal government has a majority ownership interest.

b. Over which the federal government has the ability to exercise control with expected benefits or risk of loss.

22. Each indicative principle requires criteria and guidance to assist in application. Further, determinations will require the use of professional judgment and are based on the understanding of the relationship with the entity.

23. Financial statement presentation and disclosure requirements are discussed under Government-wide Reporting Entity Presentation and Disclosure Requirements.

Support for this approach is based on the belief the principle for "established by the federal government" should be combined with one of the other two indicative principles. After further consideration, staff also believed perhaps the Board may want to consider adding the notion of carrying out federal missions and objectives to this as noted above in the language.

This option offers improvement with clear decisions regarding whether an entity is within the boundary. However, staff believes this option falls short in addressing certain situations. For example, this option would result in excluding entities:

1. either owned or controlled if they were not also established by the federal government or carrying out federal missions and objectives such as GM

2. established by the federal government but not owned or controlled (such as government-sponsored entities prior to the conservatorship)

While such entities would not necessarily meet a test for consolidation, we may wish to consider some within the boundaries of the federal entity so that disclosures or other display options might be explored.

OPTION 4—Meeting ANY Indicative Principle (with Revised Indicative Principle 1)

The task force recommended that meeting any of the indicative principles is the best test for defining the boundaries of the government-wide reporting entity. Staff revised the "established by the federal government" principle by adding "and carries out federal missions and objectives" to the principle. Staff believes it may address concerns noted by members that the principle may have been too inclusive. Staff also proposes to include exceptions/exclusion language to ensure the District of Columbia and territories are adequately addressed. Staff will work with FASAB counsel on the language in the indicative principle to ensure this is covered.

Staff believes it is important that this be included as an indicative principle to ensure all relevant types of entities, such as GSEs, FFRDCs, and others that may be part of the government-wide reporting entity are considered.

Government-wide Reporting Entity Indicative Principles and Criteria

20. Entities not meeting the conclusive principle above may still fall within the boundaries of the government-wide reporting entity; however, additional assessment against the indicative principles is required to ascertain if it is within the boundaries of the government-wide reporting entity.

21. The government-wide reporting entity includes entities meeting **any** of the following indicative principles:

a. Established by the federal government and carries out federal missions and objectives.*

b. In which the federal government has a majority ownership interest.

c. Over which the federal government has the ability to exercise control with expected benefits or risk of loss.

22. Each indicative principle requires criteria and guidance to assist in application. Further, determinations will require the use of professional judgment and are based on the understanding of the relationship with the entity.

23. Financial statement presentation and disclosure requirements are discussed under Government-wide Reporting Entity Presentation and Disclosure Requirements.

*Reminder: An explicit exception would be provided for other governments established by the federal government but which subsequently operate independently. Placement would be in the "established by the federal government" indicative principle. Staff has drafted the following wording for a footnote to be included in par. 24 of the Draft ED (Staff is still working with FASAB counsel on the final wording):

"Established by the federal government would exclude governments established by the federal government, such as geographical federal political jurisdictions (e.g., U.S. territories and other insular areas, and the District of Columbia) because they have a different status under the U.S. Constitution. For examples of different types of entities established by the federal government and how they were established, see GAO, Federally Created Entities: An Overview of Key Attributes, GAO-10-97 (Washington, D.C.: Oct. 2009)."

Staff believes this provides the most clarity for determining if an entity is within the boundary of the government wide entity by providing principles that lead to either yes you are within the boundary of the government-wide or no you are not, while still offering flexibility in determining the presentation and disclosure requirements.

The final assessment of the appropriate financial presentation and display would be made after considering the entity against all three indicative principles collectively in the aggregate, along with other criteria. For example, entities that meet only the “established by” principle may be the subject of disclosures rather than display on a statement. This assessment would be discussed under Government-wide Reporting Entity Presentation and Disclosure Requirements.

Staff recommends Option 4 as the *Approach for Considering the Indicative Principles for INCLUSION*.

QUESTION for the Board-

Does the Board agree with the staff recommendation for the approach for considering the indicative principles -- OPTION 4 Meeting ANY Indicative Principle, noted above?

Issue 3: Indicative Principles Comparison to SFFAC 2 Criteria

There was concern noted by a member that the indicative principles in the Draft ED depart from the SFFAC 2 criteria more than envisioned. Staff thought it might be useful to prepare a chart showing where the SFFAC 2 criteria fall within the three indicative principles.

This exercise is being done for informational purposes, as it was agreed at the beginning of the project that the Board may have to amend SFFAC 2 for any areas deemed necessary as a result of this project. However, staff doesn’t believe the crosswalk of the SFFAC 2 criteria to the proposed indicative principles results in inconsistencies. Staff believes the crosswalk below shows the criteria is consistent with the indicative principles. If the Board believes the chart is helpful, it could be included as a reference in the Basis for Conclusions.

As noted in SFFAC 2, the indicative principles are listed in descending order of importance—SFFAC 2 criteria # 2 directly relates to the proposed ownership principle, SFFAC 2 criteria # 3 directly relates to the proposed control principle, SFFAC 2 criteria 1 (sovereign power), 3 (carries out federal missions and objectives) & 4 (determines the outcome or disposition of matters affecting the recipients of services that the federal government provides) could be considered to be operationalized through control.

SFFAC Indicative Criteria (par. 44)	Draft ED Indicative Principle
It exercises any sovereign power of the government to carry out Federal functions. Evidence of sovereign powers are the power to collect compulsory payments, e.g., taxes, fines, or other compulsory assessments; use police powers; conduct negotiations involving the interests of the United States with other nations; or borrow funds for Government use.	CONTROL
It is owned by the Federal Government, particularly if the ownership is of the organization and not just the property. Ownership is also established by considering who is at risk if the organization fails, or identifying for whom the organization's employees work.	OWNERSHIP
It is subject to the direct or continuing administrative control of the reporting entity, as revealed by such features as (1) the ability to select or remove the governing authority or the ability to designate management, particularly if there is to be a significant continuing relationship with the governing authority or management with respect to carrying out important public functions (in contrast to selections and designations in which there is little continuing communication with, or accountability to, the appointing official); (2) authority to review and modify or approve budget requests, budgetary adjustments, or amendments or rate or fee changes; (3) ability to veto, overrule, or modify governing body decisions or otherwise significantly influence normal operations; (4) authority to sign contracts as the contracting authority; (5) approval of hiring, reassignment, and removal of key personnel; (6) title to, ability to transfer title to, and/or exercise control over facilities and property; and (7) right to require audits that do more than just support the granting of contracts. (While many of these criteria exist in a client contractor relationship, it is not necessarily intended that an entity's contractor be considered as part of the reporting entity.)	CONTROL
It carries out Federal missions and objectives.	CONTROL ESTABLISHED
It determines the outcome or disposition of matters affecting the recipients of services that the Federal Government provides.	CONTROL ESTABLISHED
It has a fiduciary relationship with a reporting entity, as indicated by such factors as the ability of a reporting entity to commit the other entity financially or control the collection and disbursement of funds; and other manifestations of financial interdependency, such as a reporting entity's responsibility for financing deficits, entitlement to surpluses (although not necessarily the assets acquired from failed units), or the guarantee of or "moral responsibility" for debt or other obligations.	SFFAS 31 ACCOUNTING FOR FIDUCIARY ACTIVITIES requires that federal entities report on their fiduciary activities.

