



**June 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 E-Standards**<sup>1</sup>

#### **MEETING OBJECTIVES**

- To review options for related party and consider issues regarding consolidation of different fiscal year ends and consolidation of FASB based information for core entities and disclosure of information relating to non-core entities.

The primary objective for the June Board meeting is to review options and approve the staff proposed language for the related party section of the federal entity exposure draft. In addition, staff will present options for consideration related to the consolidation of FASB based information and disclosure of information relation to non-core entities for the Board's approval. Specific questions related to these objectives are included on page 4 and 5 of the Staff memo. Additional objectives (time permitting) include obtaining the Board's feedback on the following:

- Revised Flowchart
- Comments on other sections of the ED.

#### **BRIEFING MATERIAL**

- ***Staff Issue Paper (beginning at page 3 of this memo)***
- ***Attachment 2— Related Party Issue Paper***
- ***Attachment 3— Consolidation Issues Paper***
- ***Attachment 4— Flowchart***
- ***Attachment 5— Draft Exposure Draft***

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<sup>1</sup> 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.

## **BACKGROUND**

As you may recall at the April 2011 meeting, the Board agreed with the staff's proposed disclosures for non-core entities. The Board also approved staff's proposed factors to assist in determining information that should be disclosed for non-core entities. The Board also approved staff's general framework for the Illustrative Guide.

The Board requested staff to develop a revised related party section and the Board would consider it in its entirety along with pertinent background information. The Board also requested staff to perform outreach to the audit community on some of the audit implications and concerns identified regarding entities with different year ends and different basis of accounting. Staff also agreed to work on other changes discussed and begin working on the Illustrative Guide.

## **NEXT STEPS**

After receiving the Board's feedback, staff will assess the open issues on the government-wide section of the ED. Staff is also in the process of working on the basis for conclusions but it has been a moving document and changing along with the direction and various versions of the ED.

Staff is aware of the need to address the Federal Reserve, amendments to SFFAC 2 and also the issue Chairman Allen brought up regarding the possibility of a note listing the non-core entities. After completing the government-wide section, staff will concentrate on the component reporting entity section of the ED. Depending on the results of this meeting, staff may have items in this area for the next meeting.

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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](mailto:loughanm@fasab.gov).

## **Attachment 1--Staff Paper- Federal Entity June 2011 Board Meeting**

### **Related Party Issue**

At the April Board meeting, it was agreed that staff would develop a revised related party section of the draft standard and the Board would consider it in its entirety at the June meeting. (The Related Party Issue Paper is included as **Attachment 2** in the Binder Materials.) The Board requested staff address issues because (1) the guidance might pull government contractors and others that may be economically dependent upon the government and (2) the “established by the federal government” criteria may be too broad.

In the binder materials, staff provided a background of the work in this area and existing guidance in the area as well as brief consideration of other standard setters. For purposes of comparison, staff noted the objectives – in brief – of the existing standards in other domains. The text of GASB, IPSASB, and FASB standards are included as an attachment to the related party paper.

The Staff Analysis section of the Related Party paper begins on page 7 of the memo. Staff’s analysis considered intra-governmental relationships among component reporting entities as well as relationships with outside entities. 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 should not be subject to the related party disclosure requirements.

The analysis discusses that when considering the universe of entities the federal government may have relationships with and who may exercise significant influence, there are infinite possibilities and countless types of entities and possible relationships that would have to be considered. It also notes the objective of relationships that the federal government enters into and the resulting transactions and thereby the need or purposes for related party reporting may be different than those in the private sector.

The analysis explains the federal government is not routinely or typically the party at an advantage in the relationship or transaction with others. Nor is the entire effect of the relationship or transaction easily expressed in financial terms. The purpose of most of these relationships is for the good of the nation or to fulfill public policy goals and society needs.

Therefore, the staff recommendation—considering the federal government’s role and its potential ‘related party relationships’ would be an infinite number of related parties reported—is to place parameters on what needs to be reported. The analysis

explains without parameters the cost of meeting this type of requirement and related disclosure would be high; the benefit of including an infinite amount of information would be lost because users would be overwhelmed.

Staff also included some views about related party reporting at the component entity reporting level and wanted to obtain the Board's tentative thoughts. Staff recognizes the Board has not deliberated on the principles for the component reporting entity as of yet.

The specific staff questions for the Board are included on page 13 of the Related Party Issue Paper:

#### **QUESTIONS:**

- 1. Does the Board agree with the Staff Recommendation for Related Party?**
  - 2. Does the Board agree with the proposed language for the ED?**
  - 3. What are the Board's tentative thoughts for Related Party Reporting at the Component Reporting Entity level? Should the objectives, definition and such be the same as the government-wide?**
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#### **Consolidation Issues**

At the April Meeting, the Board requested staff to consider issues regarding consolidation of different fiscal year ends and consolidation of FASB based information for core entities and disclosure of information relating to non-core entities. (The Consolidation Issue Paper is included as **Attachment 3** in the Binder Materials.) Specifically, the Board requested staff to perform additional research and outreach to the audit community and the federal entity task force as necessary on the audit responsibility for condensed information; especially for non-core entities on different basis of accounting or core entities with different year ends.

Therefore, staff provided a summary of the issue to the Financial Statement Audit Network, the Federal Entity Task Force and to several Independent Public Accounting audits partners and requested feedback. Although the outreach was sent to many, our response was very low and mostly through informal means. Staff summarized the comments for analysis and the Board's consideration.

After considering the comments, staff considered other standard setters and provided an analysis in the Consolidation Issues paper. Specifically, staff considered FASB and GASB guidance in this area and noted where similarities could be drawn. Staff also determined what procedures Treasury was currently

performing to address the issues. The issues, analysis and staff recommendations are divided into three areas in the Consolidation Issue paper:

Issue #1 Core Entities--Consolidation of Different Fiscal Year Ends

The staff analysis of this issue, along with the staff recommendation and proposed language is presented on pages 5-6 of Attachment 3.

**QUESTION:**

**4. Does the Board agree with the staff recommendation to require a common reporting period?**

Issue # 2 Core Entities--Consolidation of FASB Based Information

The staff analysis of this issue, along with the staff recommendation and proposed language is presented on pages 6-13 of Attachment 3.

**QUESTION:**

**5. Does the Board agree with the staff recommendation to require:**  
**a. material differences be adjusted before consolidation,**  
**b. disclosure of reliance on reconciliations between FASB and FASAB amounts where material at the CFR level, and**  
**c. component entities to disclose a reconciliation of FASB and FASAB based amounts?**

Issue # 3 Non-Core Entities— Non-core Disclosures, especially those that may relate to different year ends and the auditor's responsibility for information that is disclosed by entities audited by others

The staff analysis of this issue, along with the staff recommendation and proposed language is presented on pages 14-15 of Attachment 3.

**QUESTION:**

**6. Does the Board agree with the staff recommendation to:**  
**a. permit non-core entity disclosures to be on any GAAP basis,**  
**b. allow information for a year ended during the reporting period to be disclosed, and**  
**c. require disclosure of any significant changes in information since the non-core entities year end?**

Another issue related to the option to refer to non-core entities financial statements in the Government-wide disclosure is presented on page 15-16 of Attachment 3.

**QUESTION:**

**7. Does the Board agree with the staff recommendation to not provide an option to refer readers to non-core entity statements for more information? (Or alternatively, does the Board believe there should be an option for reference to a non-core entity financial statement for disclosures?)**

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The updated ED and flowchart is also included in the Binder materials. Staff welcomes comments on those as well. Time permitting; the Board may discuss those at the meeting.

## **Related Party Issue Paper**

At the April Board meeting, it was agreed that staff would develop a revised related party section of the draft standard and the Board would consider it in its entirety at the June meeting. The Board requested staff address issues because (1) the guidance might pull government contractors and others that may be economically dependent upon the government and (2) the “established by the federal government” criteria may be too broad. The Board suggested staff present background information, including FASB and GASB requirements and a summary of the issues at the June meeting. In resolving the related party issues, staff believes it is important to determine the objectives of related party disclosures at the government-wide and the component entity reporting levels. For purposes of comparison, staff noted the objectives – in brief – of the existing standards in other domains.

### **Background and Existing Guidance**

As you may recall, FASAB completed the American Institute of Certified Public Accountants (AICPA) Omnibus project to adopt certain accounting and financial reporting guidance that resided in the AICPA statements on auditing standards (SAS). The Board decided to continue research on related parties as part of the Entity project and noted this in the basis for conclusion of SFFAS 39, *Subsequent Events: Codification of Accounting and Financial Reporting Standards Contained in the AICPA Statements on Auditing Standards*.

(Excerpt from basis for conclusion)

## Related Parties

A8. AU Section 334, *Related Parties*, attributes the requirement for related party disclosures to the Financial Accounting Standards Board's (FASB) Accounting Standards Codification (ASC) 850 (Statement of Financial Accounting Standards 57), *Related Party Disclosures*, and provides indicators of related party transactions. The FASAB determined that the related party guidance was not readily adaptable to the federal government and discussed the applicability of related FASAB projects and current federal financial reporting practices to the issue of related party transactions.

A9. The FASAB has an on-going Federal Entity project that is intended to define and characterize federal reporting entities and to establish criteria for including various organizational units in a reporting entity. Also, the project will involve research on the various types of relationships that the federal government has established to carry out its public policy functions. The FASAB believes that it would be premature to incorporate the related party guidance before it completes its Federal Entity project. Consequently, the FASAB decided to conduct research on related parties as part of the Federal Entity project and use the research results to develop related party guidance applicable to the federal government environment.

A10. In addition, the FASAB noted that federal agencies typically purchase goods and services from other federal agencies or organizational units within the same agency and the FASAB has provided guidance to assist in reporting this activity. The guidance includes, but is not limited to:

- a. SFFAS 4, *Managerial Cost Accounting Standards and Concepts*;
- b. SFFAS 5, *Accounting for Liabilities of the Federal Government*;
- c. SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*; and
- d. SFFAS 30, *Inter-Entity Cost Implementation: Amending SFFAS 4, Managerial Cost Accounting Standards and Concepts*.

A11. The FASAB expects that this statement will not alter current reporting practices. However, some are concerned that reporting practices may change if the auditing guidance changes before the Federal Entity project is completed. If so, the FASAB would issue a Technical Bulletin to assist the federal financial reporting community.

For example, SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*, as amended, discusses inter-entity revenue and requires disclosure of the nature of intra-governmental exchange transactions in which an entity provides goods or services at a price less than full cost or does not charge a price at all.

In addition, Office of Management and Budget (OMB) Circular A-136 requires entities to report intragovernmental assets separately from those with non-federal entities and to disclose intragovernmental costs and revenue separately from costs and revenue with the public.

Beyond this, presently federal agencies are required to look to the GAAP hierarchy for guidance. Related party guidance most often cited has been the Financial Accounting Standards (FASB) 57, *Related Parties Disclosures* (FASB ASC 850).

## Consideration of Other Standard Setters

Staff considered Related Party standards of other standard setters. The text of GASB, IPSASB, and FASB standards are included at Attachment 1 to this paper and selected excerpts presented in the body of the paper.

There was notable Board interest in how GASB approached this similar project -- addressing the issue of related party because requirements resided in AICPA's auditing literature. GASB concluded that the transition from the auditing literature to the accounting and financial reporting standards should be as undisruptive as possible; therefore, the existing AICPA guidance was adapted with minimal changes so that the guidance could be provided quickly and with minimal changes in practice.

The text box below includes the language with the changes included for the characteristics of the government.

### **GASB Related Party Transactions**

4. State and local governments are required to disclose certain related party transactions. If the substance of a particular transaction is significantly different from its form because of the involvement of related parties, financial statements should recognize the substance of the transaction rather than merely its legal form.

5. Examples of transactions with related parties that have features that may indicate that governments should consider whether a *form-over-substance* condition exists include:

- a. Borrowing or lending on an interest-free basis or at a rate of interest significantly above or below market rates prevailing at the time of the transaction
- b. Selling real estate at a price that differs significantly from its appraised value
- c. Exchanging property for similar property in a nonmonetary transaction
- d. Making loans with no scheduled terms for when or how the loans will be repaid.

6. Determining the substance of a related party transaction may pose challenges not present in assessing transactions between unrelated parties. For example, a related party relationship may result in transactions that would not take place between unrelated parties or would be subject to different terms and conditions. In such cases, the substance of the related party transaction may differ from its legal form due to the related party relationship.

7. It may not be possible to determine whether a particular transaction would have taken place if the parties had not been related, or what the terms and conditions would have been. Therefore, it may be difficult to determine whether a transaction was consummated on terms comparable to those that would be present in arm's-length transactions. Furthermore, governments frequently enter into transactions and engage in activities that are driven by societal needs and concern for the "public good." Therefore, it may not be appropriate to compare some governmental programs and arrangements to what might have occurred in an arm's-length transaction in the private sector or with unrelated parties.

The objectives of GASB's related party requirements appear to be:

1. ensure transactions are accounted for at amounts consistent with arms-length transactions (e.g., to avoid understating costs or asset values)
2. allow for the fact that governments often engage in transactions at non-arms-length amounts (e.g., non-exchange transactions) and provide that amounts for these transactions need not be adjusted

GASB's approach focuses on identifying transactions that are not arms-length and does not provide characteristics of related parties. Instead, when non-arms-length transactions are identified the question of relationships between the parties would be raised.

The IPSASB model also appeared relevant and staff found the following sections of particular interest because it was very specific to governmental departments and consideration of consolidated component entities.

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#### **IPSASB Related Party Transactions**

18. Related party relationships exist throughout the public sector, because:

- (a) Administrative units are subject to the overall direction of the executive government and, ultimately, the Parliament or similar body of elected or appointed officials, and operate together to achieve the policies of the government;
- (b) Government departments and agencies frequently conduct activities necessary for the achievement of different components of their responsibilities and objectives through separate controlled entities, and through entities over which they have significant influence; and
- (c) Ministers or other elected or appointed members of the government and senior management group can exert significant influence over the operations of a department or agency.

14. Economic dependency, where one entity is dependent on another in that it relies on the latter for a significant volume of its funding or sale of its goods and services, would on its own be unlikely to lead to control or significant influence and is therefore unlikely to give rise to a related party relationship. As such, a single customer, supplier, franchisor, distributor, or general agent with whom a public sector entity transacts a significant volume of business will not be a related party merely by virtue of the resulting economic dependency. However, economic dependency, together with other factors, may give rise to significant influence and therefore a related party relationship. Judgment is required in assessing the impact of economic dependence on a relationship. Where the reporting entity is economically dependent on another entity, the reporting entity is encouraged to disclose the existence of that dependency.

