FASAB

Federal Accounting Standards Advisory Board

February 10, 2011

Memorandum

To: Members of the Board

From: Melissa L. Loughan, Assistant Director

Wendy M. Payne

Through: Wendy M. Payne, Executive Director

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

MEETING OBJECTIVES

- To approve the distinction between core (or general) government entity and discrete accountable entity

The primary objective for the February Board meeting is to determine if the Board approves the distinction between core (general) government entity and discrete accountable entity. The exposure draft includes a description of the two types of entities, including a discussion of the attributes of each. This distinction is based on the degree to which the entity receives direct taxpayer support, is governed by elected officials, imposes or may impose risks and rewards on the taxpayer, and/or provides core federal government goods and services. This distinction is also important because it assists in making decisions about presentation of financial information.

BRIEFING MATERIAL

- ***Staff Issue Paper (beginning at page 3 of this memo)***
- ***Attachment 1—Draft Exposure Draft***
- ***Attachment 2—Flowchart***

[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.

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BACKGROUND

As you may recall at the December 2010 meeting, the Board approved staff's revised approach to the proposed standard. The Board also agreed with the "narrow" related party reporting, most of the entities would be considered part of the Federal entity as either part of the core or as one of several defined exceptions, with few considered a related party. The Board agreed with maintaining flexibility in the disclosures but there should also be factors provided to bring clarity to the proposal. The Board also agreed with maintaining the Misleading to Exclude Principle.

For the February meeting the Board requested staff to define and add a description of the different organizations to the beginning of the proposed exposed draft. Staff was also tasked with developing attributes and criteria for each.

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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

For the February meeting the Board requested staff to avoid reference to entities as those consolidated and those excluded from consolidation. Instead, as reported in the minutes, the Board suggested the following:

- Narrative and definitions describing the categories and relationships of the following: core or primary government, accountable or affiliated entities and related parties;
- Consider the factors in the nature and extent of the disclosures for each of the relationships (there needs to be flexibility, but there should be some factors to help guide preparers to bring clarity to the proposal);
- Flow of the related party discussion.

In general, the Board preferred that the standards establish a broad principle regarding what entities represented core government entities and non-core entities. In this draft, staff has included narrative describing the categories as core government, discrete accountable entities, and related parties. The flow of the standards has also been revised. Staff believes input from the Board on this structure is needed before developing a draft including factors guiding disclosure for various categories.

The attached draft ED builds upon some of the notions of SFFAC 2 (see par. 13-15) by establishing the organizational approach to defining reporting entities.

As set forth in the ED--differences in purposes and governance structures require differences in presentation of financial information. Decisions about federal financial reports for an entity are taken in two steps – first, determining what organizations are to be included in the reports and second, identifying the means to present relevant information about organizations.

To assist in making decisions about such presentations, a distinction is made between core (or general) government entities and discrete accountable entities. This distinction is based on the degree to which the entity receives direct taxpayer support, is governed by elected officials, imposes or may impose risks and rewards on the taxpayer, and/or provides core federal government goods and services.

<u>Core (or general) government entities</u>

- Generally provide goods and services on a non-market basis, redistribute income and wealth, and are financed through taxes and other non-exchange revenues.
- Receive taxpayer support
- Accountability rests with elected officials
- Substantially all the risks and rewards fall to the taxpayer.

- Their governance structure is vertically integrated as evidenced by the establishment of organizational authorities and budgets by elected officials, and the appointment of organizational leaders through the political process.

Discrete accountable entities

- May provide core federal government goods and services but are more likely to provide goods and services on a market basis.
- Receive limited or no taxpayer support.
- Accountability rests with elected officials but elected officials have less direct involvement in decision making than is true in core government entities.
- Limited risks and rewards fall to the taxpayers.
- In some cases, the relationship with the federal government is not expected to be permanent.

In addition to organizations for which elected officials are accountable, the federal government may be able to exercise significant influence over certain entities. Such parties are referred to as "related parties." Related parties *may* provide core federal government services but are more likely to provide market based services. Related Parties do not receive taxpayer support directly but may engage in transactions with the federal government. Accountability does not rest with elected officials. Risks and rewards do not explicitly fall to the taxpayer.

See par. 16- 24 of the ED for a full discussion.