KEY for ED Indicative Principles

1. ESTABLISHED= Established by the federal government. [NOTE: If this principle is maintained per staff recommendation in Issue 2.]

2. OWNERSHIP= In which the federal government has a majority ownership interest.

3. CONTROL= Over which the federal government has the ability to exercise control with expected benefits or risk of loss.

QUESTION for the Board-

Does the Board believe the indicative principles in the Draft ED are consistent with the criteria presented in SFFAC 2?

Issue 4: Indicative Principle—Majority Ownership (Board decided at the June Board meeting to address Minority Interest in the Proposed Statement)

Issue 4A – Scope of Guidance

At the June Board meeting, the Board discussed the indicative principle—Majority Ownership. Staff requested feedback on whether the issue of minority ownership interests (less than 50%) should be addressed within the Statement or if simply saying such interests should be accounted for in accordance with GAAP would be sufficient. Staff believed this was a relevant question because it was uncertain how broad the scope of the "entity" standard should be. The Board agreed at the June 2010 Board meeting that minority interests should be in the Statement under the majority ownership principle to address instances of less than 50% ownership.

[Excerpt from June 2010 Minutes: Mr. Dacey explained the standard ought to address it at some point. Mr. Jackson agreed the Board should have an answer. Mr. Allen agreed and said the Board would want to disclose minority interests. Mr. Steinberg stated there may be instances where the federal government owns less than 50% and something needs to be included. Mr. Granof agreed and stated the Statement should address how these are accounted for.]

Other accounting literature and other standards-setters typically require investments that are not majority (and not consolidated) to be accounted for by one of two methods—the cost method or the equity method. Staff researched other standards-setters and notes that many have separate standards on Investments, as this is a broad topic. For example, the International Public Sector Accounting Standards Board (IPSASB) covers the topic in IPSAS 7, *Investments in Associates*, and IPSAS 8, *Investment in Joint Ventures*, and briefly mentions it in IPSAS 6, *Consolidated and Separate Financial Statements*.

This demonstrates staff's first concern. That is, how much detail would the Board want to provide on such a topic in the "Entity" standard considering this topic could get complex if one chooses to get into the complexities of Investments. Therefore, staff still requests further guidance as to the level of detail the Board envisions regarding the accounting for Investments in the Entity Standard. For example, staff wonders if the standard should cover these issues covered in IPSAS 7:

1. Existence of substantial influence without at least 20% ownership
2. Absence of substantial influence with at least 20% ownership
3. Impairment losses
4. The entity ceases to have substantial influence and discontinues use of the equity method
5. The investment is intended to be disposed of within 12 months
6. Different reporting dates and significant events between reporting dates

Staff has drafted a provision that would address the most fundamental question in accounting for minority interest of 20-50% - whether to apply the equity method. However, staff is concerned that this narrow scope may be less effective than allowing the GAAP hierarchy to fill this void.

QUESTION for the Board-

Does the Board wish to provide detailed guidance on the application of the equity method in this standard?

<u>Issue 4B – Designation of the Equity Method for 20-50% Ownership Interests</u>

While practice may vary, the equity method is generally followed for investments in unconsolidated entities, joint ventures and other non-controlled entities. Under the equity method, earnings or losses are recognized in periods they are reported by the investee entity in its financial statements. The carrying amounts of an investment are adjusted to report the recognized earnings or losses in income.

The equity method may be most appropriate for investments with ownership percentages between 20-50% as it lends itself to situations where there may a degree of responsibility or ability to influence the operating or financial decisions of the investee (referred to as ‘significant influence’ by IPSASB).

Staff Recommendation for Minority Interests

Equity Method for ownership of 20-50%

Equity Method – Method of accounting whereby a reporting entity includes the aggregated net assets and net income of a separate entity on its statements of financial position and operations in lieu of consolidating line items. The equity investment is initially recorded at cost and subsequently adjusted to reflect the reporting entity’s share of the net profit or loss.

Disclosures for Minority Interests

- Name and description of the entity;
- Brief description of the relationship and pertinent facts, including percentage of ownership interest and voting;
- Condensed financial information including the assets, liabilities, equity/debt investment and other financial related exposures to potential gain and risk of loss to the federal reporting entity resulting from the ownership; and
- Other information that would provide an understanding of the possibility of potential financial reporting impact.

<u>IPSASB Definitions</u>

Cost Method -- A method of accounting for an investment, whereby the investment is recognized at cost. The investor recognizes revenue from the investment only to the extent that the investor is entitled to receive distributions from accumulated surpluses of the investee arising after the date of acquisition. Entitlements due or received in excess of such surpluses are regarded as a recovery of investment, and are recognized as a reduction of the cost of the investment.

Equity Method (relating to investments in associates)-- A method of accounting whereby the investment is initially recognized at cost, and adjusted thereafter for the post-acquisition change in the investor’s share of net assets/equity of the investee. The surplus or deficit of the investor includes the investor’s share of the surplus or deficit of the investee.

Equity Method (relating to interests in joint ventures)-- A method of accounting whereby an interest in a jointly controlled entity is initially recorded at cost, and adjusted thereafter for the post-acquisition change in the venturer’s share of net assets/equity of the jointly controlled entity. The surplus or deficit of the venturer includes the venturer’s share of the surplus or deficit of the jointly controlled entity.

Minority interest -- That portion of the surplus or deficit and net assets/equity of a controlled entity attributable to net assets/equity interests that are not owned, directly or indirectly, through controlled entities, by the controlling entity.

Staff Recommendation- Proposed Text for Majority Ownership Indicative Principle

Majority Ownership Interest

29. The federal government may acquire an ownership interest[4] in an entity. An ownership interest is a legal claim on the net residual assets of an entity or holding shares or other formal equity structure.