19. Disclosure of certain related party relationships and related party transactions and the relationship underlying those transactions is necessary for accountability purposes and enables users to better understand the financial statements of the reporting entity because:

- (a) Related party relationships can influence the way in which an entity operates with other entities in achieving its individual objectives, and the way in which it co-operates with other entities in achieving common or collective objectives;
  - (b) Related party relationships might expose an entity to risks or provide opportunities that would not have existed in the absence of the relationship; 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. This occurs frequently in government departments and agencies where goods and services are transferred between departments at less than full cost recovery as a part of normal operating procedures consistent with the achievement of the objectives of the reporting entity and the government. Governments and individual public sector entities are expected to use resources efficiently, effectively and in the manner
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intended, and to deal with public monies with the highest levels of integrity. The existence of related party relationships means that one party can control or significantly influence the activities of another party. This provides the opportunity for transactions to occur on a basis that may advantage one party inappropriately at the expense of another.

29. Public sector entities transact extensively with each other on a daily basis. These transactions may occur at cost, less than cost or free-of-charge. For example, a government department of administrative services may provide office accommodation free of charge to other departments, or a public sector entity may act as a purchasing agent for other public sector entities. In some models of government there may be the capacity for recovery of more than the full cost of service delivery. Departments are related parties because they are subject to common control and these transactions meet the definition of related party transactions. However, disclosure of information about transactions between these entities is not required where the transactions are consistent with normal operating relationships between the entities, and are undertaken on terms and conditions that are normal for such transactions in these circumstances. The exclusion of these related party transactions from the disclosure requirements of paragraph 27 reflects that public sector entities operate together to achieve common objectives, and acknowledges that different mechanisms may be adopted for the delivery of services by public sector entities in different jurisdictions. This Standard requires disclosures of related party transactions only when those transactions occur other than in accordance with the operating parameters established in that jurisdiction.

30. The information about related party transactions that would need to be disclosed to meet the objectives of general purpose financial reporting would normally include:

- (a) A description of the nature of the relationship with related parties involved in these transactions. For example, whether the relationship was one of a controlling entity, a controlled entity, an entity under common control, or key management personnel;
- (b) A description of the related party transactions within each broad class of transaction and an indication of the volume of the classes, either as a specific monetary amount or as a proportion of that class of transactions and/or balances;
- (c) A summary of the broad terms and conditions of transactions with related parties, including disclosure of how these terms and conditions differ from those normally associated with similar transactions with unrelated parties; and
- (d) Amounts or appropriate proportions of outstanding items

33. Disclosure of related party transactions between members of an economic entity is unnecessary in consolidated financial statements because consolidated financial statements present information about the controlling entity and controlled entities as a single reporting entity. Related party transactions that occur between entities within an economic entity are eliminated on consolidation in accordance with IPSAS 6. Transactions with associated entities accounted for under the equity method are not eliminated and therefore require separate disclosure as related party transactions.

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However, staff notes the objective of IPSASB is broad with the Related Party definition addressing entities with significant influence which include associates, individuals, key management and close members of the family of key management personnel, etc. The definition is included below:

**Related party** parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial and operating decisions or if the related party entity and another entity are subject to common control.

Related parties include:

- (a) Entities that directly, or indirectly through one or more intermediaries, control, or are controlled by the reporting entity;
- (b) Associates (see IPSAS 7, "Investments in Associates");
- (c) Individuals owning, directly or indirectly, an interest in the reporting entity that gives them significant influence over the entity, and close members of the family of any such individual;
- (d) Key management personnel, and close members of the family of key management personnel; and

(e) Entities in which a substantial ownership interest is held, directly or indirectly, by any person described in (c) or (d), or over which such a person is able to exercise significant influence.

The IPSASB objectives include giving readers a better understanding of influences weighing on the reporting entity, risks and opportunities resulting from relationships, and reported results that may be over or understated as a result of other than arms-length transactions. These objectives are broader than the GASB objectives. Notable differences from the GASB standards include:

1. explicit requirements for information about key management remuneration including family members
2. broad disclosure of relationships where control exists even if there are no transactions
3. disclosure of information regarding transactions between related parties unless those transactions were:
  - a. no more or less advantageous than arms-length transactions
  - b. in the normal course of business and on normal terms between government departments (components of the same larger government)
4. economic dependency is addressed (see par. 14)

As noted above, related party guidance most often cited has been the Financial Accounting Standards (FASB) 57, *Related Parties Disclosures* (FASB ASC 850). However, staff notes the Board had decided this definition and approach – which is the AICPA approach - was not applicable in the current form to the federal environment. The definition provided is as follows:

**FASB Related parties.** Affiliates of the enterprise; entities for which investments are accounted for by the equity method by the enterprise; trusts for the benefit of employees, such as pension and profit-sharing trusts that are managed by or under the trusteeship of management; principal owners of the enterprise; its management; members of the immediate families of principal owners of the enterprise and its management; and other parties with which the enterprise may deal if one party controls or can significantly influence the management or operating policies of the other to an extent that one of the transacting parties might be prevented from fully pursuing its own separate interests. Another party also is a related party if it can significantly influence the management or operating policies of the transacting parties or if it has an ownership interest in one of the transacting parties and can significantly influence the other to an extent that one or more of the transacting parties might be prevented from fully pursuing its own separate interests.

## Staff Analysis

The Board previously decided against adopting the AICPA auditing literature (i.e, the FASB standard) regarding related parties essentially “as is” because doing so may not have provided the federal financial reporting community with meaningful guidance because the AICPA language for related parties was not readily adaptable to the federal government environment. In addition, a definition of related parties for federal reporting entities was needed.

Based on a review of past minutes, Board members appear in agreement the focus of related parties should be on those entities outside the federal government and not on those within the federal government as existing guidance covers reporting of intra governmental transactions. This is also consistent with IPSASB’s approach which treats such relationships as a normal part of operations.

IPSASB also notes in its standard “Disclosure of related party transactions between members of an economic entity is unnecessary in consolidated financial statements because consolidated financial statements present information about the controlling entity and controlled entities as a single reporting entity. Related party transactions that occur between entities within an economic entity are eliminated on consolidation in accordance with IPSAS 6. Transactions with associated entities accounted for under the equity method are not eliminated and therefore require separate disclosure as related party transactions.”

When considering the main part of the related party definition—significant influence—this would be accomplished more so by certain federal entities that can significantly influence the operating policies of the transacting entities. For example, the Office of Management and Budget (OMB) provides policy and/or general management guidance to other federal entities, and the Office of Personnel Management (OPM) helps federal entities recruit nationwide and sets human resources management rules with the federal entities' involvement; administers the systems for setting federal compensation and benefits; manages federal employee health and life insurance programs; and operates the retirement program for federal employees. Thus, for the objective of better understanding the influences on entity operations—an understanding of certain relationships between federal entities may be helpful at the component level. (Note that component entities already explain – in MD&A and the statement of significant accounting policies – that they are components of a larger entity.)

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 should 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 and understood to the citizens, their elected representatives, federal executives, and

program managers.<sup>1</sup> **Therefore, a component entity should be disclosed as a related party only when significant transactions are not arms-length transactions and disclosure is necessary to meet reporting objectives. However, the standards ought to be clear and address this point explicitly regarding component entities.**

In addition to intra-governmental relationships, staff considered relationships with outside entities. Knowledge of a private sector entity's relationships with related parties is often considered important. Related party disclosures are important in the private sector because related parties may enter into transactions that (1) unrelated parties would not or (2) are not at the same amounts as would occur between unrelated parties. The mere existence of non-arms-length business relationships may be sufficient to affect the transactions of the entity with other parties. However, when considering the universe of entities the federal government may have relationships with and who may exercise significant influence, there are infinite possibilities and countless types of entities and possible relationships that would have to be considered. For example:

1. collaboration between federal and state/local governments on programs (e.g., job training programs or Medicaid experimentation) and acceptance of a portion of the cost of programs (e.g, through unfunded mandates or direct cost-sharing agreements)
2. public-private partnerships to meet ongoing needs (e.g, military housing)
3. treaties that define common goals and means for joint action (e.g., NATO)
4. trade agreements that restrict options
5. stakeholders able to exert influence through elected officials

When considering the purpose or objective for disclosing related party information, one understands the importance in business and commerce where the disclosures may be to draw attention to the possibility that profit and loss may have been affected by the existence of the related party relationships and the underlying information (reliability, completeness, validity, comparability) to ensure it is arms-length. However, the objective of relationships that the federal government enters into and the resulting transactions and thereby the need or purposes for related party reporting, are far different. The federal government is not routinely or typically the party at an advantage in the relationship or transaction with others. Nor is the entire effect of the relationship or transaction easily expressed in financial terms. The purpose of the most of these relationships is for the good of the nation or to fulfill public policy goals and society needs.

Therefore, when one considers the federal government's role and its potential 'related party relationships' there would be an infinite number of related parties reported if parameters were not placed on what needs to be reported. Unless very specific parameters were developed to exclude classes or to identify a specific class for

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<sup>1</sup> 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."

inclusion, it would be a very difficult task to identify all the related parties of the federal government. Further, some parties may not even be aware they are a related party.

Additionally, the cost of meeting this type of requirement and related disclosure would be high; the benefit of including an infinite amount of information would be lost because users would be overwhelmed. For example, staff believes there would be an infinite number of related parties reported including other countries, NATO, health care systems, treaties, United Nations, and an endless number of military and other contractors, etc. Staff does not believe the Board intended such a broad approach and has not developed an option that would encompass all the entities having relationships with and significant influence on the federal government.

Staff notes the Related Parties reported in previous CFR, such as the Federal Reserve and Amtrak may at a minimum be considered non-core in future years based on the new proposal.

The Board requested staff to consider whether the “established by the federal government” criteria may be too broad for the related party definition. Staff notes this was presented as part of the related party definition in the previous draft. The decision to put this in the related party definition was based on previous Board discussions that when a decision was made to remove it as an inclusion principle. At that time, the Board believed it would be best suited for consideration in related party. Therefore, staff believed it should be referenced in the related party definition to ensure entities that were established would be considered.

However, based on the discussion at the previous meeting, it appears the Board does not believe it is necessary to have the language in the definition. Several members noted it might bring in entities that the federal government established but has no ongoing relationship with or it will result in potentially disclosing a lot more entities. There appeared to be agreement among several members that the established by factor alone shouldn't be enough to require related party disclosures. Therefore, this is no longer included in the definition. Instead, staff proposes to include this as an indicator of significant influence or that an entity may be a related party. See the proposed language under the staff recommendation.

### **Staff Recommendation**

#### **Options:**

Staff believes best approach is as follows:

1. Modify AICPA's language as necessary to fit the federal government environment. Explicitly state the objective of related party reporting is different for the federal government because the federal government normally engages in transactions that private enterprises would not and establishes long-standing relationships that influence

decisions. The necessary changes include identifying specific parameters and/or exclude classes from related party for the federal government due to its nature.

Alternatively, the Board may consider adopting:

2. a new definition for related party that is very narrow and specific for the federal environment.
3. AICPA's language as is. [Staff includes this but finds difficulty accepting because it would be difficult to apply as is. Also, staff believes this option is very broad and would lead to an infinite number of organizations reported.]

While staff believes the objective of related party reporting is different for the federal government, staff believes this can be accomplished using a related party definition based on significant influence, tailored for the federal environment, and focusing on meeting the objectives of revealing risks and influences that are outside normal operating conditions.

Staff recognizes 'related party' is a common or at least well-accepted term that has been used in the audit and professional community for quite some time. Therefore, staff believes it may be difficult to simply change the definition of a common term such as related party and have it accepted by others. Staff believes it is best to start from what is accepted then make the deviations that are necessary or state the limitations and exclusions as necessary.

**Therefore, the staff recommendation is Option 1. Option 1 will provide users with information about the objective of related party reporting in the federal government while maintaining a definition that is based on significant influence. Staff proposes the following language for the ED:**

### **Related Party Government-wide Reporting Entity**

1. In addition to organizations for which Congress and the President are accountable, the federal government may be able to exercise significant influence over certain entities or be significantly influenced by certain entities. Where such influence is outside the scope of normal operations and/or federal government relationships, such parties are referred to as "related parties."
2. Certain information regarding related party relationships may enable 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.
3. Parties are considered to be **related parties** if the entities can be significantly influenced in making financial and operating decisions or if the federal government has an ownership interest but the entity was not included in the government-wide reporting entity.
  4. **Significant influence** is the power to participate in the financial and operating policy decisions of an entity, but it is not control over those policies.
  5. Indicators of significant influence may include the following: a large ownership interest<sup>2</sup> in an entity or if the entity was established<sup>3</sup> by the federal government. In considering related parties, attention should be directed to the substance of the relationship and not merely the legal form.
  6. The objective of related party reporting in the federal government is to identify risks and influences that would not be expected in the normal operations of the federal government. The federal government enters into relationships for the good of the nation or to fulfill public policy goals and society needs. As a result, many complex relationships exist where significant influence is exerted. Judgment will be required to identify relationships that are not routine and may pose risks or introduce influences that warrant disclosure. In the context of this Statement, the following do not constitute significant influence and are not related parties:

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<sup>2</sup> Large, but not a majority ownership interest. A majority ownership interest meets the inclusion principles set forth in the Standard.

<sup>3</sup> 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).

- Entities with which the federal government transacts a significant volume of business resulting in economic dependence such as government contractors, state and local governments, and non-profit organizations
  - Entities that have no federal representation on their governing board
  - Key executives or other employees
  - Component entities of the federal government, see full discussion in par. 8
  - Foreign governments or international bodies
7. Although par. 6 permits exclusion of certain entities as related parties, other factors may create a need for related party disclosures. The use of judgment will be necessary in identifying those factors consistent with the objectives of related party disclosures.
8. 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.<sup>4</sup> 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**

For any Related Party, the following should be disclosed:

1. Nature of the federal government's relationship with the entity, including the name of the entity or if aggregated, a description of the related parties. Such

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<sup>4</sup> 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."

information also would include as appropriate: if the entity was being influenced and/or the percentage of ownership interest.