Staff would also like to point out the revised name for the principles—Inclusion Principles. As noted in par. 18 of the ED, decisions about federal financial reports for an entity are taken in two steps – first, determining what organizations are to be included in the reports and second, identifying the means to present relevant information about organizations. Thus, inclusion principles appear to be more characteristic of what the principles are and staff believes this correlates with the flexibility as intended by the Statement and is consistent with the Board's request regarding the term consolidation.

As detailed in par. 43 of the ED, the final determination of the presentation of financial information through consolidation or disclosure is based upon the result of two assessments—first if the organization is included and second, if those included organizations are classified as core government or discrete accountable entities. Staff developed a high level flow chart of this process.

See the Flowchart at Attachment 2.

The flowchart is included to assist with Board member's review. If members find it helpful, it could be incorporated as an Attachment to the ED and referenced in par. 43

where it discusses the assessments to determine the presentation of financial information.

The chart below may look familiar; a slightly different version was presented at the December meeting. Board members noted concern with the terms “Consolidated Entities” and “Exceptions.” Now, consistent with what is presented in the statement, it has core government entities and discrete (accountable) entities. The Statement still provides flexibility for the discrete, but will provide guidance or additional factors (forthcoming staff is working in this area) to assist preparers.

Organizations Addressed in the Government-wide Report

<table>
<tr><th colspan="5">Organizations Included in the Report for Accountability Purposes</th><td rowspan="3">Related Party Disclosures
(significant influence)

Accountability does not rest with elected officials

Risks and rewards do not explicitly fall to the taxpayer

Do not receive taxpayer support directly but may engage in transactions with the federal government</td></tr>
<tr><td rowspan="2">Core (or general) government

Taxpayer support

Accountability rests with elected officials

Core goods and services on a non-market basis

Risks and rewards fall to the taxpayer</td><td colspan="4">Discrete Accountable Entities

Limited or no taxpayer support
Accountability but less direct involvement
More likely to provide market based goods and services
Limited risks and rewards fall to the taxpayers
Relationships not expected to be permanent</td></tr>
<tr><td>INTERVENTIONS

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.</td><td>CONSERVATOR / RECEIVORSHIP 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</td><td>QUASI-GOVT FINANCIAL INDEPEND.

Governance differences lead to greater independence Financial differences lead to greater fiscal autonomy</td><td>JOINTLY FUNDED MUSEUMS & OTHERS

dependent upon or supported by contributions or charity, although they may receive some funding from the federal government</td></tr>
</table>

QUESTION: Does the Board approve the distinction between core (or general) government entity and discrete accountable entity?

NOTE: Staff welcomes Board member comments on other sections of the ED.

Introduction

Purpose

1. The federal government's relationships with other entities have become increasingly complex. To meet federal financial reporting objectives, it is important to develop principles that can be used to identify organizations that must be included in the financial reports of the government-wide reporting entity and each component reporting entity. Elected officials are accountable for their public policy decisions. Public policy decisions can be carried out in a variety of ways and involve increasingly complex organizations and relationships.

2. Notwithstanding these complexities, general purpose federal financial reports for the government-wide reporting entity should be broad enough to report the elected officials' accountability for those organizations. In addition, component reporting entity reports should allow elected officials to hold management accountable for implementation of public policy decisions. Although Statement of Federal Financial Accounting Concepts (SFFAC) 2, *Entity and Display*, addresses identifying reporting entities and criteria for including components in a reporting entity, questions have continued in this area that resulted in the need for a standard.[1]

3. This Statement provides principles to guide preparers of general purpose federal financial reports[2] (GPFFR) in determining what organizations are required to be included in a federal reporting entity and what information should be presented. This will ensure that users of GPFFR are provided with complete financial information about federal reporting entities and their involvements so that federal financial reporting objectives are met.

Materiality

4. The provisions of this Statement need not be applied to immaterial items. The determination of whether an item is material depends on the degree to which omitting or misstating information about the item makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or the misstatement.

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[1] SFFAC 2 is a Concepts Statement and is considered Other Accounting Literature in the hierarchy of generally accepted accounting principles (GAAP) and therefore it is level d in the GAAP hierarchy.

[2] The term general purpose financial report is used throughout this Statement as a generic term to refer to the report that contains the entity's financial statements that are prepared pursuant to generally accepted accounting principles. In the federal government, the report for the U.S. government reporting entity is known as the Financial Report of the U.S. Government and for component reporting entities it usually called the Performance and Accountability Report or the Agency Financial Report.