30. The holding of an ownership interest often entitles the holder to an equivalent percentage interest in voting rights, but not always. In the federal government there may be instances of ownership interest with voting rights or ownership interest without voting rights.

31. An ownership interest with over 50% of the votes or 50% of the net residual assets[5] of an entity is considered a majority and within the boundaries of the government-wide reporting entity.

32. An ownership interest between 20% and 50%[6] generally allows the owner to significantly influence an entity. Therefore, such entities are within the boundaries of the government-wide entity.

<u>[Staff proposes that the following be provided in the section of the Statement addressing presentation and disclosure requirements.]</u>

<u>Government-wide Reporting Entity Presentation and Disclosure Requirements</u>

Entities should apply the equity method of accounting for ownership interests between 20% and 50%. [The Equity Method of accounting includes the aggregated net assets and net income of a separate entity on its statements of financial position and operations in lieu of consolidating line items. The equity investment is initially recorded at cost and subsequently adjusted to reflect the reporting entity's share of the net profit or loss.] In addition, the following, should be disclosed:

a. Name and description of the entity;
b. Brief description of the relationship and pertinent facts, including percentage of ownership interest and voting;
c. Condensed financial information including the assets, liabilities, equity/debt investment and other financial related exposures to potential gain and risk of loss to the federal reporting entity resulting from the ownership; and
d. Other information that would provide an understanding of the possibility of potential financial reporting impact.

[4] 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, 2009.*

[5] For example, the federal government may hold more equity in preferred stock than all other stockholders but the preferred stock may be non-voting.

[6] Ownership interests less than 20% are considered relatively small and such investments should be accounted for at cost.

QUESTION for the Board-

Does the Board agree with staff recommendation and proposed language?

REMAINING ISSUES TO BE ADDRESSED—Staff is in the process of finalizing these issues, and it may appear that some have been addressed in the Draft ED. However, these areas and issues are not presented for discussion. They will be finalized for discussion at the next or future Board meetings. The entire Draft ED is presented for the Board's reference so the areas discussed may be done so in the context of the entire Draft ED.

Issue: Clarification of 3rd Indicative Principle—Control

As discussed under the Ownership principle, the Board had noted some concern with the indicative principles Ownership and Control in light of recent activities with economic stabilization. This issue was addressed by broadening the definition of "temporary" so that it included intervention activities not expected to be permanent.

Other than that particular issue, there really haven't been any major issues brought to staff's attention regarding the control principle. This particular principle is the most subjective and involves the most judgment, so naturally it would involve the most criteria for application.

Issue: Clarification of the Misleading to Exclude Principle

The Misleading to Exclude principle ensures the Statement will accommodate rare or unique situations that may not have been contemplated or that may arise in the future. Members had previously agreed this principle should be included, but perhaps should only lead to disclosures, not consolidation. It was agreed there should be some flexibility in determining the disclosure and that it should discuss the relationship and other pertinent facts.

Staff proposes the following language

<u>Government-wide Reporting Entity Misleading to Exclude Principle</u>

1. The government-wide reporting entity should also include entities not meeting the conclusive or indicative principles if the nature and significance of their

relationships with the federal government are such that the exclusion would cause the financial statements to be misleading or incomplete.

2. For example, there may be instances when an entity is not listed in the Federal Programs by Agency and Account and it may be difficult to provide sufficient evidence it meets the indicative principles yet the government-wide financial report would be misleading or incomplete if the entity were excluded.[7]

3. Disclosure requirements for entities meeting this are discussed under <u>Government-wide Reporting Entity Presentation and Disclosure Requirements.</u>

Government-wide Reporting Entity Presentation and Disclosure Requirements

4. For entities meeting the Misleading to Exclude principle, the following should be disclosed:

    a. Name and description of the entity;

    b. Nature of the federal government's relationship with the entity and if applicable, the percentage of ownership interest and voting rights or nature of control; and

    c. Other information that would provide an understanding of the possibility of potential financial reporting impact, including financial-related exposures to potential gain and risk of loss to the government-wide reporting entity resulting from the relationship.

Issue: Temporary Exclusion

The Draft contained the Exception for Temporary Conditions to reflect the fact that temporary are situations where the conditions are not likely to remain in existence permanently and provided language specific to long-term interventions and proposed disclosures for entities meeting the temporary exclusion.

Members questioned if the focus should be on demonstrating that something is temporary or demonstrating there is no plan to make it permanent. Members appeared to prefer the approach used in the examples—"Temporary control-- the federal government has no plan to continue control permanently and instead plans to relinquish or cede control; and Temporary ownership-- the federal government acquires ownership of an entity but it is held exclusively with the view of being disposed." Certain members believed the focus of the definition needed to be based on intent. However, certain members expressed concern if things are too open ended or if it is based on intent.

Members noted concern with the requirements for disclosure of a brief description of the formal plan that describes the interventions are not expected to be permanent. A member noted that often no such plan exists and that a written assertion may be more appropriate. Also, it was suggested that the description of the plan wasn't necessary since it isn't required.

[7] Although situations such as this would be considered unique or rare, this Statement provides for situations that could potentially arise.

Members also noted that the disclosures are required for each entity, and this should be revised to include aggregations by agency, condition, etc.

Planned Actions for Issue: *Staff will work towards a revised proposal for the Temporary Exception that addresses Board members concerns while finding a middle ground while considering intent. Staff will also revise the required disclosures. This may be an area where the reporting model would have relevance in perhaps some other presentation may be more appropriate over consolidation.*

Issue: Exception for Agency Mission-Related Interventions

The Draft included language for Agency Mission-Related Interventions as a separate exception to note that certain agencies do interventions as part of their mission and naturally may not require as detailed disclosures as the temporary conditions. Certain members noted this seemed very similar to the Temporary Exclusion. There was also concern regarding the title of the section as most actions are mission related. This section was drafted to address the more routine interventions such as receiverships at the FDIC and NCUA (which are different than what's described under the Temporary Exclusion because it's described as extraordinary activities that are rare, not routine or normal activities, not part of strategic planning and so forth.)

Planned Actions for Issue: *Staff will confirm this is best handled with a separate section, clarify the language in the section and determine a more appropriate title.*

Issue: Criteria for Consolidation and Alternative Reporting Requirements

The Statement first addresses which entities are within the boundaries of the federal reporting entity. Specifically when assessing the entities against the indicative principles and criteria, there may be entities that meet all three while others may only meet one or two. From this, there are many variations of how an entity may fall within the boundaries of the federal reporting entity, which ultimately would relate to how the entity is presented and disclosed.

