



Federal Accounting Standards Advisory Board

CLASSIFIED ACTIVITIES

Statement of Federal Financial Accounting Standards

Exposure Draft

Written comments are requested by March 16, 2018

December 14, 2017

THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

The Secretary of the Treasury, the Director of the Office of Management and Budget (OMB), and the Comptroller General of the United States established the Federal Accounting Standards Advisory Board (FASAB or "the Board") in October 1990. FASAB is responsible for promulgating accounting standards for the United States government. These standards are recognized as generally accepted accounting principles (GAAP) for the federal government. Accounting standards are typically formulated initially as a proposal after considering the financial and budgetary information needs of citizens (including the news media, state and local legislators, analysts from private firms, academe, and elsewhere), Congress, federal executives, federal program managers, and other users of federal financial information. FASAB publishes the proposed standards in an exposure draft for public comment. In some cases, FASAB publishes a discussion memorandum, invitation for comment, or preliminary views document on a specific topic before an exposure draft. A public hearing is sometimes held to receive oral comments in addition to written comments. The Board considers comments and decides whether to adopt the proposed standards with or without modification. After review by the three officials who sponsor FASAB, the Board publishes adopted standards in a Statement of Federal Financial Accounting Standards. The Board follows a similar process for Statements of Federal Financial Accounting Concepts, which guide the Board in developing accounting standards and formulating the framework for federal accounting and reporting.

Additional background information and other items of interest are available on the FASAB website:

- Memorandum of Understanding among the Government Accountability Office, the Department of the Treasury, and the Office of Management and Budget, on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board
- Mission Statement
- Documents for comment
- Statements of Federal Financial Accounting Standards and Concepts
- FASAB newsletters

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Federal Accounting Standards Advisory Board

December 14, 2017

TO: ALL WHO USE, PREPARE, AND AUDIT FEDERAL FINANCIAL INFORMATION

The Federal Accounting Standards Advisory Board (FASAB or “the Board”) requests your comments on the exposure draft of a proposed Statement of Federal Financial Accounting Standards, entitled *Classified Activities*. Specific questions for your consideration appear on page 6, but you are welcome to comment on any aspect of this proposal. If you do not agree with the proposed approach, your response will be most helpful to the Board if you explain the reasons for your position and any alternative you propose. Responses are requested by March 16, 2018.

All comments received by FASAB are considered public information. Those comments may be posted to FASAB's website and will be included in the project's public record.

Mail delivery is delayed by screening procedures. Therefore, please provide your comments in electronic form by email to fasab@fasab.gov. If you are unable to email your responses, we encourage you to fax comments to 202-512-7366. Alternatively, you may mail your comments to:

Wendy M. Payne, Executive Director
Federal Accounting Standards Advisory Board
Mailstop 6H19
441 G Street, NW, Suite 6814
Washington, DC 20548

We will confirm receipt of your comments. If you do not get a confirmation, please contact our office at 202-512-7350 to determine if your comments were received.

FASAB's rules of procedure provide that the Board may hold one or more public hearings on any exposure draft. No hearing has yet been scheduled for this exposure draft.

FASAB will publish notice of the date and location of any public hearing on this document in the Federal Register and in FASAB's newsletter.

Sincerely,

D. Scott Showalter
Chair

EXECUTIVE SUMMARY

WHAT IS THE BOARD PROPOSING?

The Board is proposing guidance to protect classified national security information or activities from unauthorized disclosure in a publically issued General Purpose Federal Financial Report (GPFFR). The guidance would permit certain modifications to information required by other standards. In addition, the proposal would permit classified Interpretations that may allow other modifications to information in GPFFRs.

The matter of public disclosure has been addressed in the budget arena. As a result, the availability of budgetary information for classified activities has been limited over the years. While topline budget numbers are available publicly, details remain classified including the amount of funding for particular components within the intelligence community and other departments or agencies. Public officials concluded that disclosure of funding details at lower levels may harm national security interests.

This proposal represents the first step in balancing the need for financial reports to be publicly available with the need to protect classified information from public disclosure. It would permit modifications that do not affect net results of operations and net position. In addition, if classified information could be revealed by applying the requirements of Statement of Federal Financial Accounting Standards (SFFAS) 47, *Reporting Entity*, this proposal would permit certain modifications to protect classified information. Further, Interpretations, that may themselves contain classified information, would address the requirements of existing standards and permit other modifications when needed to protect classified information. Modifications permitted by future Interpretations may affect net results of operations and net position.

HOW WOULD THIS PROPOSAL IMPROVE FEDERAL FINANCIAL REPORTING AND CONTRIBUTE TO MEETING THE FEDERAL FINANCIAL REPORTING OBJECTIVES?

This proposal would permit component reporting entities to provide GPFFR to the public by including limited modifications necessary to protect classified information from disclosure. This would allow financial presentation and disclosure to appropriately accommodate end user needs in a manner that does not impede national security.

MATERIALITY

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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QUESTIONS FOR RESPONDENTS

The Federal Accounting Standards Advisory Board (FASAB or “the Board”) encourages you to become familiar with all proposals in the Statement before responding to the questions in this section. In addition to the questions below, the Board also welcomes your comments on other aspects of the proposed Statement. Because FASAB may modify the proposals before a final Statement is issued, it is important that you comment on proposals that you favor as well as any that you do not favor. Comments that include the reasons for your views are especially appreciated.