Effective Date

5. The proposed standards are effective for periods beginning after September 30, 20XX. Earlier implementation is encouraged.

Proposed Standards

Scope

6. 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*.

7. This Statement does not require any entity to prepare and issue GPFFR. The purpose of this Statement is to enable entities preparing and issuing GPFFR to determine what organizations should be included in the federal reporting entity. The Statement also provides principles on determining what organizations should be included in government-wide report and into each component reporting entity's financial statement. The Statement also provides information about and required disclosures for related parties.

Definitions

8. Definitions in paragraphs 9 through 12 are presented first 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.

9. **Reporting Entity** The term "reporting entity" refers to both the government-wide reporting entity and component reporting entities that issue a General Purpose Federal Financial Report (GPFFR) because either there is a statutory or administrative requirement to prepare the GPFFR or they choose to prepare one. SFFAC 2 explains for the entity to be a reporting entity,[3] 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.

[3] SFFAC 2, par. 29-37, provides a discussion on Identifying the Reporting Entity for General Purpose Financial Reporting.

10. **<u>Government-wide Reporting Entity</u>** The government-wide reporting entity includes all entities existing within the federal government, which includes all component reporting entities within the executive, legislative, and judicial branches as well as other organizations for which elected officials are accountable based on principles established in this Statement.

11. **<u>Component Reporting Entity</u>** Component reporting entity is used broadly to refer to a reporting entity within a larger reporting entity[4] that issues GPFFR. Examples of component reporting entities include entities such as executive departments, legislative agencies, federal courts, independent agencies, and government corporations. Component reporting entities would also include sub-components (entities that are part of a larger component reporting entity[5]) 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.

12. **<u>Control with expected benefits or risk of loss</u>** Control with expected benefits or risk of loss is the power to govern the financial and/or operating policies of another organization with expected benefits or the risk of loss[6] to the federal reporting entity.

Organizational Approach to Defining Reporting Entities

13. The federal government is an extremely complex organization responsible for the common defense and general welfare of the Nation. Although there are other perspectives,[7] such as a budget perspective, in understanding the composition of the federal government, an organizationally based approach appears most appropriate in defining reporting entities for GPFFRs.

14. An organizationally based approach in defining reporting entities provides accountability because there is a management responsible for controlling and deploying resources to produce outputs and outcomes. Focusing on organizations helps to identify who is accountable. Each organization operates under an established governance structure intended to meet an established public policy objective.

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

[5] 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.

[6] 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.

[7] SFFAC 2, par. 13-28 discusses the budget and program perspective of the federal government, as well as the intertwining of the perspectives.

15. The governance structures allow for varying degrees of autonomy in relation to elected and appointed officials. In addition, the scope with an organizational approach would provide meaningful financial statements and there would likely be users of them.

Organizations – Purposes and Governance

16. The federal government is unique because its constitutionally established powers, motivations, and functions are different than other organizations. To be fully accountable to citizens, the federal government must report on organizations that serve varied purposes and have complex governance structures and finances. Differences in purposes and governance structures require differences in presentation of financial information.

17. Accountability demands comprehensive reporting; however, certain organizational distinctions must be maintained for financial reports to meet budgetary integrity, operating performance, and stewardship reporting objectives established in SFFAC 1. For example, elected officials may allow an organization greater financial autonomy and/or shield the citizenry from bearing the full cost of an organization fulfilling a public policy objective. In such cases, discrete rather than consolidated financial information for the organization would better meet these objectives.

18. Thus, decisions about federal financial reports for an entity are taken in two steps – first, determining what organizations are to be included in the reports and second, identifying the means to present relevant information about organizations. To assist in making decisions about such presentations, a distinction will be made between core (or general) government entities and discrete accountable entities. This distinction is based on the degree to which the entity receives direct taxpayer support, is governed by elected officials, imposes or may impose risks and rewards on the taxpayer, and/or provides core federal government goods and services.

19. Core (or general) government entities generally provide goods and services on a non-market basis, redistribute income and wealth, and are financed through taxes and other non-exchange revenues. Their governance structure is vertically integrated as evidenced by the establishment of organizational authorities and budgets by elected officials, and the appointment of organizational leaders through the political process. Ultimately, core government entities receive taxpayer support to deliver goods and services on a non-market basis. Accountability rests with elected officials and substantially all the risks and rewards fall to the taxpayer.