Consolidation highlights the ultimate aggregation of entities is into the entire federal government; the independent federal entity controlling and financing its components. However, ensuring adequate disclosures for those entities that are not consolidated is equally important.

One consideration is using some sort of risk and rewards approach as a test to determine what would be consolidated for the government wide statement. However, this may not be appropriate at the component level, and perhaps an accountability test would be applicable.

The Board had agreed that consolidation is not the only option for presentation. The federal entity project was initiated to answer the question of what gets consolidated in the federal entity. However, in doing so one must also consider what type of reporting may be required for entities not consolidated. Therefore, when considering other reporting formats, there are questions that relate to the reporting model and what information is important for presentation and how tightly this needs to be integrated with the reporting model project. The Board agreed the two different projects that can continue simultaneously.

The Board also discussed whether alternative display options (discrete presentation) could be considered or if this was considered outside of the scope of the entity project and belonged in the reporting model project. The Board member responses did not give staff a clear direction in this area. Two members were very clear in not wanting to explore other options and believed

Note Disclosure would be appropriate for entities not consolidated. Four members appeared comfortable with exploring other options for presentation. Three members suggested that there were advantages to considering other options but it should be done in the Reporting Model project.

Staff believes it was important to confirm the Board's view because many of the other issue areas to be addressed involve determining options for disclosures or other alternatives and specifically an area where the reporting model would have relevance in perhaps some other presentation may be more appropriate over consolidation.

<u>Planned Actions for Issue:</u> Staff will coordinate with the Reporting Model project in all areas. However, the federal entity project will be completed much earlier. Unless otherwise directed, staff will bring all presentation alternatives for consideration and allow the Board to determine if it is outside the scope. Staff will work with the task force to develop criteria for determining when entities meeting indicative principles are consolidated and disclosures for entities that are not consolidated.

Issue: Flowchart

A Flowchart *Determining the Boundaries of the Federal Reporting Entity and Display* was included with the proposal because the task force thought it would be a useful Appendix to the Statement. The Flowchart will have to be updated to reflect the final Statement.

<u>Planned Actions for Issue:</u> Staff will revise the flowchart for consideration with the Exposure Draft.

Issue: Related Parties

The Board agreed Related Parties should be addressed after completing the Draft Statement (either within this statement or a separate statement on Related Parties.)

<u>Planned Actions for Issue:</u> The Related Party issue will be researched and explored further once the draft is near completion.

Issue: Amendments to SFFAC 2

Once the Draft Statement is near completion, a detailed review of SFFAC 2 must be done to determine if any areas should be amended or rescinded.

Possible Amendment to SFFAS 6 reversionary interest FFRDC

Issue: What about the Federal Reserve?

It was agreed that as part of the federal entity project, the Federal Reserve exclusion from consolidation in the financial statements of the U.S. government would be reconsidered. Par. 47 of SFFAC 2, *Entity and Display* specifically provides the exclusion as follows:

> In establishing and monitoring monetary policy, the Federal Reserve System, i.e., the Board of Governors of the Federal Reserve System and the Federal Reserve Banks, could be considered as functioning consistent with the indicative criteria presented in paragraph 44. However, in the

> United States, the organization and functions pertaining to monetary policy are traditionally separated from and independent of the other central government organizations and functions in order to achieve more effective monetary and fiscal policies and economic results. Therefore, the Federal Reserve System would not be considered part of the government-wide reporting entity. Payments made to or collections received from the Federal Reserve System would be reported in the financial statements of the Federal Government. Certain other disclosures might also be appropriate in the financial statement for the entire government.

<u>Planned Actions for Issue:</u> Federal Entity Task Force will develop a recommendation for the Board. The Task Force will first focus on the entity issue as this is the first question and display should not bias the decision on entity. The Task Force will consider the Federal Reserve as a whole, the Board of Governors, and the Federal Reserve Banks against the conclusive principle, the indicative principles, and misleading to exclude framework and then provide a final conclusion/recommendation with justification on whether each potential unit is part of the federal reporting entity. This may be an area where the reporting model would have relevance in perhaps some other presentation may be more appropriate over consolidation.

Issue: Intelligence Community Entities

Issue: General Fund

Issue: Other categories/ relationships to address at end of project?

Issue: Consideration of Unintended Consequences

Members agreed that most of the principles and related criteria in the proposal sound appropriate, but there was concern whether it would result in unintended consequences or changes. Members suggested a separate study to determine what changes may result.

<u>Planned Actions for Issue:</u> Staff will perform test cases either prior to, and perhaps some in conjunction with the exposure draft. Staff will consider the best timing and method to incorporate testing.

Issue3: Project Scope Expanded to Include Consolidation Issues Related to Entities with a Different Source of GAAP and Different Year Ends

Board confirmed during June 2010 meeting these areas would be addressed in the Statement.

ISSUE: LOOK at Par. 33 in conjunction w/component entity reporting & put this entire section as an appendix to proposed Statement

SFFAC 2 also provides the following discussion on identifying reporting entities, which staff referenced in the definition of federal reporting entity:

> ***Identifying the Reporting Entity for General Purpose Financial Reporting***
>
> 29. 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.

- 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.

30. Budget accounts, in and of themselves, do not meet the criteria in the preceding paragraph and, therefore, would not be considered a reporting entity for the purposes of issuing general purpose financial statements. Also, the size and scope of the budget accounts across all government agencies lack sufficient consistency for them to be universally considered as the reporting entity. Similarly, programs generally do not meet the criteria in paragraph 29 and, therefore, would not be a considered a reporting entity that prepares general purpose financial statements.

31. On the other hand, organizations, and particularly larger organizations, meet the criteria in paragraph 29. While the occasional overlap of programs and budget accounts among more than one organizational unit could complicate financial reporting, the association of data with the responsibility centers, revenue centers, profit centers, cost centers, etc. which managers typically use for organizing and operating permit the following:

- aggregating information for not only the organization (and suborganizations), but also for one or more of the programs performed by the organization, and one or more of the budget accounts for which the organization is responsible, and
- the subsequent arraying of the information not only by organization, but also by sub-organization, program, and/or budget accounts.

32. This approach to defining the appropriate reporting entities in the Federal Government supports establishment of accountability in the organizations (and suborganizations) while still enabling them to provide information pertaining to their programs.

33. Although a reporting entity might not control all the budget accounts used to finance one or more of the programs it administers, any revenues attributable to or costs incurred on behalf of the programs it administers should be associated with that reporting entity. This notion holds true regardless of whether the reporting entity maintains personnel on a payroll.