2. 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.

**QUESTIONS:**

**Does the Board agree with the Staff Recommendation for Related Party?**

**Does the Board agree with the proposed language for the ED?**

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**Related Party for Component Reporting Entity (This is shaded to alert the Board because it relates to the Component Reporting Entity. Although all Board deliberations up to this point have been on the government-wide reporting entity, it was difficult to consider the Related Party issue without also considering the component reporting issue.)**

Component Entity Reports are not a consolidation of a single economic reporting entity. Related party relationships exist among the component entities of the federal government because component entities are subject to the overall direction and operate together to achieve the policies of the federal government. Therefore the issue of whether other component relationships should be considered for related parties for disclosure must be assessed slightly different—from the component entity perspective. In addition, the component entity's relationship with outside entities is considered from the component entity perspective.

Although materiality may differ, staff considers if the same objectives and exclusions agreed upon for the government-wide perspective should apply at the component reporting entity? Is this a safe assumption or should this be explored further after the Board deliberates the government-wide?

Does the Board wish to make these decisions before the decisions regarding the component reporting entity standard are finalized?

**Component Reporting Entity--**

9. In addition to organizations for which the [component Department or equivalent ] are accountable, the component reporting entity may be able to exercise significant influence over certain entities or be significantly influenced by certain entities. Where such influence is outside the scope of normal operations and/or component reporting entity relationships, such parties are referred to as “related parties.”
10. Certain information regarding related party relationships may enable users to better understand the financial statements of the government-wide reporting entity because:
  - (a) Related party relationships might expose the component reporting entity 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 component reporting entity 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.
11. Parties are considered to be **related parties** if the entities can be significantly influenced in making financial and operating decisions or if the component reporting entity has an ownership interest but the entity was not included in the component reporting entity.
12. **Significant influence** is the power to participate in the financial and operating policy decisions of an entity, but it is not control over those policies.

**QUESTION: What are the Board’s tentative thoughts for Related Party Reporting at the Component Reporting Entity level? Should the objectives, definition and such be the same as the government-wide?**

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## Attachment

### GASB

#### STANDARDS OF GOVERNMENTAL ACCOUNTING AND FINANCIAL REPORTING

##### Scope and Applicability of This Statement

2. This Statement establishes accounting and financial reporting standards for related party transactions, subsequent events, and going concern considerations. This Statement applies to all state and local governments.

3. This Statement amends paragraph 26 of the National Council on Governmental Accounting (NCGA) Statement 5, *Accounting and Financial Reporting Principles for Lease Agreements of State and Local Governments*.

##### Related Party Transactions

4. State and local governments are required to disclose certain related party transactions. If the substance of a particular transaction is significantly different from its form because of the involvement of related parties, financial statements should recognize the substance of the transaction rather than merely its legal form.

5. Examples of transactions with related parties that have features that may indicate that governments should consider whether a *form-over-substance* condition exists include:

- a. Borrowing or lending on an interest-free basis or at a rate of interest significantly above or below market rates prevailing at the time of the transaction
- b. Selling real estate at a price that differs significantly from its appraised value
- c. Exchanging property for similar property in a nonmonetary transaction
- d. Making loans with no scheduled terms for when or how the loans will be repaid.

6. Determining the substance of a related party transaction may pose challenges not present in assessing transactions between unrelated parties. For example, a related party relationship may result in transactions that would not take place between unrelated parties or would be subject to different terms and conditions. In such cases, the substance of the related party transaction may differ from its legal form due to the related party relationship.

7. It may not be possible to determine whether a particular transaction would have taken place if the parties had not been related, or what the terms and conditions would have been. Therefore, it may be difficult to determine whether a transaction was consummated on terms comparable to those that would be present in arm's-length transactions. Furthermore, governments frequently enter into transactions and engage in activities that are driven by societal needs and concern for the "public good." Therefore, it may not be appropriate to compare some governmental programs and arrangements to what might have occurred in an arm's-length transaction in the private sector or with unrelated parties.

## IPSASB

### IPSAS 20, *Related Party Disclosures*

#### Definition

**Related party** parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial and operating decisions or if the related party entity and another entity are subject to common control.

Related parties include:

- (a) Entities that directly, or indirectly through one or more intermediaries, control, or are controlled by the reporting entity;
- (b) Associates (see IPSAS 7, “Investments in Associates”);
- (c) Individuals owning, directly or indirectly, an interest in the reporting entity that gives them significant influence over the entity, and close members of the family of any such individual;
- (d) Key management personnel, and close members of the family of key management personnel; and
- (e) Entities in which a substantial ownership interest is held, directly or indirectly, by any person described in (c) or (d), or over which such a person is able to exercise significant influence.

**Related party transaction** is a transfer of resources or obligations between related parties, regardless of whether a price is charged. Related party transactions exclude transactions with any other entity that is a related party solely because of its economic dependence on the reporting entity or the government of which it forms part.

**Significant influence** (for the purpose of this Standard) is the power to participate in the financial and operating policy decisions of an entity, but not control those policies. Significant influence may be exercised in several ways, usually by representation on the board of directors or equivalent governing body but also by, for example, participation in the policy making process, material transactions between entities within an economic entity, interchange of managerial personnel or dependence on technical information. Significant influence may be gained by an ownership interest, statute or agreement. With regard to an ownership interest, significant influence is presumed in accordance with the definition contained in IPSAS 7.

#### Related Parties

10. In considering each possible related party relationship, attention is directed to the substance of the relationship, and not merely the legal form.

11. Where two entities have a member of key management personnel in common, it is necessary to consider the possibility, and to assess the likelihood, that this person would be able to affect the policies of both entities in their mutual dealings. However, the mere fact that there is a member of key management personnel in common does not necessarily create a related party relationship.

12. In the context of this Standard, the following are deemed not to be related parties:

- (a) (i) Providers of finance in the course of their business in that regard; and
- (ii) Trade unions; in the course of their normal dealings with an entity by virtue only of those dealings (although they may circumscribe the freedom of action of an entity or participate in its decision-making process); and
- (b) An entity with which the relationship is solely that of an agency.

13. Related party relationships may arise when an individual is either a member of the governing body or is involved in the financial and operating decisions of the reporting entity. Related party relationships may also arise through external operating relationships between the reporting entity and the related party. Such relationships will often involve a degree of economic dependency.

14. Economic dependency, where one entity is dependent on another in that it relies on the latter for a significant volume of its funding or sale of its goods and services, would on its own be unlikely to lead to

control or significant influence and is therefore unlikely to give rise to a related party relationship. As such, a single customer, supplier, franchisor, distributor, or general agent with whom a public sector entity transacts a significant volume of business will not be a related party merely by virtue of the resulting economic dependency. However, economic dependency, together with other factors, may give rise to significant influence and therefore a related party relationship. Judgment is required in assessing the impact of economic dependence on a relationship. Where the reporting entity is economically dependent on another entity, the reporting entity is encouraged to disclose the existence of that dependency.

15. The definition of related party includes entities owned by key management personnel, close family members of such individuals or major shareholders (or equivalent where the entity does not have a formal equity structure) of the reporting entity. The definition of related party also includes circumstances in which one party has the ability to exercise significant influence over the other party. In the public sector, an individual or entity may be given oversight responsibility for a reporting entity, which gives them significant influence, but not control, over the financial and operating decisions of the reporting entity. For the purposes of this Standard, significant influence is defined to encompass entities subject to joint control.

### **Remuneration of Key Management Personnel**

16. Remuneration of key management personnel includes remuneration derived by individuals from the reporting entity for services provided to the reporting entity in their capacity as members of the governing body or employees. Benefits derived directly or indirectly from the entity for services in any capacity other than as an employee or a member of the governing body do not satisfy the definition of remuneration of key management personnel in this Standard. However, paragraph 34 requires disclosures to be made about certain of these other benefits. Remuneration of key management personnel excludes any consideration provided solely as a reimbursement for expenditure incurred by those individuals for the benefit of the reporting entity, such as the reimbursement of accommodation costs associated with work-related travel.

### **Voting Power**

17. The definition of related party will include any individuals owning, directly or indirectly, an interest in the voting power of the reporting entity that gives them significant influence over the entity. The holding of an interest in the voting power of an entity can arise when a public sector entity has a corporate structure and a minister or government agency holds shares in the entity.

### **The Related Party Issue**

18. Related party relationships exist throughout the public sector, because:

- (a) Administrative units are subject to the overall direction of the executive government and, ultimately, the Parliament or similar body of elected or appointed officials, and operate together to achieve the policies of the government;
- (b) Government departments and agencies frequently conduct activities necessary for the achievement of different components of their responsibilities and objectives through separate controlled entities, and through entities over which they have significant influence; and
- (c) Ministers or other elected or appointed members of the government and senior management group can exert significant influence over the operations of a department or agency.

19. Disclosure of certain related party relationships and related party transactions and the relationship underlying those transactions is necessary for accountability purposes and enables users to better understand the financial statements of the reporting entity because:

- (a) Related party relationships can influence the way in which an entity operates with other entities in achieving its individual objectives, and the way in which it co-operates with other entities in achieving common or collective objectives;
- (b) Related party relationships might expose an entity to risks or provide opportunities that would not have existed in the absence of the relationship; 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. This occurs frequently in government departments and agencies where goods and services are transferred between departments at less than full cost recovery as a part of normal operating procedures

consistent with the achievement of the objectives of the reporting entity and the government. Governments and individual public sector entities are expected to use resources efficiently, effectively and in the manner intended, and to deal with public monies with the highest levels of integrity. The existence of related party relationships means that one party can control or significantly influence the activities of another party. This provides the opportunity for transactions to occur on a basis that may advantage one party inappropriately at the expense of another.

20. Disclosure of certain types of related party transactions that occur and the terms and conditions on which they were conducted allows users to assess the impact of those transactions on the financial position and performance of an entity and its ability to deliver agreed services. This disclosure also ensures that the entity is transparent about its dealings with related parties.

#### **Remuneration of Key Management Personnel**

21. Key management personnel hold positions of responsibility within an entity. They are responsible for the strategic direction and operational management of an entity and are entrusted with significant authority. Their salaries are often established by statute or an independent tribunal or other body independent of the reporting entity. However, their responsibilities may enable them to influence the benefits of office that flow to them or their related parties. This Standard requires certain disclosures to be made about the remuneration of key management personnel and close members of the family of key management personnel during the reporting period, loans made to them and the consideration provided to them for services they provide to the entity other than as a member of the governing body or an employee. The disclosures required by this Standard will ensure that appropriate minimum levels of transparency are applied to the remuneration of key management personnel and close members of the family of key management personnel.

#### **Materiality**

22. IPSAS 1, “Presentation of Financial Statements” requires the separate disclosure of material items. The materiality of an item is determined with reference to the nature or size of that item. When assessing the materiality of related party transactions, the nature of the relationship between the reporting entity and the related party and the nature of the transaction may mean that a transaction is material regardless of its size.

#### **Disclosure**

23. In many countries, the laws, and other authoritative financial reporting rules, require financial statements of private sector entities and government business enterprises to disclose information about certain categories of related parties and related party transactions. In particular, attention is focused on the entity’s transactions with its directors or members of its governing body and with its senior management group, especially their remuneration and borrowings. This is because of the fiduciary responsibilities of directors, members of the governing body and senior management group, and because they have extensive powers over the deployment of entity resources. In some jurisdictions, similar requirements are included in the statutes and regulations applicable to public sector entities.

24. Some IPSASs also require disclosure of transactions with related parties. For example, IPSAS 1 requires disclosure of amounts payable to and receivable from controlling entities, fellow controlled entities, associates and other related parties. IPSAS 6, “Consolidated and Separate Financial Statements” and IPSAS 7 require disclosure of a list of significant controlled entities and associates. IPSAS 3, “Accounting Policies, Changes in Accounting Estimates and Errors” requires disclosure of extraordinary items and items of revenue and expense within surplus or deficit from ordinary activities that are of such size, nature or incidence that their disclosure is relevant to explain the performance of the entity for the period.

#### **Disclosure of Control**

**25. Related party relationships where control exists should be disclosed irrespective of whether there have been transactions between the related parties.**

26. In order for a reader of financial statements to form a view about the effects of related party relationships on a reporting entity, it is appropriate to disclose related party relationships where control exists, irrespective of whether there have been transactions between the related parties. This would involve the disclosure of the names of any controlled entities, the name of the immediate controlling entity and the name of the ultimate controlling entity, if any.

#### **Disclosure of Related Party Transactions**

**27. In respect of transactions between related parties other than transactions that would occur within a normal supplier or client/recipient relationship on terms and conditions no more or less favorable than those which it is reasonable to expect the entity would have adopted if dealing with that individual or entity at arm's length in the same circumstances, the reporting entity should disclose:**

- (a) The nature of the related party relationships;**
- (b) The types of transactions that have occurred; and**
- (c) The elements of the transactions necessary to clarify the significance of these transactions to its operations and sufficient to enable the financial statements to provide relevant and reliable information for decision making and accountability purposes.**

28. The following are examples of situations where related party transactions may lead to disclosures by a reporting entity:

- (a) Rendering or receiving of services;
- (b) Purchases or transfers/sales of goods (finished or unfinished);
- (c) Purchases or transfers/sales of property and other assets;
- (d) Agency arrangements;
- (e) Leasing arrangements;
- (f) Transfer of research and development;
- (g) License agreements;
- (h) Finance (including loans, capital contributions, grants whether in cash or in kind and other financial support including cost sharing arrangements); and
- (i) Guarantees and collaterals.

29. Public sector entities transact extensively with each other on a daily basis. These transactions may occur at cost, less than cost or free-of-charge. For example, a government department of administrative services may provide office accommodation free of charge to other departments, or a public sector entity may act as a purchasing agent for other public sector entities. In some models of government there may be the capacity for recovery of more than the full cost of service delivery. Departments are related parties because they are subject to common control and these transactions meet the definition of related party transactions. However, disclosure of information about transactions between these entities is not required where the transactions are consistent with normal operating relationships between the entities, and are undertaken on terms and conditions that are normal for such transactions in these circumstances. The exclusion of these related party transactions from the disclosure requirements of paragraph 27 reflects that public sector entities operate together to achieve common objectives, and acknowledges that different mechanisms may be adopted for the delivery of services by public sector entities in different jurisdictions. This Standard requires disclosures of related party transactions only when those transactions occur other than in accordance with the operating parameters established in that jurisdiction.