20. Federal officials may rely on organizations that have a greater degree of autonomy than core government entities to fulfill public policy objectives. Such entities may maintain a separate legal identity, have a governance

structure that vests greater decision making authorities in a governing body to insulate the entity from political influence, and/or allow for relative financial independence.

21. Maintaining a distinction between the finances of such entities and core government entities will more effectively meet federal financial reporting objectives. Such a distinction would allow core government entity financial statements to reveal the costs to taxpayers as well as how such entities have impacted the net position of the core government. However, federal financial reporting objectives can not be met without further information regarding such entities. Therefore, these entities are included for accountability purposes but are considered "discrete accountable entities."

22. Discrete accountable entities may provide core federal government goods and services but are more likely to provide goods and services on a market basis. Discrete accountable entities receive limited or no taxpayer support. Accountability rests with elected officials but elected officials have less direct involvement in decision making than is true in core government entities. Limited risks and rewards fall to the taxpayers. In some cases, the relationship with the federal government is not expected to be permanent.

23. In addition to organizations for which elected officials are accountable, the federal government may be able to exercise significant influence over certain entities. Such parties are referred to as "related parties." Related parties *may* provide core federal government services but are more likely to provide market based services. Related Parties do not receive taxpayer support directly but may engage in transactions with the federal government. Accountability does not rest with elected officials. Risks and rewards do not explicitly fall to the taxpayer. See Related Party discussion beginning at par. 70 for definition, disclosures and additional information.

24. The following paragraphs set forth principles for inclusion of an organization in Government-wide federal financial reports.

Principles for Inclusion in the Government-wide Report

25. Clearly defining which entities should be include in 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. To determine which organizations should be included[8] in the government-wide report, the Statement provides three principles for inclusion in the GPFFR.

[8] Included means consolidated or disclosed. Disclosures may include presentation of summary financial information.

26. An organization meeting any of the three principles below is included in the government-wide GPFFR:

    a. In the Budget;

    b. Majority Ownership Interest; and

    c. Control with expected benefits or risk of loss.

In the Budget

27. An entity listed in the *Budget of the United States Government: Analytical Perspectives- Supplemental Materials* schedule *Federal Programs by Agency and Account* should be included in the government-wide reporting entity.

28. Some non-federal organizations receiving federal financial assistance[9] are named in the schedule of Federal Programs by Agency and Account. A review of the facts and circumstances in each case may suggest that the named organizations receives federal financial assistance but is not an organization for which elected officials should be held accountable. If so, it should not be included the government-wide reporting entity based solely on being in the budget. Instead, the entity should be assessed against the next two principles (*Ownership* and *Control*) to determine if it should be included in the government-wide reporting entity for the purpose of meeting accountability goals.

29. While the principle In the Budget is the most efficient means[10] to identify organizations for inclusion, there may be other organizations that should be included in the government-wide reporting entity and there are additional principles to be considered when entities are not in the Budget.

Majority Ownership Interest

30. The federal government may acquire an ownership interest[11] 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.

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[9] 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.

[10] For example, inclusion in the President's Budget is the clearest evidence an entity is federal because absent budgetary actions originating with the President's Budget and leading to appropriations, federal agencies would be unable to continue operations.

[11] 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, 2010.*

31. 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.

32. Majority ownership interest exists with over 50% of the votes or the net residual assets[12] of an entity. When the federal government holds a majority ownership in an entity it should be included in the government-wide reporting entity.[13]

Control with Expected Benefits or Risk of Loss

33. An entity that is controlled by the federal government should be included in the government-wide reporting entity. For these purposes, it is defined as follows:

    Control with expected benefits or risk of loss is the power to govern the financial and/or operating policies of another entity with expected benefits or the risk of loss[14] to the federal reporting entity. <u>Both</u> the power and either the expected benefit or risk of loss aspects of the definition should be met to justify inclusion of an entity.