34. The departments and major independent agencies are organizational units and therefore would be the primary reporting entities. However, in many instances, financial statements that present aggregations of information into suborganization entities, i.e., bureaus, administrations, or agencies, may be more useful than statements that present only aggregations into organizational entities. The former can provide a better understanding of the financial results and status of the many individual suborganizations and programs constituting a department or major independent agency. They can reveal instances where programs are carried out by several suborganizations within the department or major independent agency.

35. Similar to other budget accounts, trust funds, special funds, and revolving funds are usually administered by a single organization. For financial reporting purposes, the organization would be the reporting entity; the trust fund or revolving fund would be a component of the organization that administers the fund in the same manner that a suborganization or other type of budget account is a component of the organization. This would not preclude separate reporting for the trust fund, special fund, or revolving fund by the managing organization, nor would it preclude disclosure of trust fund, special fund, or revolving fund information within the organization's report when there is sufficient interest.[8]

[8] For some trust funds, the collection of the revenues is performed by an organizational entity acting in a custodial capacity that differs from the organizational entity that administers the trust fund. In those instances, the organizational entity that collects the revenues would be responsible for reporting only the collection and subsequent disposition of the funds. The organizational entity responsible for carrying out the program(s) financed by a trust fund, or in the case of multiple responsible entities, the entity with the preponderance of fund activity, will report all assets, liabilities, revenues, and expense of the fund, notwithstanding the fact that another entity has custodial responsibility for the assets.

36. Likewise, some programs are coterminous, i.e., share the same boundaries, with an organization or sub-organization, while other programs—such as student loan programs—are the component for which resources are deployed, are responsible for achieving objectives, and/or are of great interest to outsiders. In both instances, the financial operations and results of the program might warrant highlighting or even separate reporting by the organization or suborganization which manages the program.

37. Financial statements for organizationally-based reporting entities may be audited and issued to external parties, unaudited and used for internal management purposes, or, perhaps to be more relevant and meaningful, combined with financial statements from other organizationally-based reporting entities.

38. The ultimate aggregation of entities is into the entire Federal Government which, in reality, is the only independent economic entity—although some would say the entire country is the ultimate economic entity. The Federal Government entity would encompass all of the resources and responsibilities existing within the component entities, whether they are part of the Executive, Legislative, or Judicial branches (although, as noted in paragraph 5, FASAB's recommendations pertain only to the Executive Branch). The aggregation would include organizations for which the Federal Government is financially accountable as well as other organizations for which the nature and significance of their relationship with the government (see paragraphs 39 through 50) are such that their exclusion would cause the Federal Government's financial statements to be misleading or incomplete.

Federal Accounting Standards Advisory Board

Government-wide Reporting Entity and Component Reporting Entities

Statement of Federal Financial Accounting Standards

Exposure Draft

Written comments are requested by Date 90 days after issuance

Month Date, Year

Working Draft – Comments are Not Requested on This Draft

Proposed Standards

Scope

7. This Statement applies to federal entities that prepare general purpose federal financial reports (GPFFR) in conformance with Statement of Federal Financial Accounting Standards (SFFAS) 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*.

8. This Statement does not specify which federal entities are reporting entities or require that any such entity must prepare and issue GPFFR. The purpose of this Statement is to enable entities preparing and issuing GPFFR to identify the boundaries of their reporting entity.

Definitions

9. Definitions in paragraphs 10 through 13 are presented first in the proposed Statement because of their importance in understanding the Statement. Other terms shown in boldface type the first time they appear in this document are presented in the Glossary at Appendix C. Users of this document may want to examine all definitions before reviewing the Statement and Basis for Conclusions.

10. **Federal Reporting Entity** The term "federal reporting entity," which refers to both the government-wide reporting entity and component reporting entities is an organization that issues a General Purpose Federal Financial Report (GPFFR) because either there is a statutory or administrative requirement to prepare the GPFFR or it chooses to prepare one. SFFAC 2 explains for the entity to be a reporting entity,[4] it would need to meet all of the following criteria:

    a. There is a management responsible for controlling and deploying resources, producing outputs and outcomes, executing the budget or a portion thereof (assuming that the entity is included in the budget), and held accountable for the entity's performance.

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

[4] SFFAC 2, par. 29-38, provides a discussion on Identifying the Reporting Entity for General Purpose Financial Reporting.

c. There are likely to be users of the financial statements who are interested in and could use the information in the statements to help them make resource allocation and other decisions and hold the entity accountable for its deployment and use of resources.

11. **Government-wide Reporting Entity** The government-wide reporting entity includes all entities existing within the federal government, which include all component reporting entities within the executive, legislative, and judicial branches as well as other entities assessed to be included based on the principles and criteria established in this Statement.

12. **Component Reporting Entity** Component reporting entity is used broadly to refer to a federal reporting entity within a larger federal reporting entity[5] that issues GPFFR. Examples of component reporting entities include entities that are part of the federal government, such as executive departments, independent agencies, and government corporations. Component reporting entities would also include sub-components (entities that are part of a larger component reporting entity[6]) that prepare GPFFR. One example is a bureau of a larger department that prepares stand alone financial reports. Other examples include commercial functions, revolving funds, and/or other accounts for which GPFFR are prepared.

13. **Special Purpose Reports** Special purpose reports are any special purpose financial (and other, such as a compliance) report outside GPFFRs and outside the scope of FASAB. Entities preparing these types of reports are not necessarily reporting entities for purposes of this Statement.

Principles Defining the Boundaries of the Government-wide Reporting Entity

14. Clearly defining the boundary of the government-wide reporting entity ensures that the financial reports contain all the information essential for fair presentation of the financial position and results of operations.

15. Determining whether an entity is within the boundary of the government-wide reporting entity involves assessing organizations against the principles below. An entity must first be assessed against the conclusive principle to determine if it is within the boundaries. Entities not meeting the conclusive principle are assessed against the indicative principles to determine if they are within the

[5] The larger federal reporting entity could be the government-wide reporting entity or another component reporting entity.

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

boundaries of the government-wide reporting entity. Lastly, entities not meeting the indicative principles should be assessed against the misleading to exclude principle. See the Flowchart at Appendix X.

16. After defining the entities within the boundaries of the government-wide reporting entity, additional analysis is required to determine which entities should be consolidated and which require alternative display presentations or disclosures as discussed under Government-wide Reporting Entity Presentation and Disclosure Requirements.