30. The information about related party transactions that would need to be disclosed to meet the objectives of general purpose financial reporting would normally include:

- (a) A description of the nature of the relationship with related parties involved in these transactions. For example, whether the relationship was one of a controlling entity, a controlled entity, an entity under common control, or key management personnel;
- (b) A description of the related party transactions within each broad class of transaction and an indication of the volume of the classes, either as a specific monetary amount or as a proportion of that class of transactions and/or balances;
- (c) A summary of the broad terms and conditions of transactions with related parties, including disclosure of how these terms and conditions differ from those normally associated with similar transactions with unrelated parties; and

(d) Amounts or appropriate proportions of outstanding items.

31. Paragraph 34 of this Standard requires additional disclosures to be made about certain transactions between an entity and key management personnel and/or the close members of the family of key management personnel.

**32. Items of a similar nature may be disclosed in aggregate except when separate disclosure is necessary to provide relevant and reliable information for decision making and accountability purposes.**

33. Disclosure of related party transactions between members of an economic entity is unnecessary in consolidated financial statements because consolidated financial statements present information about the controlling entity and controlled entities as a single reporting entity. Related party transactions that occur between entities within an economic entity are eliminated on consolidation in accordance with IPSAS 6. Transactions with associated entities accounted for under the equity method are not eliminated and therefore require separate disclosure as related party transactions.

#### **Disclosure — Key Management Personnel**

**34. An entity shall disclose:**

**(a) The aggregate remuneration of key management personnel and the number of individuals, determined on a full time equivalent basis, receiving remuneration within this category, showing separately major classes of key management personnel and including a description of each class;**

**(b) The total amount of all other remuneration and compensation provided to key management personnel, and close members of the family of key management personnel, by the reporting entity during the reporting period showing separately the aggregate amounts provided to:**

**(i) Key management personnel; and**

**(ii) Close members of the family of key management personnel; and**

**(c) In respect of loans which are not widely available to persons who are not key management personnel and loans whose availability is not widely known by members of the public, for each individual member of key management personnel and each close member of the family of key management personnel:**

**(i) The amount of loans advanced during the period and terms and conditions thereof;**

**(ii) The amount of loans repaid during the period;**

**(iii) The amount of the closing balance of all loans and receivables; and**

**(iv) Where the individual is not a director or member of the governing body or senior management group of the entity, the relationship of the individual to such.**

35. Paragraph 27 of this Standard requires the disclosure of related party transactions which have occurred other than on an arm's length basis consistent with the operating conditions established for the entity. This Standard also requires the disclosure of information about certain transactions with key management personnel identified in paragraph 34, whether or not they have occurred on an arm's length basis consistent with the operating conditions that apply in respect of the entity.

36. Persons who are key management personnel may be employed on a full or part time basis. The number of individuals disclosed as receiving remuneration in accordance with paragraph 34(a) needs to be estimated on a full time equivalent basis. Entities will make separate disclosures about the major classes of key management personnel that they have. For example, where an entity has a governing body that is separate from its senior management group, disclosures about remuneration of the two groups will be made separately. Where an individual is a member of both the governing body and the senior management group, that individual will be included in only one of those groups for the purposes of this Standard. The categories of key management personnel identified in the definition of key management personnel provide a guide to identifying classes of key management personnel.

37. Remuneration of key management personnel can include a variety of direct and indirect benefits. Where the cost of these benefits is determinable, that cost will be included in the aggregate remuneration is closed.

Where the cost of these benefits is not determinable, a best estimate of the cost to the reporting entity or entities will be made and included in the aggregate remuneration disclosed.

38. Requirements on the measurement of employee benefits are found in IPSAS 25, "Employee Benefits." When non-monetary remuneration that is able to be reliably measured has been included in the aggregate amount of remuneration of key management personnel disclosed for the period, disclosure would also be made in the notes to the financial statements of the basis of measurement of the non-monetary remuneration.

39. This Standard requires the disclosure of certain information about the terms and conditions of loans made to key management personnel and close members of the family of key management personnel, where these loans:

- (a) Are not widely available to persons outside the key management group; and
- (b) May be widely available outside the key management group but whose availability is not widely known to members of the public.

The disclosure of this information is required for accountability purposes. The exercise of judgment may be necessary in determining which loans should be disclosed to satisfy the requirements of this Standard. That judgment should be exercised after consideration of the relevant facts and in a manner consistent with the achievement of the objectives of financial reporting.

40. Paragraph 34(a) of this Standard requires disclosure of the aggregate remuneration of key management personnel. Key management personnel include directors or members of the governing body and members of the senior management group of the entity. Directors or members of the governing body of the entity may also receive remuneration or compensation from the entity for services provided in a capacity other than as director or member of the governing body of the entity or as an employee of the entity. Paragraph 34(b)(i) of this Standard requires the disclosure of the total amount of this other remuneration or compensation.

41. Close members of the family of key management personnel may influence, or be influenced by, key management personnel in their transactions with the reporting entity. Paragraph 34(b)(ii) of this Standard requires the disclosure of the total remuneration and compensation provided during the period to close members of the family of key management personnel.

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### **FASB FAS 57 Summary**

This Statement establishes requirements for related party disclosures. The requirements of this Statement are generally consistent with those in Statement on Auditing Standards No. 6, *Related Party Transactions*, issued by the Auditing Standards Executive Committee of the American Institute of Certified Public Accountants.

#### **INTRODUCTION**

1. The FASB has been asked to provide guidance on disclosures of transactions between **related parties**. Examples of related party transactions include transactions between (a) a parent company and its subsidiaries; (b) subsidiaries of a common parent; (c) an enterprise and trusts for the benefit of employees, such as pension and profit-sharing trusts that are managed by or under the trusteeship of the enterprise's **management**; (d) an enterprise and its **principal owners**, management, or members of their **immediate families**; and (e) **affiliates**. Transactions between related parties commonly occur in the normal course of

business. Some examples of common types of transactions with related parties are: sales, purchases, and transfers of realty and personal property; services received or furnished, for example, accounting, management, engineering, and legal services; use of property and equipment by lease or otherwise; borrowings and lendings; guarantees; maintenance of bank balances as compensating balances for the benefit of another; intercompany billings based on allocations of common costs; and filings of consolidated tax returns. Transactions between related parties are considered to be related party transactions even though they may not be given accounting recognition. For example, an enterprise may receive services from a related party without charge and not record receipt of the services.

## **STANDARDS OF FINANCIAL ACCOUNTING AND REPORTING**

### **Disclosures**

2. Financial statements shall include disclosures of material related party transactions, other than compensation arrangements, expense allowances, and other similar items in the ordinary course of business. However, disclosure of transactions that are eliminated in the preparation of consolidated or combined financial statements is not required in those statements. The disclosures shall include:

- a. The nature of the relationship(s) involved
- b. A description of the transactions, including transactions to which no amounts or nominal amounts were ascribed, for each of the periods for which income statements are presented, and such other information deemed necessary to an understanding of the effects of the transactions on the financial statements
- c. The dollar amounts of transactions for each of the periods for which income statements are presented and the effects of any change in the method of establishing the terms from that used in the preceding period
- d. Amounts due from or to related parties as of the date of each balance sheet presented and, if not otherwise apparent, the terms and manner of settlement
- e. The information required by paragraph 49 of FASB Statement No. 109, *Accounting for Income Taxes*.

3. Transactions involving related parties cannot be presumed to be carried out on an arm's-length basis, as the requisite conditions of competitive, free-market dealings may not exist. Representations about transactions with related parties, if made, shall not imply that the related party transactions were consummated on terms equivalent to those that prevail in arm's-length transactions unless such representations can be substantiated.

4. If the reporting enterprise and one or more other enterprises are under common ownership or management **control** and the existence of that control could result in operating results or financial position of the reporting enterprise significantly different from those that would have been obtained if the enterprises were autonomous, the nature of the control relationship shall be disclosed even though there are no transactions between the enterprises.

### **Appendix B: GLOSSARY**

24. For purposes of this Statement, certain terms are defined as follows:

- a. **Affiliate.** A party that, directly or indirectly through one or more intermediaries, controls, is controlled by, or is under common control with an enterprise.

- b. **Control.** The possession, direct or indirect, of the power to direct or cause the direction of the management and policies of an enterprise through ownership, by contract, or otherwise.
- c. **Immediate family.** Family members whom a principal owner or a member of management might control or influence or by whom they might be controlled or influenced because of the family relationship.
- d. **Management.** Persons who are responsible for achieving the objectives of the enterprise and who have the authority to establish policies and make decisions by which those objectives are to be pursued. Management normally includes members of the board of directors, the chief executive officer, chief operating officer, vice presidents in charge of principal business functions (such as sales, administration, or finance), and other persons who perform similar policymaking functions. Persons without formal titles also may be members of management.
- e. **Principal owners.** Owners of record or known beneficial owners of more than 10 percent of the voting interests of the enterprise.
- f. **Related parties.** Affiliates of the enterprise; entities for which investments are accounted for by the equity method by the enterprise; trusts for the benefit of employees, such as pension and profit-sharing trusts that are managed by or under the trusteeship of management; principal owners of the enterprise; its management; members of the immediate families of principal owners of the enterprise and its management; and other parties with which the enterprise may deal if one party controls or can significantly influence the management or operating policies of the other to an extent that one of the transacting parties might be prevented from fully pursuing its own separate interests. Another party also is a related party if it can significantly influence the management or operating policies of the transacting parties or if it has an ownership interest in one of the transacting parties and can significantly influence the other to an extent that one or more of the transacting parties might be prevented from fully pursuing its own separate interests.
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## ATTACHMENT 2

Related Party from 2010 Financial Report of the United States Government

### S. Related Party Transactions

Federal Reserve banks (FRBs) and private banks, which are not part of the reporting entity, serve as the Government's depository and fiscal agents. They process Federal payments and deposits to the Treasury General Account (which functions as the Government's checking account for deposits and disbursements) and service Treasury securities. As of September 30, 2010, the FRBs had total holdings of \$813.6 billion, including a net of \$1.9 billion in Treasury securities held by the FRB as collateral for securities lending activities. As of September 30, 2009, the FRB had total holdings of \$769.2 billion, excluding a very small amount in Treasury securities lent by the FRB to dealers. These securities are held in the FRBs' System Open Market Account (SOMA) for the purpose of conducting monetary policy. Additionally, under the Supplementary Financing Program (SFP), the Government had on deposit \$200 billion and \$165 billion with the Federal Reserve as of September 30, 2010, and 2009 respectively, to support Federal Reserve initiatives (see Note 2—Cash and Other Monetary Assets). FRBs earnings that exceed statutory amounts of surplus established for FRBs are paid to the Government and are recognized as nonexchange revenue. Those earnings totaled \$75.8 billion and \$34.3 billion for the years ended September 30, 2010, and 2009, respectively and reflect the increase in securities held by the FRB. Also, the FRBs hold Special Drawing Rights Certificates (SDRCs) (see Note 19—Other Liabilities, international monetary liabilities and gold

## Tab E Federal Entity -Attachment 2

certificates). The U.S. Government—primarily Treasury and the Federal Deposit Insurance Corporation—and the Board of Governors of the Federal Reserve System and the FRBs engaged in concurrent and/or coordinated actions during fiscal years 2009 and 2010 to help stabilize the financial system and the housing market. See further details in Note 5—TARP Direct Loans and Equity Investments, net, Note 6—Beneficial Interest in Trust, and Note 11—Investments in and Liabilities to Government-Sponsored Enterprises and Other Financial and Housing Market Stabilization. FRBs issue Federal Reserve notes, the circulating currency of the United States. Specific assets owned by FRBs, typically Treasury securities, collateralize these notes. Federal Reserve notes are backed by the full faith and credit of the Government. The Government generally does not guarantee payment of the liabilities of Government-Sponsored Enterprises such as Fannie Mae, Freddie Mac, or the Federal Home Loan Banks, which are privately owned. Fannie Mae and Freddie Mac have been placed under conservatorship as of September 7, 2008. On December 24, 2009, Treasury amended the SPSPAs to replace the existing fixed \$200 billion cap per the Government-Sponsored Enterprises (GSE) on Treasury advances, with a formulaic cap for the next 3 years that will adjust upwards quarterly by the cumulative amount of any losses realized by either Fannie Mae or Freddie Mac and downwards by the cumulative amount of any gains, but not below \$200 billion per GSE. At the conclusion of the 3-year period, the remaining commitment will then be fixed and available to be drawn per the terms of the agreements (referred to as the “Adjusted Cap”). As of September 30, 2010, the Government has committed to provide up to \$508 billion in capital (i.e., adjusted cap amounts as of September 30, 2010) to Fannie Mae and Freddie Mac to the extent that these entities liabilities exceed assets (see Note 11—Investments in and Liabilities to Government-Sponsored Enterprises and Other Financial and Housing Market Stabilization). These entities also are excluded from the reporting entity.

The Department of Transportation (DOT) has possession of two long term notes with the National Railroad Passenger Service Corporation (more commonly referred to as AMTRAK). The first note is for \$4 billion and matures in 2975 and; the second note is for \$1.1 billion and matures in 2082 with renewable 99 year terms. Interest is not accruing on these notes as long as the current financial structure of AMTRAK remains unchanged. If the financial structure of AMTRAK changes, both principal and accrued interest are due and payable. DOT does not record the notes in its financial statements because the present value of the notes was immaterial at September 30, 2010. These notes were discounted according to rates published in OMB M-10-07 Appendix C and the maturity dates of 2975 and 2082. In addition, DOT has possession of all the preferred stock shares (109.4 million) of AMTRAK. Congress through the DOT continues to fund AMTRAK since 1981; originally through the purchase of preferred stock, notes receivable and then through grants after 1997. The AMTRAK Reform and Accountability Act of 1997 (Act) changed the structure of the preferred stock by rescinding the voting rights and eliminating the preferred stock's liquidation preference over the common stock. The Act also eliminated further issuance of preferred stock to the DOT. DOT does not record the AMTRAK stock in its financial statements because it is not publicly traded and no fair market value can be placed on it. AMTRAK is not a department, agency or instrumentality of the Government or the DOT. The nine members of AMTRAK's Board of Directors are appointed by the President of the United States and are subject to confirmation by the United States Senate. Once appointed, Board Members, as a whole, act independently without the consent of the Government or any of its officers to set AMTRAK policy, determine its budget and decide operational issues. The Secretary of Transportation is statutorily appointed to the nine member Board. Traditionally, the Secretary of Transportation has designated the Administrator of the Federal Rail Administration to represent the Secretary at Board meetings.