34. Control 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 the legal form of the relationship.

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 government. At the other end, the entity will have the power to act independently and, while

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[12] For example, the federal government may hold more equity in preferred stock than all other stockholders but the preferred stock may be non-voting.
[13] Ownership interests 50% or less should be accounted for in accordance with the appropriate accounting standards per the GAAP hierarchy.
[14] 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.

the federal government may have a level of influence, it will be clear that it does not have control.

Indicators of Control

37. As discussed in the following paragraphs, there are indicators that should be considered in determining whether the federal government controls an entity. As noted above, much judgment and consideration needs to be given to the nature of the relationship between the federal government and the entity in order to determine whether control exists.

38. Certain indicators[15] provide persuasive evidence that control exists. These indicators provide strong evidence of control, however; the absence of one or more of these specific indicators does not lead to a presumption that control is not present. These indicators are 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. Unilaterally dissolve the entity thereby having access to the assets and responsibility for the obligations; or

    d. Establish or amend the entity's fundamental purpose and mission, which may include authorizing the entity to exercise sovereign power of the federal government and requiring the entity to carry out federal missions and objectives.

39. Other indicators provide evidence that control exists, but must be considered in the aggregate and often require the application of professional judgment in assessing. These indicators are when the federal government has the ability 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. Access entity's assets or direct the ongoing use of those assets, or has ongoing responsibility for losses;

    c. Appoint or remove key executives or personnel;

[15] The indicators noted in par. 38 and 39 provide support for both the power and/or benefit part of the control definition. As noted in par. 33 a federal reporting entity should meet both the power and benefit elements for determining whether control exists.

d. Approve the budgets or business plans for the entity and right to require audits;

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

f. Finance the deficits of and provide financial support to or settle liabilities;

g. Direct the entity to work with the government to achieve services to taxpayers which may include determining the outcome or disposition of matters affecting the recipients of services that the federal government provides;

h. Establish, rescind, or amend management policies;

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

j. 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, control would not be inferred from:

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

b. Economic dependency of the entity on the federal government.

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. Certain entities may be economically dependent on the federal government but ultimately retain discretion as to whether to accept funding or do business with the federal government. For example, many not-for-profits rely on federal government funding but that does not mean they are controlled by the federal government. Although the federal government may be able to influence entities dependent on federal funding or business through purchasing power, the federal government does not govern their financial and operating policies.

Government-wide Reporting Entity Consolidation and Disclosure

43. The principles above were used to assess what organizations to include in reports. Another assessment must be made to classify those included organizations as core government or discrete accountable entities. The result of these two assessments considered together will help determine the presentation of financial information.

44. This step is critical and can be challenging for entities that may possess mixed characteristics. In these complex organizational structures there may be shades of gray, where professional judgment must be relied upon to determine the most meaningful and fair financial presentation.

45. Core government entities receive taxpayer support to deliver core federal goods and services on a non-market basis. Accountability rests with elected officials and substantially all the risks and rewards fall to the taxpayer. Entities listed in the budget (as described at Par. 27-29) are presumed to qualify as core government entities while greater judgment will be needed to classify other entities.

46. The Statement provides for consolidation[16] of core government entities to facilitate an assessment of the financial position of the federal government and the cost of operations financed by taxpayers. Consolidation aggregates the individual financial statements of entities comprising a reporting entity and results in presentation of information for a single economic entity representing core taxpayer supported activities, resources, and obligations where accountability rests with elected officials.

47. For those organizations not classified as core government entities, the Statement provides for flexibility and allows judgment by the preparer to determine whether consolidation or disclosure would provide the most meaningful presentation for discrete accountable entities that meet the government-wide principles for inclusion. Discrete accountable entities receive limited or no taxpayer support. Accountability rests with elected officials but elected officials have less direct involvement in decision making than is true in core government entities. Limited risks and rewards fall to the taxpayers. In some cases, the relationship with the federal government is not expected to be permanent. Discrete accountable entities may provide core federal government goods and services but are more likely to provide market based good and services. While these entities and their relationship with the federal government must be addressed in order for the GPFFR to be complete and fully accountable the proposed standard provides flexibility

[16] 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.

and allows judgment by the preparer to determine whether consolidation or disclosure would provide the most meaningful presentation.[17]

48. Full consolidation of discrete accountable entities may not meet the basic qualitative characteristics of information in financial reports. Along with judgment, the standard provides factors and other considerations that are discussed below. (ADDITIONAL GUIDANCE AND FACTORS FORTHCOMING IN THIS AREA.)