Government-wide Reporting Entity Conclusive Principle

17. An entity listed in the *Budget of the United States Government: Analytical Perspectives- Supplemental Materials* schedule *Federal Programs by Agency and Account*[7] is within the boundaries of the government-wide reporting entity.

18. Some non-federal entities receiving federal financial assistance[8] are named in the schedule of *Federal Programs by Agency and Account*. If so, a review of the facts and circumstances in each case may result in a conclusion that the named entity is a non-federal entity receiving federal financial assistance. Such an entity would not be considered within the boundaries of the government-wide reporting entity based on the conclusive principle. Instead, the entity, like other entities the federal government has a relationship with, would be assessed against the indicative principles to determine if it is within the boundaries of the U.S. government reporting entity.

19. If an entity meets the conclusive principle, no further assessment against the indicative principles is required; it is considered within the boundaries of the government-wide reporting entity.

[7] While an organization or an account, such as a trust fund, may be identified in the schedule not all of its accounts, transactions, events, and relationships will be identified in the schedule. Once an entity is determined to be a “federal reporting entity”, another account, such as a non-budgetary account, may be associated with the entity because it meets the indicative criteria or because it is used to account for an asset (or liability) of the entity under applicable principles. Ultimately, the content of an entity’s financial statements is governed by applicable accounting principles and not by whether a specific item, account, transaction, event, or relationship is listed in the schedule. [Note: Slightly different language will be needed in the section addressing component entities.]

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

Government-wide Reporting Entity Indicative Principles

20. Entities not meeting the conclusive principle above may still fall within the boundaries of the government-wide reporting entity; however, additional assessment against the indicative principles is required to ascertain if it is within the boundaries of the government-wide reporting entity.

21. The government-wide reporting entity includes entities meeting **any** of the following indicative principles:

    a. Established by the federal government and carries out federal missions and objectives.

    b. In which the federal government has a majority ownership interest.

    c. Over which the federal government has the ability to exercise control with expected benefits or risk of loss.

22. Each indicative principle requires criteria and guidance to assist in application. Further, determinations will require the use of professional judgment and are based on the understanding of the relationship with the entity.

23. Financial presentation and display and disclosure requirements are discussed under Government-wide Reporting Entity Presentation and Disclosure Requirements.

Established by the Federal Government and Carries out Federal Missions and Objectives

24. The government-wide reporting entity includes entities established by the federal government and carrying out federal missions and objectives. The phrase "established by the federal government" means that an entity takes its existence or is formed through the operation of federal statute or regulation or by some person or organization either required or authorized by federal statute or regulation to establish the entity.[9] This includes the act of incorporation or other official filing or notice that an entity is established.

[9] Established by the federal government would exclude governments established by the federal government, such as geographical federal political jurisdictions (e.g., U.S. territories and other insular areas, and the District of Columbia) because they have a different status under the U.S. Constitution. For examples of different types of entities established by the federal government and how they were

25. Such entities may take many forms, including administrations, agencies, banks, boards, commissions, corporations, departments, foundations, and institutions and may be given any combination of powers and privileges of the federal government. It also includes entities such as government-sponsored enterprises and federally funded research and development centers (FFRDCs).[10]

26. From among all entities established by the federal government, the government-wide reporting entity in particular includes all the entities existing as a matter of law within the federal government, which comprises three branches: the legislative (Congress and its support entities); the executive (the President and executive entities); and the judicial (the Supreme Court and inferior courts established by law).

27. Federal statutes or regulations that establish (or require or authorize the establishment of) an entity within a branch (or within another entity) of the federal government often clearly state so.[11] On the other hand, federal statutes or regulations may state that an entity established by the federal government is "private" or that it is "not an agency or instrumentality of the United States Government."[12] However, in other cases, the applicable federal statutes or regulations may not be as clear, requiring additional analysis. Federal statutes or regulations may omit any express statement about the location of the entity as either within or outside the federal government.

28. While all entities established by the federal government are within the boundaries of the government-wide reporting entity, those entities that exist as a matter of law within the federal government would have a closer

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established, see GAO, Federally Created Entities: An Overview of Key Attributes, GAO-10-97 (Washington, D.C.: Oct. 2009).

[10] Such entities would not include those whose existence preceded federal recognition, such as many federally chartered corporations that received a congressional charter under Title 36 of the U.S. Code because many of these organizations were incorporated under state law before receiving their congressional charter (e.g., the Boy Scouts of America). For examples of different types of entities established by the federal government and how they were established, see GAO, Federally Created Entities: An Overview of Key Attributes, GAO-10-97 (Washington, D.C.: Oct. 2009).

[11] For example, for the executive branch, the U.S. Department of Defense is created by statute as "an executive department of the United States," 10 U.S.C. § 111, and the United States Postal Service is "an independent establishment of the executive branch of the Government of the United States," 39 U.S.C. § 201.

[12] Congress defines what constitutes an agency or instrumentality of the federal government for purposes of a particular statute or set of statutes that assigns duties, liabilities, and administrative requirements and grants privileges of the federal government to individual entities or types of entities. Even in cases where Congress defines an entity as "not an agency or instrumentality" of the federal government for a statute or set of statutes, the entity may be considered to be part of the federal government for certain purposes and should be assessed against the indicative principles.

relationship. The nature of this relationship is relevant in assessing the presentation of the entity in the GPFFR of the government-wide reporting entity, as detailed under Government-wide Reporting Entity Presentation and Disclosure Requirements.

Majority Ownership Interest

29. The federal government may acquire an ownership interest[13] in an entity. An ownership interest is a legal claim on the net residual assets of an entity or holding shares or other formal equity structure.

30. The holding of an ownership interest often entitles the holder to an equivalent percentage interest in voting rights, but not always. In the federal government there may be instances of ownership interest with voting rights or ownership interest without voting rights.

31. An ownership interest with over 50% of the votes or 50% of the net residual assets[14] of an entity is considered a majority and within the boundaries of the government-wide reporting entity.