The Export-Import Bank of the United States (Ex-Im Bank) has contractual agreements with the Private Export Funding Corporation (PEFCO). PEFCO, which is owned by a consortium of private-sector banks, industrial companies and financial services institutions, makes medium-term and long-term fixed-rate and variable-rate loans to foreign borrowers to purchase U.S. made equipment when such loans are not available from traditional private sector lenders on competitive terms. Ex-Im Bank's credit and guarantee agreement with PEFCO extends through December 31, 2020. Through its contractual agreements with PEFCO, Ex-Im Bank exercises a broad measure of supervision over PEFCO's major financial management decisions, including approval of both the terms of individual loan commitments and the terms of PEFCO's long-term debt issues, and is entitled to representation at all meetings of PEFCO's board of directors, advisory board and exporters' council. The contractual agreements provide that Ex-Im Bank will (1) guarantee the due and punctual payment of principal and interest on export loans made by PEFCO and (2) guarantee the due and punctual payment of interest on PEFCO's long-term secured debt obligations when requested by PEFCO. Related to the amounts for Ex-Im Bank as shown in Note 4—Loans Receivable, Mortgage Backed Securities, and Loan Guarantee Liabilities, Net, these guarantees to PEFCO, aggregating \$5.1 billion and \$5.0 billion at September 30, 2010 and 2009, respectively, are included within the principal amounts guaranteed by the United States. The allowance related to these transactions is included within the

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guaranteed loan liability. Ex-Im Bank received fees totaling \$0.03 billion and \$0.04 billion in fiscal years 2010 and 2009, respectively, for the agreements, which are included as earned revenue on the Statements of Net Costs.

## Consolidation Issues Paper

**Purpose:** To consider issues regarding consolidation of different fiscal year ends and consolidation of FASB based information for core entities and disclosure of information relating to non-core entities

### Audit Outreach to FSAN, Federal Entity Task Force and IPAs

As noted in the minutes, the Board requested staff to perform additional research and outreach, perhaps to the audit community and the federal entity task force as necessary on the audit responsibility of condensed information as it relates to the potential audit implications especially for non-core entities on different basis of accounting or core entities with different year ends. (Note: The Board agreed the year end issue for non-core entities should be revised to the year ending within the fiscal year of the core entity is acceptable.)

Therefore, staff requested feedback regarding the audit responsibility and implications on issues related to consolidating different year ends with core entities, consolidating FASB based entities with core entities, and the auditor's responsibility for information that is disclosed for non-federal entities audited by others (non-core disclosures, especially those that may relate to different year ends.) Specifically, staff provided the following Background and Issue to the Financial Statement Audit Network, the Federal Entity Task Force and to several Independent Public Accounting audit partners.

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**Background:** The Background section below provided key points of consideration for the outreach but also referenced the FASAB active projects page for additional information.

The draft proposal is for an organization meeting any of the three principles below to be included in the government-wide General Purpose Federal Financial Report:

- In the Budget;
- Majority Ownership Interest; or
- Control with expected benefits or risk of loss.

Once an entity is determined to be included in the government-wide reporting entity, the proposal would be to classify the entity as either a core or non-core entity based upon the degree to which the entity is taxpayer supported, is governed by the Congress and the President, imposes or may impose risks and rewards on the taxpayer, and/or provides core federal government goods and services.

### Core (or general) government entities:

- Generally provide core federal goods and services on a non-market basis, and are financed primarily through taxes and other non-exchange revenues.
- Receive taxpayer support as evidenced by inclusion in the budget
- Accountability rests with Congress or the President
- Significant 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.

Non-core 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 Congress or the President but they have less direct involvement in decision making than is true in core government entities.
- Limited risks and rewards fall to the taxpayers.

**Core entities are consolidated.**

**Non-core entities** are subject to flexible **disclosures**.

Additional background information can be found on the Federal Entity Active Projects page at <http://fasab.gov/projectsfedentity.html> .

**Issue for Consideration:**

**Core Entities**

The draft exposure draft (ED) provides **core entities** should apply the GAAP hierarchy established in SFFAS 34. Staff doesn't anticipate many issues with the core entities because most core federal entities should follow FASAB GAAP and have a 9/30 year end.

However, some **core entities** follow FASB and have a different year end as noted in FASAB's ongoing Appropriate Source of GAAP project. The Appropriate Source of GAAP project will address which federal entities should be permitted to continue applying FASB GAAP and, if so, whether additional reporting such as certain budgetary information should be required. The federal entity standards should address how you consolidate entities that may have a different display based on application of FASB standards. In addition, standards should address the consolidation of different year ends. The expectation is that most core entities are already producing audited financial statements and that inspectors general and/or the Comptroller General have sufficient and timely access to the audit results. The two open issues -- consolidating different year ends and how to consolidate FASB based entities -- should be addressed and an understanding of the audit perspective and views on them would be helpful as the Board deliberates this issue.

**Non-core Entities**

The basis of accounting section of the draft ED provides **non-core entities** should be reported on accrual based standards provided in generally accepted accounting principles. This includes generally accepted accounting principles for any domain (FASAB, Governmental Accounting Standards Board, or Financial Accounting Standards Board). Therefore, there may be instances where information such as condensed financial information is included for non-core entities on a different basis of accounting in the notes

to the financial statements. There may also be instances when this information is presented for a different year end.

**Non-core entities'** information included may pose a different problem for several reasons. The information may be condensed information or summary information taken from financial statements that may or may not have been audited. (Staff would like to assume that in most instances it would be audited.) Considering the entity was determined to be non-core, it often will involve information audited by an outside or different auditor so there is a question regarding the audit responsibility and implications of that information. Therefore, one must consider what the auditor's responsibility is for information that is disclosed for non-federal entities audited by others. An understanding of the audit perspective and views on this would be helpful as the Board deliberates this issue.

Note: The different year end issue for non-core entities appears to be resolved by the FASAB Board. While the same year end is encouraged, it was agreed that a non-core year ending within the fiscal year of the core entity is acceptable for disclosing information in the notes. Any additional feedback the audit community would like to provide on this is welcome.

**QUESTION FOR CONSIDERATION FROM OUTREACH PARTICIPANTS:**

What audit responsibility and other implications should be considered by the Board on the issues presented above? Please provide a response for both 1.) **Core entities** and 2.) **Non-core entities**.

**FEEDBACK FROM OUTREACH:**

Some of the feedback was via phone conversations, informal email and one formal letter. Therefore, staff chose to summarize in the narrative below. Note also that the response was very limited given the time constraints.

**2 IPAs**

**1 Federal Auditor**

**3 Federal Accountants**

**Summary of Comments:**

**Core Entity Issues**

In summary, auditors prefer to work with as much specificity as possible, especially as it pertained to this area. There was a strong consensus among most respondents that converting is a very tough issue. Most agree issue itself is problematic, a cost burden (conversion and audit) and difficult as there are potential differences between the accounting principles for federal GAAP vs commercial GAAP.

One IPA respondent believed if an entity is a core federal entity—the entity should be required to follow FASAB GAAP and use a 9/30 year end. Additionally, FASB based statements would have to be converted to be presented in accordance with OMB Circular

A-136 and FASAB standards, which could be costly. FASB GAAP does not follow the US Standard General Ledger and there are no budgetary accounts and statements, so this creates a conversion problem. Also there may be line items that don't easily relate or interpret correctly when converting from one basis to another. There may be other differences between federal GAAP and commercial GAAP that need to be considered by the entity and the auditor, depending upon the entity. The IPAs reiterated the importance of FASAB completing the Appropriate Source of GAAP project.

### Non-Core Issues

There seemed to be agreement, that without adequate guidance the differing year ends may result in roll-forward issues for the potential period not covered by audit and/or trying to get information in sync. However there appeared to be consensus there probably won't be major audit issues at the government-wide level because differences would be considered immaterial. Audit of disclosures could be problematic but not as big of an issue. There might need to be some additional issues resolved at the component level.

The auditors noted concern about timing issues with including information that might be 9 months old or almost a year old when the financial statements are published. They questioned what is an acceptable time lag? Should there be a provision for disclosing significant changes? Alternatively the challenge for the reporting entity disclosing information as of the component's date would be receipt of the components audited financial statements to meet November 15th deadline.

The IPAs seemed to believe there may also be issues in reviewing information from an outside auditor if necessary. In addition, if the information is audited, the auditor will have to determine when or if to make reference to the component auditor in their report. Alternatively, if the information is not audited, one must determine if this should be disclosed and if procedures should be done by the reporting entity auditor.

One respondent suggested that Treasury be given the option to refer to non-core entities financial statements in the Government-wide disclosure; the respondent believed this would be similar to SFFAS 32 *Consolidated Financial Report of the United States Government Requirements: Implementing Statement of Federal Financial Accounting Concepts 4 "Intended Audience and Qualitative Characteristics for the Consolidated Financial Report of the United States Government,"* that allows Treasury to refer to agencies financial statements for certain disclosures rather than reporting the information in the consolidated financial report (CFR). The respondent believed this should be the same case for certain non-core entities, or at least an option for consideration in certain situations. The example provided asked if GM was considered a non-core entity, what would be included in TARP's financial statements.

## Staff Analysis and Recommendation

### ***Issue #1 Core Entities--Consolidation of Different Fiscal Year Ends***

In reviewing FASB guidance, staff notes FASB ASC 810 Consolidation, Section 45-12 Differing Fiscal Year-Ends Between Parent and Subsidiary allows consolidating different year ends if the difference in year ends is not more than three months. The FASB standard requires disclosure of the effect of material events during the intervening periods. The section specifically states:

#### Differing Fiscal Year-Ends Between Parent and Subsidiary

45-12 It ordinarily is feasible for the subsidiary to prepare, for consolidation purposes, financial statements for a period that corresponds with or closely approaches the fiscal period of the parent. However, if the difference is not more than about three months, it usually is acceptable to use, for consolidation purposes, the subsidiary's financial statements for its fiscal period; if this is done, recognition should be given by disclosure or otherwise to the effect of intervening events that materially affect the financial position or results of operations.

GASB 14 encourages a common fiscal year end; it allows component units to have a different year-end if it is determined to be impractical to adopt a common one. If so, the reporting entity (which reports using the primary government's fiscal year) "should incorporate financial statements for the component unit's fiscal year ending during the reporting entity's fiscal year." The standard also notes if transactions between units that have a different fiscal year result in inconsistencies in amounts reported as due to or due from, transfer to or from, and so forth, the nature and amount of those transactions should be disclosed in the notes to ensure consistent reporting from year to year and any changes in fiscal years should be disclosed. However, the FASAB situation differs from the GASB situation because component units are not consolidated with the 'primary government' in the state/local reporting model, but instead are presented discretely.

Staff inquired about current practices and Treasury staff identified three entities that are currently consolidated in the CFR that have a different fiscal year end: Farm Credit System Insurance Corporation; Federal Deposit Insurance Corporation; and the National Credit Union Administration. For Closing Package purposes, Treasury asks them to provide 12-month balances and amounts as of September 30. They do not require them to provide full scope audited data as of September 30, but do request some audit assurance on material line items. Specifically Treasury Financial Manual I TFM 2-4700, Agency Reporting Requirement for the Financial Report of the United States Government, Section 4705.25—Special Basis of Accounting addresses the different fiscal year issue, as well as the different basis of accounting. The section is included as follows:

"Section 4705.25—Special Basis of Accounting- Verifying agencies under SFFAS No. 34, The Hierarchy of Generally Accepted Accounting Principles, that use accounting standards other than FASAB standards (for example, Financial Accounting Standards Board), as the basis for their audited financial statement data, or that do not have a fiscal yearend of September 30, are collectively referred to as converting agencies in GFRS. Converting agencies must perform an additional step in GFRS before reclassifying their financial statement line items to the Closing Package line items. They must convert their latest set of audited financial statements to a 12-month set of financial statements using the FASAB standards and a September 30 ending date. Converting agencies will reclassify the converted data to the Closing Package line items instead of the data from their latest audited financial statements."

**Staff Recommendation:**

Staff proposes the following wording:

Core government entities

1. The Statement provides for consolidation<sup>1</sup> 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 the Congress and the President.
2. Core government entities should apply the GAAP hierarchy established in SFFAS 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*.
3. Amounts consolidated for core entities should be based on a common reporting period.

**QUESTION: Does the Board agree with the staff recommendation to require a common reporting period?**

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***Issue # 2 Core Entities--Consolidation of FASB Based Information***

As noted, the goal of this project is to address how to consolidate FASB based entities in the government-wide entity. Staff expects there might be core entities that will continue applying FASB GAAP in the future or something other than federal government GAAP because it may be more appropriate to their objectives and operations. These federal entities would be permitted to use this as their primary source of GAAP for reporting in component entity financial statements. NOTE: The FASB Reporting by Federal Entities (previously called the Appropriate Source of GAAP Project) will address which federal entities should be permitted to continue applying FASB GAAP and, if so, whether additional reporting such as certain budgetary information should be required.

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<sup>1</sup> 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.

Examples of core entities that apply FASB include U.S. Government Printing Office (GPO), Pension Benefit Guaranty Corporation (PBGC), Federal Deposit Insurance Corporation (FDIC), United States Postal Service (USPS), Tennessee Valley Authority, and the U.S. House of Representatives.

Based on discussion with Treasury, it handles the consolidation of FASB statements with the same guidance noted in the issue above--specifically Treasury Financial Manual TFM 2-4700, Agency Reporting Requirement for the Financial Report of the United States Government, Section 4705.25—Special Basis of Accounting addresses the different fiscal year issue, as well as the different basis of accounting.

In reviewing GASB, there are situations where organizations are included that follow FASB standards. For example, there are college and university foundations organized as 501(3)(c) not for profits that follow the FASB model. GASB concluded in Statement 39, Determining Whether Certain Organizations Are Component Units—an amendment of GASB Statement No. 14—that those organizations can be included without conversion. The organizations are required to be discretely presented rather than blended. Statement 39 provided an exception to blending and through discrete presentation allowed the primary government to incorporate the financial information straight from the component unit's financial statements. There is no requirement to remeasure amounts or for different disclosures. The only differences are formatting and display and this is accomplished by presenting the financial information of those organizations on a separate page.