49. Amounts for non-consolidated discrete (accountable) entities must be disclosed so that readers can assess risks and rewards and other information as needed separate from the core government entities. Disclosure of summary financial statements or information that would provide an understanding of the potential financial reporting impact, including financial-related exposures to potential gain and risk of loss to the government-wide reporting entity, is required.

50. This Statement provides guidance for the following discrete (accountable) entities category types: federal governmental intervention actions, receiverships and conservatorships, and quasi governmental financially independent entities. (ADDITIONAL GUIDANCE AND FACTORS FORTHCOMING IN THIS AREA.)

51. Although entities in these types of relationships are not consolidated, the core government entity transactions with the non-consolidated entities are still accounted for based on the GAAP standards and reflected in the financial statements of the consolidated core government entity.

Federal Government Intervention Actions

52. The federal government with its broad responsibility may often intervene for the well being of the country, but those actions are not expected to be permanent. The federal government's intervention in exceptional circumstances, such as an economic crisis situation or military occupation is not intended to be permanent.

53. Although there is no specific time limit, the federal government's intention is not to make such interventions permanent. Typically federal government intervention actions in these instances are not routine activities and strategic planning documents are unlikely to include objectives to routinely initiate such interventions.

[17] For example there may be certain instances when consolidation may undermine the ability to provide the most meaningful presentation because it may obscure results and make it difficult to separate the activities or certain entities and activities.

54. Examples of intervention actions are:

    a. Temporary control-- the federal government seizes control of an established entity but expects to relinquish or cede control.

    b. Temporary ownership--the federal government acquires an ownership interest of an entity but expects to end its interests as soon as practicable.

55. Temporary situations that exist at fiscal year-end must be assessed to confirm they are not expected to be permanent.

56. Entities where the federal government has intervened should be excluded from consolidation. Disclosures should include the following for each significant[18] entity: (ADDITIONAL GUIDANCE AND FACTORS FORTHCOMING IN THIS AREA.)

    a. Name and description of the entity;

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

    c. Primary reasons for and description of the intervention actions, brief description of any exit strategy[19] or other information relating the intervention is not expected to be permanent and timeframes; and

    d. Present Summary Financial Statements or Information that would provide an understanding of the 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.[20]

<u>Receiverships and Conservatorships</u>

57. There are certain federal entities whose mission may include taking control or ownership of failed financial institutions such as banks with no goal to maintain control or ownership. For example, certain federally-created

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[18] 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.

[19] 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.

[20] The determination as to whether summary financial statements or other information is disclosed is made by the preparer based on materiality and significance of the federal government intervention actions.

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.[21]

58. The entities related to these types of activities should be excluded from consolidation.[22] Disclosures should include the following: (ADDITIONAL GUIDANCE AND FACTORS FORTHCOMING IN THIS AREA.)

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

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

Quasi Governmental Financially Independent Entities[23]

59. Quasi Governmental Financially Independent Entities are hybrid entities where accountability and transparency of these unique organizations are important yet they differ in key areas that would make information less meaningful and results obscure if consolidated.

60. These entities differ when assessing the governance and financial (risk and rewards) areas. Although the entities receive limited or no taxpayer support, limited risks or rewards fall to the taxpayers yet accountability rests with federal or elected officials.

61. Governance differences lead to greater independence. Characteristics may include the following:

a. Longer appointments, not dominated by elected officials.

b. Delegated operational authority to carry on a business in a manner similar to private business enterprises.

c. May posses private sector legal characteristics or be voluntarily affiliated with purposes to implement government policies.

[21] 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."

[22] This exception differs slightly from the federal interventions because receivership activities are considered part of the normal activities and mission of the federal reporting entities that perform them and the duration is typically shorter. The disclosures required are consistent with existing practices.

[23] Quasi Governmental Financially Independent Entities is used to describe the entities, none of the terms should be viewed exclusively, for example Congress establishes independent agencies (such as NASA) that are simply not under an established department.

62. Financial differences lead to greater fiscal autonomy. Characteristics may include the following:

    a. Primary funding is derived from a source other than through appropriations.

    b. Delegated financial authority to carry on business in a manner similar to private business enterprises.

    c. Sells goods and/or services to individuals outside of the government reporting entity as its principal activity.

    d. Intended to, in the normal course of its operations, maintain its operations and meet its liabilities from revenues received from sources outside of the government reporting entity.