32. An ownership interest between 20% and 50%[15] generally allows the owner to significantly influence an entity. Therefore, such entities are within the boundaries of the government-wide entity

> [Staff proposes that the following be provided in the section of the Statement addressing presentation and disclosure requirements.]
>
> Government-wide Reporting Entity Presentation and Disclosure Requirements
>
> Entities should apply the equity method of accounting for ownership interests between 20% and 50%. [The Equity Method of accounting includes the aggregated net assets and net income of a separate entity on its statements of financial position and operations in lieu of consolidating line items. The equity investment is initially recorded at cost and subsequently adjusted to reflect the reporting entity's share of the net profit or loss.] In addition, the following, should be disclosed:

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[13] 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, 2009.*
[14] For example, the federal government may hold more equity in preferred stock than all other stockholders but the preferred stock may be non-voting.
[15] Ownership interests less than 20% are considered relatively small and such investments should be accounted for at cost.

a. Name and description of the entity;

b. Brief description of the relationship and pertinent facts, including percentage of ownership interest and voting;

c. Condensed financial information including the assets, liabilities, equity/debt investment and other financial related exposures to potential gain and risk of loss to the federal reporting entity resulting from the ownership; and

d. Other information that would provide an understanding of the possibility of potential financial reporting impact.

Control with Expected Benefits (or Risk of Loss)

33. For purposes of defining the boundaries of the federal reporting entities for financial reporting, control is defined as follows: **Control** is the power to govern the financial and/or operating policies of another entity with expected benefits (or the risk of loss)[16] to the federal reporting entity. Entities controlled by the federal government are considered within the boundaries of the government-wide reporting entity.

34. Control for these purposes refers to the ability to control and should be assessed at the reporting date regardless of the federal government's ability to change it in the future. In determining if control exists, it is necessary to determine the substance of the relationship between the federal government and the entity as it may not be completely reflected by their legal form.

35. Control does not necessarily mean the federal government has responsibility for the management of the day-to-day operations of an entity. It is the federal government's authority to determine the policies governing those activities that indicates control.

36. Determining whether control exists requires the application of professional judgment. The federal government achieves its objectives through a wide range of entities which individually will fall somewhere along a continuum. At one end of the continuum, it will be clear that an entity does not have the power to act independently and is controlled by the federal reporting entity. At the other end, the entity will have the power to act independently and, while the federal government may have a level of influence on the entity, it will be clear that it does not have control. Along the continuum, consideration

[16] The expected benefit or risk of loss may be financial or non-financial. For example, a non-financial benefit would be the federal government benefits from a service being provided on its behalf.

needs to be given to the nature of the relationship between the federal government and the entity in order to determine whether control exists.

Indicators of Control

37. There are certain indicators of control that should be considered in determining whether the federal government controls an entity. These indicators provide strong evidence of control, however; the absence of one of these specific indicators does not lead to a presumption that control is not present.

38. There are certain indicators[17] that provide more persuasive evidence of control. Control generally exists when the federal government has the authority to:

    a. Unilaterally appoint or remove a majority of the governing board members of another entity;

    b. Govern or direct the governing body on the financial and operating policies of the entity;

    c. Access entity's assets or direct the ongoing use of those assets, or has ongoing responsibility for losses; or

    d. Unilaterally dissolve the entity thereby having access to the assets and responsibility for the obligations.

39. Other indicators, when considered in the aggregate, provide evidence that control exists when the federal government has the power to:

    a. Provide significant input into the appointment of members of the governing body of the entity or being involved in the appointment or removal of a significant number of members;

    b. Establish or amend the entity's fundamental purpose and mission, which may include requiring the entity to carry out federal missions and objectives;

    c. Appoint or remove key executives or personnel;

    d. Approve the budgets or business plans for the entity;

[17] The indicators noted in par. 38 and 39 provide support for both the power and/or benefit part of the control definition. When assessing control for financial reporting purposes, a federal reporting entity should meet both the power and benefit elements for determining whether control exists.

e. Veto, overrule, or modify governing board decisions or otherwise significantly influence normal operations;

f. Establish, rescind, or amend management policies;

g. Establish limits or restrictions on borrowing and investments of the entity; or

h. Restrict the capacity to generate revenue of the entity, especially the sources of revenue.

Situations Where Control Does Not Exist

40. Because of the uniqueness of the federal government, it is important to distinguish what does not constitute control. Specifically, control would not be inferred from:

a. The authority to exercise regulatory powers over an entity;

b. Constitutional responsibility for a particular matter related to the entity's mission or operations; or

c. Economic dependency on the federal government in relation to the entity.

41. The federal government has the power to regulate many entities by use of its sovereign and legislative powers. For example, the federal government has the power to regulate the behavior of entities by imposing conditions or sanctions on their operations. However, the governing bodies of the regulated entities make decisions within the regulatory framework. Regulatory powers do not constitute control for purposes of this Statement because the federal government's interest in these entities extends only to the regulatory aspects of the operations.

42. Control does not stem simply from the federal government's constitutional responsibility for a certain activity. When the federal government has constitutional responsibility for a certain activity, it does not mean the federal government controls all the entities performing such activities. The nature of the relationship between the federal government and the entity performing the activity is the determining factor.

43. Certain entities may be economically dependent on the federal government but ultimately retain discretion as to whether it will accept funding or do business with the federal government. For example, many not-for-profits rely

on the federal government funding but that does not mean they are controlled by the federal government. Although the federal government may be able to influence the entity which is dependent on its funding or business through purchase power, the federal government does not govern the entity's financial and operating policies.

44. In addition, the federal government may take temporary control which would not meet the indicative principle, see section <u>Exception—Temporary Conditions of Indicative Principles</u>

<u>Government-wide Reporting Entity Misleading to Exclude Principle</u>

45. The government-wide reporting entity should also include entities not meeting the conclusive or indicative principles if the nature and significance of their relationships with the federal government are such that the exclusion would cause the financial statements to be misleading or incomplete.

46. For example, there may be instances when an entity is not listed in the Federal Programs by Agency and Account and it may be difficult to provide sufficient evidence it meets the indicative principles yet the government-wide financial report would be misleading or incomplete if the entity were excluded.[18]

47. Disclosure requirements for entities meeting this are discussed under <u>Government-wide Reporting Entity Presentation and Disclosure Requirements.</u>

Government-wide Reporting Entity Presentation and Disclosure Requirements

48. Consolidation aggregates the individual financial statements of entities comprising a reporting entity. Consolidation is a method of accounting that combines the accounts of those entities line by line on a uniform basis of accounting and eliminates balances and transactions among the entities. For selected financial statements such as the statement of budgetary resources, a combined financial statement which does not eliminate balances and transactions among the entities is acceptable.

[18] Although situations such as this would be considered unique or rare, this Statement provides for situations that could potentially arise.

49. The principles and related criteria described above provide guidance on determining the boundaries of the government-wide reporting entity. An assessment must be made to determine which of those entities should be consolidated and what disclosures or alternative presentations are necessary for those not consolidated.

50. An entity meeting the conclusive principle is consolidated in the government-wide reporting entity. With the exception of TBD JOINTLY FUNDED MUSEUMS, PERFORMING ARTS?