Also, staff believed the Basis for Conclusion provided an important explanation:

**Different Reporting Formats**

47. Another concern expressed by some respondents related to component units that report using a different generally accepted accounting principles (GAAP) reporting format than most primary governments do. However, the answer to question 104 in the Guide to Implementation of GASB Statement 14 on the Financial Reporting Entity states, in part: "Any noncompatible or additional statements required by the component unit's reporting model would not be combined with either governmental or proprietary component units, but instead would be presented as separate statements in the [general purpose financial statements]." Therefore, component units that use different GAAP reporting models need not be presented on the same page as the primary government, but may be reported on separate pages. In addition, Appendix E provides illustrative financial statements that demonstrate how information presented in a nongovernmental format can be presented so that it is "compatible" with the primary government's financial statement formats.

However, the FASAB situation differs from the GASB situation because component units are not consolidated with the 'primary government' in the state/local reporting model, but instead are presented discretely.

Based on previous meetings and work on the project FASB Reporting by Federal Entities, staff believes it was the Board's tentative position that none of the federal entities applying FASB will be required to convert to FASAB standards for their standalone general purpose financial reports until completion of the FASB Reporting by Federal Entities project which will provide standards to determine which entities may be allowed to continue using FASB GAAP.

Therefore, staff believes the Board is comfortable with including two sources of GAAP in the CFR until that project is completed. Therefore, staff explored options that allowed for this as well. The Board may wish to confirm this fact since it has been some time since this issue has been discussed and the FASB Reporting by Federal Entities project is coming back on the agenda. Much research has been performed in the FASB Reporting by Federal Entities project and the options below are based on the work performed in that project.

## **OPTIONS**

### Option 1- Conversion to FASAB through Audited Note Reconciliation

This option would be to require entities currently following FASB GAAP to continue to do so but require that they present in their individual financial statements an audited note reconciliation of the differences between FASB GAAP and FASAB GAAP that would support the numbers submitted to Treasury for the CFR. This option requires no change to the entity-level presentation other than the addition of an audited reconciliation footnote.

The standard should state that information provided to the U.S. Department of the Treasury for inclusion in the CFR should be presented in accordance with FASAB GAAP but should conform with accounting and reporting principles issued by the FASAB only if material differences would exist as a result of application of standards issued by the two boards. Amounts presented for entities applying FASB standards need not be restated to conform to FASAB standards to avoid unnecessary confusion and reconciliation among different sources of GAAP unless material differences occur.

Entities may apply FASB standards which is consistent with the GAAP hierarchy for federal entities because a FASAB standard specifically permits this approach. This principle would continue to be true for separately issued reports.

When financial information of FASB based entities is included in general purpose financial reports of a larger federal reporting entity (including Treasury's consolidated financial statements), any applicable standards issued by the FASAB that call for additional disclosure or supplemental information should be applied.

This option changes current practice only by requiring (1) component entities applying FASB GAAP to provide a disclosure of any material differences between FASB and FASAB amounts and (2) the CFR to disclose the use of reconciliation for any material amounts.

#### Proposed Standard Wording:

1. As all information in the consolidated financial report of the U.S. Government (CFR) will be reported in accordance with FASAB standards and supported by the individual component entity audited footnote reconciliations, there are no required disclosures for

the CFR other than a statement in the significant accounting policies note regarding the use of reconciliations in preparation of the report and a reference to the individual financial statements where reconciliations that have a material impact on the CFR can be found.

However, for component reporting:

2. A federal entity that has prepared its statements on a FASB basis should prepare a note that reconciles its FASB-based statements to FASAB-based statements for each line item on the entity's statements of financial position (stock statement) and operations (flow statement) on a line by line basis. Material differences are to be explained in a narrative that accompanies the note.

#### Option 2--Separate Accounting and Reporting by Line Item

Entities may apply FASB standards which is consistent with the GAAP hierarchy for federal entities because a FASAB standard specifically permits this approach. This principle would continue to be true for separately issued reports.

When financial information of FASB based entities is included in general purpose financial reports of a larger federal reporting entity (including Treasury's consolidated financial statements), any applicable standards issued by the FASAB that call for additional disclosure or supplemental information would still be applied.

The consolidated financial report of the U.S. Government (CFR) should report on the same basis as its component reporting entities – that is, amounts presented for entities applying FASB standards need not be restated to conform to FASAB standards – to avoid unnecessary confusion and reconciliation among different sources of GAAP. However, these FASB-based amounts would be appropriately segregated from FASAB-based amounts by line item and labeled accordingly, if material.

Proposed Standard wording:

1. The consolidated financial report of the U.S. Government (CFR) should distinguish FASB based line items on the face of its consolidated balance sheet and statement of net cost.
2. Significant federal entities that prepare their statements on a FASB basis should be explicitly listed in the notes to the financial statements with a reference to where the component financial reports can be located for additional information.

#### Option 3- Separate Accounting and Reporting Using the Modified Equity Method

This option contains the same general concept as option 2 except for the use of the modified equity method instead of line item reporting in order to simplify the financial statement display. In accepting this option, one would need to forgo an additional level of detail in favor of simplification for readers.

Entities may apply FASB standards which is consistent with the GAAP hierarchy for federal entities because a FASAB standard specifically permits this approach. This principle would continue to be true for separately issued reports.

When financial information of FASB based entities is included in general purpose financial reports of a larger federal reporting entity (including Treasury's consolidated financial statements), any applicable standards issued by the FASAB that call for additional disclosure or supplemental information would still be applied.

Staff research in the FASB Reporting by Federal Entities project, identified that most of the FASB based entities were *Business-type Activities*. Business-type activities are primarily funded by offsetting collections and receipts resulting from businesslike transactions or market-oriented activities with the public or transactions between appropriated activities.<sup>2</sup> These activities are financed and operated in a manner similar to private business enterprises—where the intent of the federal government is that the costs (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges.

A federal business-type activity differs from other government organizations in its relationship to the government, objectives, and operations. A federal business-type activity represents a financial asset of the government and given its autonomy, business-oriented objectives, and financial self-sufficiency, the equity method of accounting is appropriate. Accounting for a federal business-type activity by the equity method of accounting avoids commingling the independently-managed business-type activity's budget and actual results with those of other government organizations on a line-by-line basis. It also avoids including the business-type activity's gross debt with that of other government organizations as the business-type activity is expected to repay that debt from its own revenues.

Because a federal business-type activity operates a business, its financial statements may be prepared on the same basis as a private sector business as long as that basis best meets the needs of its primary financial statement users. This basis is most appropriate for measuring the government's investment in the organization and the impact it has on the government's financial position and results. As such, the modified equity method is the most suitable form of equity accounting.

The consolidated financial report of the U.S. Government (CFR) should report on the same basis as its component reporting entities – that is, amounts presented for entities applying FASB standards need not be restated to conform to FASAB standards – to avoid unnecessary confusion and reconciliation among different sources of GAAP. However,

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<sup>2</sup> Budget Glossary, pg. 29.

these FASB-based amounts would be grouped and appropriately segregated using the modified equity method.

Proposed Standard Wording:

1. The consolidated financial report of the U.S. Government (CFR) should include the aggregated net assets, net cost and net operating results of any core government entities permitted to apply primarily FASB standards on its balance sheet and statements of net cost and changes in net position in lieu of consolidating these financial statements line by line. The equity investment is initially recorded at cost and subsequently adjusted to reflect the reporting entity's share of the net profit or loss.
2. A schedule listing the core government entities primarily applying FASB standards, the audit opinion received on the applicable financial statements, and where the individual financial statements can be found should be disclosed.
3. Transactions with entities accounted for under the equity method are not eliminated and therefore require separate disclosure as related party transactions.

Although staff agrees that many of the FASB based entities may operate as federal business-type activities and that differs from other government organizations in its relationship to the government, objectives, and operations. A federal business-type activity may in some respects represent a financial asset given its autonomy, business-oriented objectives, and financial self-sufficiency, but based on the way the federal government participates in relationships with these entities it doesn't appear the most true depiction to show the federal government's right to the assets or resources held for its benefit. Therefore staff does not support the line item or modified equity recommendations. This would be very similar to GASB's contemplation of Line-Item Presentation for affiliated organizations in GASB 39, *Determining Whether Certain Organizations Are Component Units*. Specifically, par, 42-43 state

***Line-Item Presentation***

42. The Board also discussed using a line-item presentation on the statement of net assets/balance sheet of the primary government for displaying affiliated organizations. Some respondents to the revised ED suggested that line-item presentation was consistent with the guidance contained in FASB Statement 136. They believe that because the Board's decision to include "financially interrelated," as defined by that FASB Statement, in the "otherwise access" examples provided additional support for this position.

43. The line-item presentation is conceptually rooted in the primary government's control over or ownership of the net assets held by the organization. This display would have included the "net assets" of the organization to which the primary government was entitled. Similar to reporting an equity interest in a joint venture in Statement 14, this approach would consist of reporting an asset representing the participating government's entitlement to the resources held for its benefit. However, unlike a joint venture, a primary government does not have "an explicit, measurable right to the net resources of [the organizations addressed in this Statement] that is usually based on an investment of financial or capital resources ..." (Statement 14, paragraph 72). Because the Board emphasized the significance of the *relationship* between the component unit and the primary government as the premise of Statement 14, the Board believes that it is appropriate to display the

entire operations of these component units, not merely the net resources that the primary government is entitled to from these organizations. Compared to the line-item approach, discrete presentation displays more comprehensive financial information about the organization. Although some argue that discrete presentation results in double-counting revenues—once when received by the organization, and again when distributed to the primary government—the Board believes that clearly displaying and describing the intra-entity transactions, as required for all other transactions of a similar type between a primary government and its component units, should minimize the potential for misunderstanding. In addition, the presentation of a consolidated total for the reporting entity would eliminate any double-reporting concerns.

**Staff Recommendation:**

Staff believes Option 1 provides the best resolution for consolidating FASB based entities. The standard should state that information provided to the U.S. Department of the Treasury for inclusion in the CFR should be presented in accordance with FASAB GAAP should conform with accounting and reporting principles issued by the FASAB only if material differences would exist as a result of application of standards issued by the two boards. Amounts presented for entities applying FASB standards need not be restated to conform to FASAB standards to avoid unnecessary confusion and reconciliation among different sources of GAAP unless material differences occur.

This option requires no change to the entity-level presentation which staff believes would have been a big source of conversion costs--if the entities were required to prepare FASAB based statements. When one considers the materiality at the government-wide level and the fact they are both accrual based accounting basis, one must wonder how many material differences would occur between the two bases of accounting that would be considered material at the government-wide level.

Staff notes the FASB Reporting by Federal Entities project will continue researching the differences between the two, as objective c. of the project is “Establish requirements necessary to ensure that the stand alone federal financial reports prepared pursuant to FASB standards meet federal financial reporting objectives” That objective would be addressed by analyzing differences between the standards and developing additional guidance as needed. As noted in the project plan, the following list includes some of the areas where differences have been noted between FASAB and FASB accounting and reporting:

- SFFAS 1, *Accounting for Selected Assets and Liabilities*:
  - Valuation of Investments in Treasury Securities, pars. 68-70;
- SFFAS 2, *Accounting for Direct Loans and Loan Guarantees, as amended by SFFAS 18 and 19*:
  - Valuation of liability for guarantees of principal and interest payments on loans between a non-federal lender and a non-federal borrower;
- SFFAS 3, *Accounting for Inventory and Related Property*:
  - Inventory Valuation, par. 20;
- SFFAS 4, *Managerial Cost Accounting Standards and Concepts*:
  - General Requirement for Cost Accounting, pars. 67-76;
  - Inter-entity Costs, pars. 108 and 109;
- SFFAS 5, *Accounting for Liabilities of the Federal Government*.
  - Recognition of Nonexchange Transactions, par. 24;
  - Accounting and Reporting for Pensions, Other Retirement Benefits, And Other Postemployment Benefits, pars. 56-96;

- SFFAS 6, *Accounting for Property, Plant, and Equipment (PP&E)*:
  - Valuation of Transferred PP&E, par. 31;
- SFFAS 7, *Accounting for Revenue and Other Financing Sources*:
  - Financing Imputed for Cost Subsidies, par. 73;
  - Budgetary Reporting, pars. 77-82;
- SFFAS 15, *Management's Discussions and Analysis*; and
- SFFAC 2, *Entity and Display*.

The following are some of the areas that are reported by federal entities applying FASB standards but are not addressed by FASAB standards:

- FASB SFAS 71, *Accounting for the Effects of Certain Types of Regulation*;
- FASB SFAS 115, *Accounting for Certain Investments in Debt and Equity Securities* (regarding available-for-sale securities);
- FASB SFAS 133, *Accounting for Derivative Instruments and Hedging Activities*;
- FASB SFAS 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* (FASAB has recently initiated a joint project on asset impairment and deferred maintenance); and,
- FASB SFAS 143, *Accounting for Asset Retirement Obligations*.

Since these areas are not currently addressed by FASAB, the hierarchy of accounting principles for federal entities would most likely permit the application of accounting and reporting principles issued by FASB in these areas. This list is not exhaustive and will be further researched during the project.

As noted above, recall the feedback from the auditors generally supported that core entities should be required to follow FASAB GAAP. However, staff believes that additional entities will convert upon completion of the FASB Reporting by Federal Entities project. Also, there have been instances where certain components such as the US Mint, Export Import Bank, Millennium Challenge Corporation and others have voluntarily switched to FASAB GAAP, so this is encouraging news that others may do so. Lastly, the standard should provide for instances where core entities should continue to apply FASB GAAP and must be consolidated.

**QUESTION:**

**Does the Board agree with the staff recommendation to require:**

- a. material differences be adjusted before consolidation,**
- b. disclosure of reliance on reconciliations between FASB and FASAB amounts where material at the CFR level, and**
- c. component entities to disclose a reconciliation of FASB and FASAB based amounts?**

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***Issue # 3 Non-Core Entities— Non-core Disclosures, especially those that may relate to different year ends and the auditor’s responsibility for information that is disclosed entities audited by others***

The Board tentatively agreed at the April meeting that while the same year end is encouraged for non-core entities, it was agreed that a non-core year ending within the fiscal year of the core entity is acceptable for disclosing information in the notes. Based on the other feedback there didn’t appear to be other major issues that might arise considering the materiality and the fact these are disclosures.