63. Quasi Governmental Financially Independent Entities should be excluded from consolidation in the government-wide reporting entity. Disclosures should include the following for each significant[24] entity: (ADDITIONAL GUIDANCE AND FACTORS FORTHCOMING IN THIS AREA.)

    a. Name and description of the entity;

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

    c. Present Summary Financial Statements or Information that would provide an understanding of the 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.[25]

64. This Statement allows for judgment and the preparer to determine the most meaningful presentation (i.e. consolidation or disclosure.)

Museums and Performing Arts Organizations and Universities

65. 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.

66. The federal government's relationship is on-going and often includes various degrees of control, yet the organizations are reliant upon donations

[24] Determining significant entities should be based on both quantitative and qualitative materiality considerations. Information about other entities not deemed material, may be aggregated.

[25] The determination as to whether summary financial statements or other information is disclosed is made by the preparer based on materiality and significance of the Quasi Governmental Financially Independent Entity.

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 as stewards of the donated funds.

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

68. 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 following should be disclosed:

    a. Name 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; and

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

Misleading to Exclude Principle

69. There may be instances when an entity does not meet the inclusion principles in this standard (ie. It is not included in the Federal Programs by Agency and Account and it may be difficult to provide sufficient evidence it meets the control principle) yet the government-wide financial report would be misleading or incomplete if the entity were excluded.[26] For entities meeting the Misleading to Exclude principle, the following should be disclosed:

    a. Name and description of the entity; and

    b. Information that would provide an understanding of the 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.

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

Related Party Government-wide Reporting Entity

70. In addition to organizations for which elected officials are accountable, the federal government may be able to exercise significant influence over certain entities. Such parties are referred to as “related parties.” Related parties *may* provide core federal government services but are more likely to provide market based services. Related parties do not receive taxpayer support directly but may engage in transactions with the federal government. Accountability for the operating performance and financial position of related parties does not rest with elected officials. However, certain information regarding related party relationships may be necessary for accountability purposes. Such information enables users to better understand the financial statements of the government-wide reporting entity because:

    (a) Related party relationships might expose the federal government to risks or provide opportunities that would not have existed in the absence of the relationship;

    (b) Related party relationships can influence the way in which the federal government operates with other entities in achieving its individual objectives; and

    (c) Related parties may enter into transactions that unrelated parties would not enter into, or may agree to transactions on different terms and conditions than those that would normally be available to unrelated parties.

71. **Related Party** parties are considered to be related if the entity was established[27] by the federal government, or if the entity can be significantly influenced in making financial and operating decisions, or if the federal government has an ownership interest[28] but the entity was not included in the government-wide reporting entity.

72. **Significant influence** is the power to participate in the financial and operating policy decisions of an entity, but not control those policies. Significant influence may also be gained by an ownership interest.

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[27] Established by the federal government would exclude geographical political jurisdictions established by the federal government, (e.g., U.S. territories and insular areas, and the District of Columbia) because they have a different status under the U.S. Constitution. It also 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).

[28] Included means consolidated or disclosed. Disclosures may include alternate presentations of summary financial information.

73. Although related party relationships exist among the component entities of the federal government, component entities are subject to the overall direction and operate together to achieve the policies of the federal government and are not subject to the related party disclosure requirements. The government-wide reporting entity is presented on a consolidated basis and the transactions are eliminated to accurately reflect the distinctive nature of the federal government and provide information useful to and understood by the citizens, their elected representatives, federal executives, and program managers.[29] However, a component entity should be disclosed as a related party if deemed material when significant transactions are not arms length transactions or when the preparer deems disclosure necessary.

Related Party Disclosures for Government-wide Reporting Entity

74. For any Related Party, 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, if the entity was being influenced and/or the percentage of ownership interest and voting rights; and

c. Other information that would provide an understanding of the 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.

Part II of Proposed Standard

<u>Component Reporting Entities</u>

Effect on Existing Concepts

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

[29] Par, 21 of SFFAC 1, *Objectives of Federal Financial Reporting* states that "federal financial reporting helps to fulfill the government's duty to manage programs economically, efficiently, and effectively and to be publicly accountable."

Effective Date

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

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

HIGH LEVEL FLOW CHART