51. As the indicative principles require professional judgment in assessing, the same applies for determining when entities meeting certain indicative principles should be consolidated. This Statement allows for judgment by the preparer to determining if consolidation would provide the most meaningful presentation or if an alternative would best provide full disclosure.

52. Meeting one of the indicative principles alone would not necessarily lead to consolidation in the federal reporting entity. When assessing the entities against the criteria, there may be entities that meet all three of the indicative principles while others may only meet one or two. From this, there are many variations of how an entity may fall within the boundaries of the federal reporting entity, which ultimately relate to how the entity is presented and disclosed.

53. Risks and Rewards approach in assessing for consolidation

54. In making this assessment, materiality of the entity and the relationship with the federal government should be considered. Materiality includes both quantitative and qualitative factors.

55. This Statement provides guidance on how entities meeting the indicative principles may be reported. However, as noted above professional judgment by the preparer should be a determining factor in the assessment

    a. An entity meeting all three Indicative principles, if applicable[19], should be consolidated in the government-wide reporting entity.

    b. An entity meeting

    c. An entity meeting

    d. An entity meeting

[19] In some situations, the principle of majority ownership may not apply for particular entities.

56. Indicative 1--Is there some way to group established entities by degree of relationship?

57. Indicative 2—Majority ownership

58. Indicative 3--Control

59. For entities meeting the Misleading to Exclude principle, the following should be disclosed:

    a. Name and description of the entity;

    b. Nature of the federal government's relationship with the entity and if applicable, the percentage of ownership interest and voting rights; and

    c. Other information that would provide an understanding of the possibility of potential financial reporting impact, including financial-related exposures to potential gain and risk of loss to the government-wide reporting entity resulting from the relationship.

Exceptions and Unique Relationships

<u>Exception--Temporary Conditions of Indicative Principles</u>

60. Temporary conditions are not expected to be permanent. Although there is no specific time limit, the federal government's intention is not to make the conditions permanent.

61. Example of temporary conditions are:

    a. Temporary control-- the federal government has no plan to continue control of an entity permanently and instead plans to relinquish or cede control; and

    b. Temporary ownership--the federal government acquires ownership of an entity but it is held exclusively with the view of being disposed.

62. Typically the federal government intervention actions in these instances are not routine activities. For example, strategic planning documents are unlikely to include objectives to routinely initiate such interventions and the actions are not necessarily taken to further established government policies.

63. The federal government's 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. Circumstances may arise that necessitate the federal government intervention to be longer than would normally be anticipated, but considering the conditions are not expected to be permanent, it meets the temporary exclusion.

64. Temporary situations that exist at fiscal year-end[20] must be assessed to confirm they are in fact temporary conditions and not expected to be permanent. If deemed temporary or not permanent, the entity should be excluded from consolidation. However, certain disclosures would be appropriate as described below.

65. Entities where the conditions are deemed temporary should not be consolidated in the government-wide reporting entity. Disclosures for temporary situations should include the following for each significant[21] entity:

    a. Name and description of the entity;

    b. Nature of the federal government's relationship with the entity and if applicable, the percentage of ownership interest and voting rights;

    c. Primary reasons for the temporary situation or intervention and intended timeframes;

    d. Brief description of the exit strategy[22] or other information that describes the federal government's intervention is not expected to be permanent; and

    e. Other information that would provide an understanding of the possibility of potential financial reporting impact, including financial-related exposures to potential gain and risk of loss to the government-wide reporting entity resulting from the temporary situation.

<u>Exception-- Receiverships</u>

[20] Temporary situations may last several reporting periods. In such situations, the federal reporting entity should confirm such conditions are not likely to remain in existence permanently as of each reporting period.
[21] Determining significant entities should be based on both quantitative and qualitative materiality considerations. Information about other entities not deemed material, may be aggregated by intervention.
[22] The brief narrative may include options being considered, plans for ending the intervention, information regarding the length of such arrangement or plans to change terms of such arrangement.

66. There are certain federal entities whose mission may include taking control or ownership of an entity with no goal to maintain control or ownership. For example, certain federally-created entities may act as a receiver to liquidate failing financial institutions or as a conservator to guide such institutions back to safe and sound conditions.[23]

67. The entities related to these types of mission-related activities would be excluded from consolidation. However, this exemption is due to the activities being part of the normal activities and mission of the federal reporting entity (not because of the temporary exclusion) and disclosures would be appropriate.[24]

68. Disclosures should include the following:

    a. Nature and description of the federal reporting entity's relationship with the entities.

    b. Other information that would provide an understanding of the possibility of potential financial reporting impact, including financial-related exposures to potential gain and risk of loss to the federal reporting entity resulting from the relationship.

    c. Other information about the entities may be voluntarily disclosed if deemed necessary or included as RSI or Other Accompanying Information (OAI).

<u>Jointly Funded Museums and Performing Arts Organizations and Universities</u>

69. Jointly Funded Museums and Performing Arts Organizations and Universities are dependent upon or supported by contributions or charity, although they may receive some funding from the federal government.

70. The federal government's relationship is on-going and often includes various degrees of control, yet the organizations are reliant upon donations and support with the understanding it will be used for the designated purposes (and not for general federal government operations). This unique relationship is based upon public trust that reinforces the need for the federal government to be accountable to the public for its stewardship of donated funds.

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

71. If the federal government provides 80% or more of the total funding, the entity should be consolidated in the government-wide reporting entity.

72. If the federal government provides less than 80% of the total funding, the entity should not be consolidated in the government-wide reporting entity. Instead the government-wide reporting entity should disclose the:

    a. name, purpose, and description of the entity;

    b. nature of the federal government's relationship with the entity and the amount of funding or subsidy provided to the entity, and if applicable, the percentage of ownership interest and voting;

    c. condensed financial information for the entity, e.g. assets, liabilities, fund balances, total expenditures and sources of revenues.

    d. other information that would provide an understanding of the possibility of potential financial reporting impact, including financial-related exposures to potential gain and risk of loss to the government-wide reporting entity.

73. Joint Ventures?

74. Other Rships? GSEs? FFRDC?

Principles Defining the Boundaries of Component Reporting Entities

<u>Component Reporting Entity Indicative Principles and Criteria</u>

75.

76.

77.

78.

Related Parties
Related parties are entities with whom the federal government has a relationship, but is not [within the boundaries of the federal reporting entity] or [consolidated in the federal reporting entity.]
To Be Completed

Effect on Existing Concepts

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

Effective Date

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

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