As noted above, GASB 14 encourages a common fiscal year end, but allows component units to have a different year-end if it is determined to be impractical to adopt a common one. If so, the reporting entity (which reports using the primary government’s fiscal year) “should incorporate financial statements for the component unit’s fiscal year ending during the reporting entity’s fiscal year.” The standard also notes if transactions between units that have a different fiscal year result in inconsistencies in amounts reported as due to or due from, transfer to or from, and so forth, the nature and amount of those transactions should be disclosed in the notes to ensure consistent reporting from year to year and any changes in fiscal years should be disclosed.

Based on the feedback and research, staff believes different fiscal year ends for non-core entity disclosures can be incorporated. However, due to the fact there could be a large time lag, there should be a provision for disclosing significant changes in information (whether financial condition or other information) occurring from the audited financial statements to the reporting entity’s fiscal year end.

**Staff Recommendation:**

Staff proposes the following wording for Non-core basis of accounting:

Basis of Accounting for Non-core accountable entities<sup>3</sup>

1. Non-core accountable entities disclosed in the government-wide report should be reported on accrual based standards provided in generally accepted accounting principles for its specific type of entity. This includes generally accepted accounting principles for any domain (FASAB, Governmental Accounting Standards Board, or Financial Accounting Standards Board).
2. Although a common fiscal year-end is encouraged, it is not mandatory and the cost and benefits of establishing a common fiscal year-end may be considered. If non-core accountable entities have a different fiscal year-end than the core government-wide entity, financial information included for non-core accountable entities should be for the year ended within the core government entity’s year end, while being timely and accurate.

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<sup>3</sup> Core government entities should apply the GAAP hierarchy established in SFFAS 34, The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board.

3. Any significant changes in information occurring from the non-core entity's financial statement date to the core government entity's year end should be disclosed.

**QUESTION: Does the Board agree with the staff recommendation to:**

- a. permit non-core entity disclosures to be on any GAAP basis,
  - b. allow information for a year ended during the reporting period to be disclosed, and
  - c. require disclosure of any significant changes in information since the non-core entities year end?
- 

**Issue separate from different fiscal year end:**

Other concerns mentioned in the feedback appeared to relate to what the auditor might have to determine in testing the disclosures, audit work and whether to refer to the other auditor in the audit report and other audit specific items. The respondents discussed the issue of audit work and questioned when and if it might need to be performed. The Board considers the cost-benefit of the disclosures as well as the respective audit costs associated with the standards.

While staff believes some of the audit specific items appear beyond the scope of the FASAB and what the standard would address, one respondent suggested that Treasury be given the option to refer to non-core entities financial statements in the Government-wide disclosure. The respondent believed this should be the same case for certain non-core entities, or at least an option for consideration in certain situations. Staff notes this would be somewhat similar in principal to SFFAS 32, *Consolidated Financial Report of the United States Government Requirements: Implementing Statement of Federal Financial Accounting Concepts 4 "Intended Audience and Qualitative Characteristics for the Consolidated Financial Report of the United States Government,"* that allows Treasury to simply refer to agencies financial statements for certain disclosures rather than reporting the information in the consolidated financial report (CFR). However, SFFAS 32 reliance on the reference to the component reports is that the information is clearly audited and based on the same reporting model. A disclosure to a non-core entity financial statement could not be construed to have the same meaning. A question for the Board to consider is whether a reference to a non-core entity financial statement, especially one that may be significant—is this type reference an adequate substitution for full disclosure or one that would meet the disclosure requirements set forth in the proposed statement? Staff believes the proposed statement provides flexibility and factors that help to determine the extent of appropriate disclosures. Additionally, the proposed statement provides flexibility in what should be presented, not only in the type of required information but also in that the disclosures may be met through existing requirements. For example, the statement provides "if the federal government's risk of exposure is significant, then a set of summary

financial statements may be appropriate, whereas if the exposures are limited then an explanation of the amount of support offered (risk assumed) with selected financial info (net position and net results) might be appropriate.”

Considering the above reasons and the flexibility provided with disclosures, staff doesn't believe the option for a reference to a non-core entity financial statement would be appropriate.

**QUESTION: Does the Board agree with the staff recommendation to not provide an option to refer readers to non-core entity statements for more information? (Or alternatively, does the Board believe there should be an option for reference to a non-core entity financial statement for disclosures?)**

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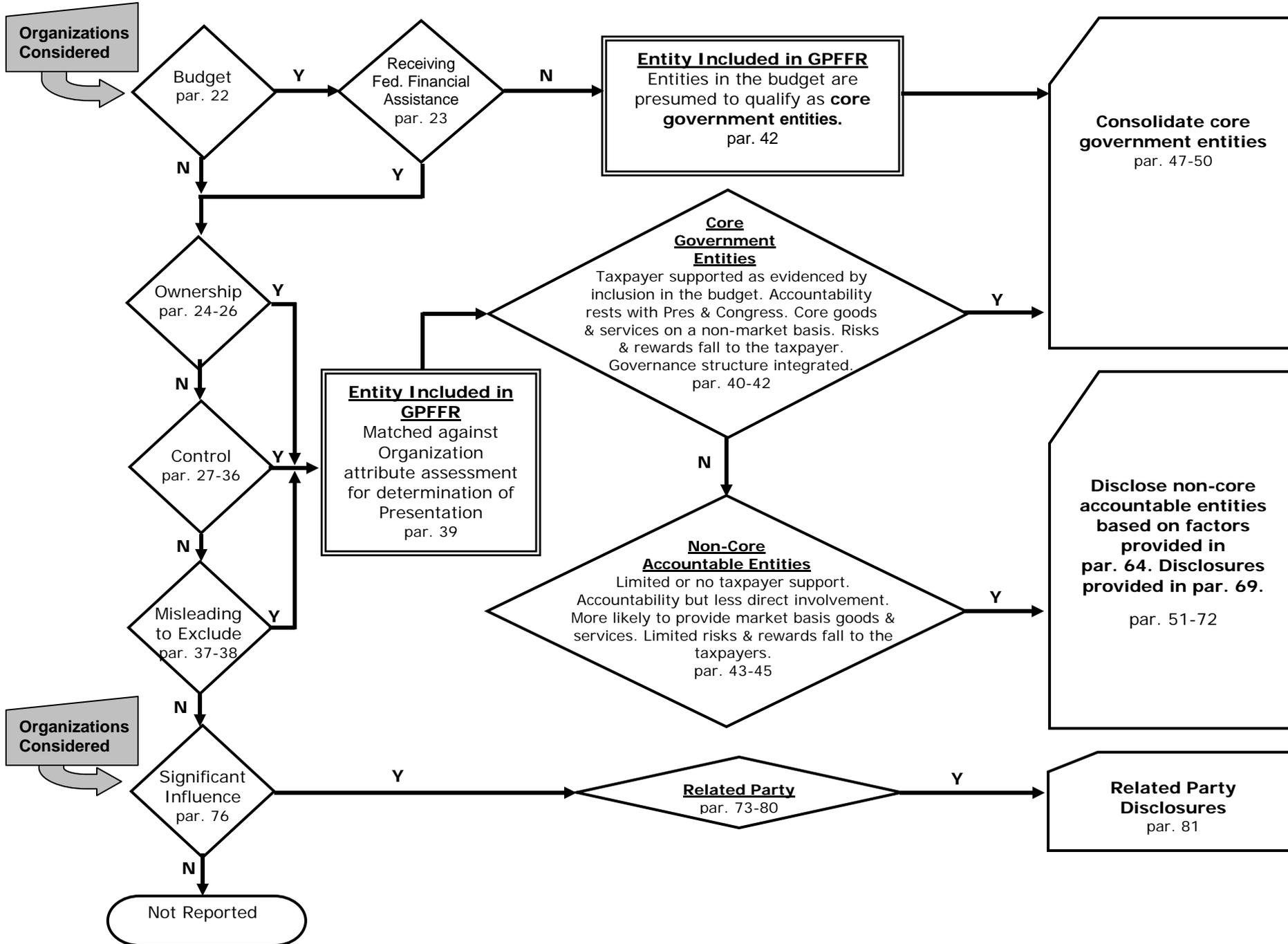


# HIGH LEVEL FLOW CHART

## Inclusion Principles

## Organization Type

## Presentation



## Introduction

### Purpose

1. The federal government's relationships with other entities have become increasingly complex. Public policy decisions can be carried out in a variety of ways and involve increasingly complex organizations and relationships. To meet federal financial reporting objectives, it is important to develop standards 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.
2. Notwithstanding these complexities, general purpose federal financial reports for the government-wide reporting entity should be broad enough to report the Congress and the President's accountability for those organizations. In addition, component reporting entity reports should allow the Congress and the President 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.<sup>1</sup>
3. This Statement guides preparers of general purpose federal financial reports<sup>2</sup> (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 comprehensive 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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<sup>1</sup> SFFAC 2 is a Concepts Statement and is considered Other Accounting Literature, see SFFAS 34, *The Hierarchy of Generally Accepted Accounting Principles (GAAP) Including the Application of Standards Issued by FASB* for more information regarding the hierarchy.

<sup>2</sup> The term general purpose federal 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-wide reporting entity is known as the Financial Report of the U.S. Government and for component reporting entities it is usually called the Performance and Accountability Report, the Agency Financial Report, or the Annual Management 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 for determining what organizations should be included in government-wide report and into each component reporting entity's financial report. 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. Statement of Federal Financial Accounting Concepts (SFFAC) 2 explains for the entity to be a reporting entity,<sup>3</sup> 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

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<sup>3</sup> SFFAC 2, par. 29-37, provides a discussion on Identifying the Reporting Entity for General Purpose Financial Reporting.

allocation and other decisions and hold the entity accountable for its deployment and use of resources.

10. **Government-wide Reporting Entity** 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 the Congress and the President are accountable based on principles established in this Statement.
11. **Component Reporting Entity** Component reporting entity is used broadly to refer to a reporting entity within a larger reporting entity<sup>4</sup> 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) 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. **Control with expected benefits or risk of loss** 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<sup>5</sup> to the federal reporting entity.

### Organizational Approach to Defining Reporting Entities

13. The federal government is unique because its constitutionally established powers, motivations, and functions are different than other organizations. It is an extremely complex organization responsible for the common defense and general welfare of the Nation. Although there are other perspectives,<sup>6</sup> such as a program perspective, in understanding the composition of the federal government, an organizationally based approach appears most appropriate in defining reporting entities for GPFFRs.
14. Focusing on organizations helps to identify who is accountable because there is a management responsible for controlling and deploying resources to produce outputs and outcomes. Each organization operates

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<sup>4</sup> The larger reporting entity could be the government-wide reporting entity or another component reporting entity.

<sup>5</sup> 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.

<sup>6</sup> SFFAC 2, par. 13-28 discusses the budget and program perspective of the federal government, as well as the intertwining of the perspectives.

under an established governance structure intended to meet an established public policy objective. Governance structures allow for varying degrees of autonomy in relation to the Congress and the President and appointed officials.

15. Accountability demands comprehensive reporting. To provide comprehensive reporting, the federal government must report on organizations that serve varied purposes and have complex governance structures and finances. Some differences in purposes and governance structures require differences in presentation of financial information. For example, certain organizational distinctions must be maintained for financial reports to meet budgetary integrity, operating performance, and stewardship reporting objectives established in SFFAC 1. In such cases, disclosures about the organization rather than financial information consolidated across all organizations may better meet these objectives.
16. Thus, decisions about reporting entities 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.
17. This Statement first establishes the principles for including organizations (see Principles for Inclusion in the Government-wide Report) then a distinction will be made between core government entities and non-core accountable entities (see Core Government Entities and Non-core Accountable Entities which describes these types of entities) for those organizations. Lastly, the presentation of financial information based on those decisions is addressed (see Government-wide Reporting Entity Consolidation and Disclosure).
18. PLACEHOLDER – DESCRIBE WHAT STANDARD WILL ADDRESS REGARDING COMPONENT REPORTING ENTITIES

### **Principles for Inclusion in the Government-wide Report**

19. General purpose federal financial reports for the government-wide reporting entity should be broad enough to report the Congress and the President’s accountability for organizations. The following paragraphs set forth principles for inclusion of an organization in Government-wide federal financial reports.
20. Clearly defining which entities should be included in the government-wide reporting entity ensures that the financial reports contain all the information essential for fair presentation of the financial position and the results of operations. To determine which organizations should be

included<sup>7</sup> in the government-wide report, this Statement provides three principles for inclusion in the GPFFR and requires inclusion of entities if it would be misleading to exclude them (see par. 37).

21. An organization meeting any of the three principles below is included in the government-wide GPFFR:
  - a. In the Budget;
  - b. Majority Ownership Interest; or
  - c. Control with expected benefits or risk of loss.

#### *In the Budget*

22. 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 unless it meets the exception provided in the next paragraph.
23. If the preparer believes an entity listed in the schedule *Federal Programs by Agency and Account* is actually a non-federal organization receiving federal financial assistance,<sup>8</sup> a review of the facts and circumstances is conducted to confirm the entity is not an organization for which the Congress and the President are accountable. Therefore, such an organization 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.

#### *Majority Ownership Interest*

24. The federal government (directly or through its components) may have an ownership interest<sup>9</sup> 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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<sup>7</sup> Included means basic information includes information regarding the entity..

<sup>8</sup> As defined by the Single Audit Act Amendments of 1996, federal financial assistance 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.

<sup>9</sup> 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*.

25. The holding of an ownership interest often entitles the holder to an 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.
26. Majority ownership interest exists with over 50% of the votes or the net residual assets<sup>10</sup> of an entity. When the federal government holds a majority ownership in an entity it should be included in the government-wide reporting entity.<sup>11</sup>

*Control with Expected Benefits or Risk of Loss*

27. An entity that is controlled by the federal government with the expectation of benefits or risk of loss to the federal reporting entity should be included in the government-wide reporting entity. For these purposes, such control 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<sup>12</sup> to the federal reporting entity. Both the power and either the expected benefit or risk of loss aspects of the definition should be met to justify inclusion of an entity. Hereafter, control with expected benefits or risk of loss is referred to simply as “control.”

28. 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.
29. 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.
30. 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.

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<sup>10</sup> For example, the federal government may hold more equity in preferred stock than all other stockholders but the preferred stock may be non-voting.

<sup>11</sup> Ownership interests 50% or less should be accounted for in accordance with the appropriate accounting standards per the GAAP hierarchy. However, the entity should still be assessed against the control and the misleading to exclude inclusion principles.

<sup>12</sup> 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.

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—such as an Executive Department. At the other end, the entity will have the power to act independently and, while the federal government may have a level of influence, it will be clear that it does not have control—such as a state government.

#### Indicators of Control

31. 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.
32. Certain indicators<sup>13</sup> 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. Typically, meeting any one of these indicators would mean control is 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. 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 fundamental purpose and mission of the entity, 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.
33. 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;

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<sup>13</sup> The indicators noted in par. 32 and 33 provide support for both the power and/or benefit part of the control definition. As noted in par. 27 a federal reporting entity should meet both the power and benefit elements for determining whether control exists. These are indicators and may list one or both elements of the definition.

- c. Appoint or remove key executives or personnel;
- d. Approve the budgets or business plans for the entity;
- e. Require audits;
- f. Veto, overrule, or modify governing board decisions or otherwise significantly influence normal operations;
- g. Finance the deficits of and provide financial support to or settle liabilities;
- h. Direct the entity to work with the government to provide services to taxpayers which may include determining the outcome or disposition of matters affecting the recipients of services;
- i. Establish, rescind, or amend management policies;
- j. Establish limits or restrictions on borrowing and investments of the entity; or
- k. Restrict the capacity to generate revenue of the entity, especially the sources of revenue.

#### Situations Where Control Does Not Exist

- 34. 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.
- 35. 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.
- 36. 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.

*Misleading to Exclude Principle*

37. There may be instances when an organization does not meet the inclusion principles in this Statement (ie. It is not included in the Federal Programs by Agency and Account, there is not majority ownership, or 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.<sup>14</sup>
38. This Statement requires inclusion of entities in the government-wide reporting entity if it would be misleading to exclude them.

**Organizations--Core Government Entities and Non-core Accountable Entities**

39. The principles above would be used to assess what organizations to include in reports. To assist in making decisions about presentation, a distinction will be made between core (or general) government entities and non-core accountable entities. This assessment is based on the degree to which the following characteristics are met: the entity is taxpayer supported, is governed by the Congress and the President, imposes or may impose risks and rewards on the taxpayer, and/or provides core federal government goods and services on a non-market basis. However, not all characteristics are required to be met; classification is based on the assessment as a whole.

Core government entities

40. Core (or general) government entities generally provide core federal goods and services on a non-market basis.<sup>15</sup> Such entities are financed primarily through taxes, fees, and other non-exchange revenues as evidenced by inclusion in the budget. Significant risks and rewards fall to the taxpayer for core government entities.
41. Accountability for core government entities rests with the President and the Congress. Their governance structure is vertically integrated with elected officials as evidenced by the chain of command and manner of decision making. Vertical integration may include the establishment of organizational authorities, development and approval of budgets, and the

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<sup>14</sup> Although situations such as this would be considered rare, this Statement provides for situations that may arise.

<sup>15</sup> Goods and services are provided on a non-market basis when they are provided free of charge or at charges that are not economically significant.

appointment of organizational leaders by the Congress and the President or their agents.

42. Entities listed in the budget and for which management has not asserted the entity is actually a non-federal entity receiving non-federal assistance (see par. 22-23) are presumed to qualify as core government entities while greater judgment will be needed to classify other entities.

#### Non-core accountable entities

43. 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.
44. Maintaining a distinction between the finances of such entities and core government entities will more effectively meet federal financial reporting objectives. Such a distinction allows 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 “non-core accountable entities.”
45. Non-core accountable entities may provide core federal government goods and services but are more likely to provide goods and services on a market basis.<sup>16</sup> Non-core accountable entities receive limited or no taxpayer support. Accountability rests with the Congress and the President, but they have less direct involvement in decision making than is true in core government entities. Limited risks and rewards fall to the taxpayers.
46. In addition to organizations for which the Congress and the President are accountable, the federal government may be able to exercise significant influence over certain entities or be subject to significant influence from certain entities. Such parties are referred to as “related parties.” See Related Party discussion beginning at par. **Error! Reference source not found.** for definition, disclosures and additional information.

### **Government-wide Reporting Entity Consolidation and Disclosure**

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<sup>16</sup> Goods and services are provided on a market basis when prices are determined in a competitive marketplace between willing buyers and sellers.

Core government entities

47. The Statement provides for consolidation<sup>17</sup> of core government entities financial statements 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 the Congress and the President.
48. Core government entities should apply the GAAP hierarchy established in SFFAS 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*.
49. Amounts consolidated for core entities should be based on a common reporting period.
50. Consolidation of FASB based statements addressed here--depends upon option selected by Board.

Non-core accountable entities

51. For those organizations not classified as core government entities, this Statement provides for judgment by the preparer in determining the appropriate disclosures based on the factors and principles provided herein.
52. Non-core accountable entities include but are not limited to: quasi governmental and/or financially independent entities, receiverships and conservatorships, and federal governmental intervention actions. In some cases, the relationship with the federal government is not expected to be permanent. The non-core entity types are presented to assist in identifying entities that are non-core accountable entities.
53. Non-core entities need not be grouped by type and no distinction is made by type for purposes of determining the appropriate presentation or disclosure. These types of entities and any other types of entities identified as non-core should provide disclosures consistent with Disclosures for Non-core Accountable Entities as detailed in par. 64 to 69 below after considering the factors listed in par. 64.

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<sup>17</sup> 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.

***Quasi Governmental and/or Financially Independent Entities***

54. Quasi Governmental and/or Financially Independent Entities are hybrid entities where accountability and transparency of these unique organizations are important yet they differ from core entities when assessing the governance and/or the financial (risk and rewards) arrangements.
55. Governance differences typically lead to greater independence. Characteristics may include the following:
  - a. Longer appointments of key executives or governing boards allow these appointees a degree of independence from the Congress and the President.
  - b. Delegated operational authority to provide a service or execute a program in a manner similar to private business enterprises.
  - c. May possess private sector legal characteristics.
  - d. May be voluntarily affiliated with the federal government and share purposes to implement government policies.
56. Financial differences typically 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 provide a service or execute a program 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.
57. Examples of Quasi Governmental and/or Financially Independent Entities may include Federally Funded Research and Development Centers (FFRDCs) However, details may differ among FFRDCs and some may potentially be core entities and therefore flexibility is necessary for determining the most meaningful presentation. The accompanying Illustrative Guide offers examples that may be useful in application.
58. Additional examples of Quasi Governmental and/or Financially Independent Entities may include museums, performing arts organizations and universities, venture capital funds, [OTHER GENERIC AND

SPECIFIC CASES WILL BE ADDED AS NEEDED TO AVOID UNINTENDED CONSEQUENCES.] The accompanying Illustrative Guide offers examples that may be useful in application.

### ***Receiverships and Conservatorships***<sup>18</sup>

59. 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 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.<sup>19</sup>

### ***Federal Government Intervention Actions***

60. 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.
61. 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 or to permanently operate entities acquired through past interventions.
62. Examples of intervention actions include:
- 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.
63. Temporary situations that exist at fiscal year-end must be assessed to confirm they are not expected to be permanent.

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<sup>18</sup> This differs slightly from 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.

<sup>19</sup> 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."

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Factors in Determining Non-Core Entity Disclosures

64. Materiality is an overarching consideration in financial reporting. Preparers should consider both qualitative and quantitative materiality in determining non-core entity disclosures. Beyond materiality, the following factors<sup>20</sup> should be considered in making judgments about the extent of appropriate non-core (accountable) entity disclosures:
- **Relevance to reporting objectives of reporting entity** - Significance of the entity in light of the reporting objectives. This would include the significance of the balances and/or information regarding results of operations and financial position to meeting the operating performance and stewardship reporting objectives.
  - **Nature of the potential benefits or risks/exposures associated with the relationship**- Information is needed to provide an understanding of the potential financial impact, including financial-related exposures to potential gain and risk of loss to the core entity resulting from the entity's operations.
  - **Organization views/perspective**- How the organization itself accounts for or reports on its relationship with the federal government. For example, whether the organization views itself as an extension of the federal government or operationally independent of the President and the Congress may influence the amount of information disclosed.
  - **Complexity of the relationship**- The more complex relationships would involve more detail to ensure the relationship is understood by the readers.
  - **Extent to which the information interests, or may be expected to interest, a wide audience** - Due to the sensitivity, materiality of the transactions or even perhaps a notable news headline, or other reasons, interested parties may expect some type of disclosures regarding the organization or the relationship with the federal government.
  - **Extent to which there are not alternative sources of reliable information**- An objective of general purpose federal financial reporting is to meet the needs of users who may have limited access to information or statements and lack the ability to demand the desired information.

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<sup>20</sup> The factors are presented in a list for consideration in the aggregate; no individual weights should be assigned or interpreted.

Disclosures<sup>21</sup> for Non-core Accountable Entities

65. Determining significant entities should be based on both qualitative and quantitative materiality considerations. Information about other entities not deemed material and similar type entities may be aggregated, where appropriate<sup>22</sup>. For each significant entity and aggregation of entities include the following:
  66. Nature of the federal government's relationship, including the name and description of the entity. Such information also would include as appropriate:
    - a. The nature of any control over the entity and/or the percentage of ownership interest and voting rights
    - b. For intervention actions, the primary reasons for the intervention and a brief description of the government's plan<sup>23</sup> relative to operating or disposing of the entity (including timeframes) and/or a statement that the intervention is not expected to be permanent
  67. For any core government entity transactions with the non-consolidated non-core entities (which are accounted for in accordance with the GAAP hierarchy established in SFFAS 34), a summary of amounts reported in the core government entity financial statements and the basis for determining the amounts reported
  68. The amount that best represents the federal government's maximum exposure to gain or loss from that involvement, including how the maximum exposure to gain or loss is determined. If this cannot be quantified, that fact should be disclosed
  69. Information that would provide an understanding of the potential financial impact, including financial-related exposures to potential gain and risk of loss to the government-wide reporting entity resulting from the entity. Examples of information that may provide the necessary understanding include:
    - a. Summary financial statements, condensed financial information for the entity (e.g. assets, liabilities, fund balances, total expenditures and sources of revenues), or key indicators. For example, if the federal government's risk of exposure is significant, then a set of summary

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<sup>21</sup> These may include disclosures accomplished through existing reporting requirements.

<sup>22</sup> Aggregation is flexible and based on the preparer's judgment. It may be based on non-core entity type, class, investment, or a particular event deemed significant by the preparer. The goal would be concise, meaningful and transparent disclosures.

<sup>23</sup> The plan 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.

financial statements may be appropriate, whereas if the exposures are limited then key indicators of financial impacts with selected financial info (net position and net results) might be appropriate.

- b. key terms of contractual agreements regarding financial impacts (including those terms of the arrangements to provide financial support and liquidity, including events or circumstances that could expose the federal government to a loss)
- c. the nature of, and changes in, the risks associated with the control or involvement with the entity such as changes in bond ratings, publicly-traded share prices, or other indicators of financial health or changes in financial health
- d. key statutory or other legal authorities relating to financial impacts

#### Basis of Accounting for Non-core accountable entities<sup>24</sup>

70. Non-core accountable entities disclosed in the government-wide report should be reported on accrual based standards provided in generally accepted accounting principles for its specific type of entity. This includes generally accepted accounting principles for any domain (FASAB, Governmental Accounting Standards Board, or Financial Accounting Standards Board).
71. Although a common fiscal year-end is encouraged, it is not mandatory and the cost and benefits of establishing a common fiscal year-end may be considered. If non-core accountable entities have a different fiscal year-end than the core government-wide entity, financial information included for non-core accountable entities should be for the year ended within the core government entity's year end, while being timely and accurate.
72. Any significant changes in information occurring from the non-core entity's financial statement date to the core government entity's year end should be disclosed.

#### **Related Party Government-wide Reporting Entity**

73. In addition to organizations for which Congress and the President are accountable, the federal government may be able to exercise significant

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<sup>24</sup> Core government entities should apply the GAAP hierarchy established in SFFAS 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*.

influence over certain entities or be significantly influenced by certain entities. Where such influence is outside the scope of normal operations and/or federal government relationships, such parties are referred to as “related parties.”

74. Certain information regarding related party relationships may enable 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.
75. Parties are considered to be **related parties** if the entities can be significantly influenced in making financial and operating decisions or if the federal government has an ownership interest but the entity was not included in the government-wide reporting entity.
76. **Significant influence** is the power to participate in the financial and operating policy decisions of an entity, but it is not control over those policies.
77. Indicators of significant influence may include the following: a large ownership interest<sup>25</sup> in an entity or if the entity was established<sup>26</sup> by the federal government. In considering related parties, attention should be directed to the substance of the relationship and not merely the legal form.

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<sup>25</sup> Large, but not a majority ownership interest. A majority ownership interest meets the inclusion principles set forth in the Standard.

<sup>26</sup> 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).

78. The objective of related party reporting in the federal government is to identify risks and influences that would not be expected in the normal operations of the federal government. The federal government enters into relationships for the good of the nation or to fulfill public policy goals and society needs. As a result, many complex relationships exist where significant influence is exerted. Judgment will be required to identify relationships that are not routine and may pose risks or introduce influences that warrant disclosure. In the context of this Statement, the following do not constitute significant influence and are not related parties:
- Entities with which the federal government transacts a significant volume of business resulting in economic dependence such as government contractors, state and local governments, and non-profit organizations
  - Entities that have no federal representation on their governing board
  - Key executives or other employees
  - Component entities of the federal government see full discussion in par. 80
  - Foreign governments or international bodies
79. Although par. 78 permits exclusion of certain entities as related parties, other factors may create a need for related party disclosures. The use of judgment will be necessary in identifying those factors consistent with the objectives of related party disclosures.
80. 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.<sup>27</sup> 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.

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<sup>27</sup> 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.”

**Related Party Disclosures for Government-wide Reporting Entity**

81. For any Related Party, the following should be disclosed:
- a. Nature of the federal government's relationship with the entity, including the name of the entity or if aggregated, a description of the related parties. Such information also would include as appropriate: if the entity was being influenced and/or the percentage of ownership interest.
  - b. 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.
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**Part II of Proposed Standard****Component Reporting Entities****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**

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

<p>The provisions of this Statement need not be applied to immaterial items.</p>
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