The Board believes that this proposal would improve federal financial reporting and contribute to meeting the federal financial reporting objectives. The Board has considered the perceived costs associated with this proposal. In responding, please consider the expected benefits and perceived costs and communicate any concerns that you may have in regard to implementing this proposal.

The questions in this section are available in a Microsoft Word file for your use at <http://www.fasab.gov/documents-for-comment/>. Your responses should be sent to fasab@fasab.gov. If you are unable to respond by email, please fax your responses to 202-512-7366. Alternatively, you may mail your responses to:

Wendy M. Payne, Executive Director
Federal Accounting Standards Advisory Board
Mailstop 6H19
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All responses are requested by March 16, 2018.

Q1. Classified information is prohibited from public release and the Board is proposing an approach for protecting classified information from unauthorized disclosure. The proposed Statement would provide general guidance for protecting classified information and, when detailed guidance is needed, the Board proposes to provide classified Interpretations¹ of existing standards. GPFFR modified pursuant to this Statement and related Interpretations would be considered in accordance with generally accepted accounting principles.

Do you agree or disagree with the Board's overall proposed approach for protecting classified information? Please provide the rationale for your answer.

Q2. The proposed Statement permits reporting entities to modify unclassified financial statement presentations, disclosures, and required supplementary information (RSI) to protect classified information. The modifications are (1) those that do not change the net results of operations and net position and (2) the inclusion of an organization in a manner that would not reveal classified information.

a. Do you agree or disagree with permitting reporting entities to modify presentations to protect classified information when it does not change net

¹ With respect to Interpretations, the Board would follow its due process and appropriate protections would be applied to classified information.

results of operations and net position? Please provide the rationale for your answer.

- b. Do you agree or disagree with permitting certain modifications when applying the provisions of SFFAS 47, *Reporting Entity*, when necessary to protect classified information? Please provide the rationale for your answer.
- c. Do you agree or disagree with permitting modifications to disclosures and required supplementary information? Please provide the rationale for your answer.

Q3. In the future, the Board may issue classified Interpretations of existing standards. The Interpretations would permit other presentation and disclosure options as needed to produce unclassified GPFFR. The other options would protect specific financial statement elements from unauthorized disclosure in an unclassified GPFFR. The classified Interpretations would be developed following a due process involving:

- a. development of classified proposals,
- b. comment on the proposals from individuals and organizations holding appropriate clearances,
- c. consideration of comments, and
- d. issuance of Interpretations to individuals and organizations holding appropriate clearances. (See par. A9 and A10 for a more detailed discussion of the process.)

Do you agree or disagree with the proposed approach? Please provide the rationale for your answer.

Q4. The Board is proposing that recorded amounts related to classified information reconcile in aggregate to schedules or other documentation subject to audit. Documentation must be retained in the appropriate environment and/or domain to adequately support classified information.

Do you agree or disagree with the conditions necessary to apply the proposed Statement? Please provide the rationale for your answer.

Q5. The Board has considered how to inform readers of GPFFRs regarding the potential modifications given the classified nature of the modifications themselves.

- a. Do you agree or disagree with the disclosure requirements (see par. 10-14)? Please provide the rationale for your answer.
- b. Do you agree or disagree that component reporting entities may choose to consistently disclose that certain presentations may have been modified? Please provide the rationale for your answer.
- c. Alternatively, do you believe every component reporting entity of the federal government should be required to disclose that certain presentations may have been modified? Please provide the rationale for your answer.

PROPOSED STANDARDS

SCOPE

1. This Statement applies to federal entities that present general purpose federal financial reports (GPFFRs), including the consolidated financial report of the U.S. Government (CFR), in conformance with generally accepted accounting principles (GAAP), as defined by paragraphs 5 through 8 of 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*.

DEFINITIONS

2. **Classified National Security Information**, also known as "classified information," is any information that has been determined pursuant to Executive Order (EO) 13526, as amended; or any successor orders, to require protection against unauthorized disclosure and is marked to indicate its classified status. Information may be classified at one of the following three levels:
 - a. **TOP SECRET**, which is applied to information, the unauthorized disclosure of which reasonably could be expected to cause exceptionally grave damage to the national security that the original classification authority is able to identify or describe;
 - b. **SECRET**, which is applied to information, the unauthorized disclosure of which reasonably could be expected to cause serious damage to the national security that the original classification authority is able to identify or describe; and
 - c. **CONFIDENTIAL**, which is applied to information, the unauthorized disclosure of which reasonably could be expected to cause damage to the national security that the original classification authority is able to identify or describe.
3. **Original classification authority** is an individual authorized in writing, either by the President, the Vice President, or by agency heads or other officials designated by the President, to classify information in the first instance.
4. **Derivative Classification** is incorporating, paraphrasing, restating, or generating in new form information that is already classified, and marking the newly developed material consistent with the classification markings of the source of the information. Derivative classification includes the classification of information based on classification guidance. The duplication or reproduction of existing classified information is not derivative classification.

APPLICATION OF STANDARDS AND DISCLOSURES

5. Classified information is prohibited from public release. Classified information is determined by an Original Classification Authority (OCA) or by applying derivative classification.
6. A reporting entity's unclassified GPFFR should not reveal classified information. Therefore, unclassified reports should be presented in a manner that protects the classified information.

The entity may modify unclassified financial statement presentations, disclosures, and required supplementary information (RSI) required by other standards to protect the information if the modification does not change the net results of operations and net position. In this context, modify means:

- a. Presenting amounts associated with one financial statement line item in another financial statement line item but not presenting narrative explaining that fact so that classified information would not be disclosed
 - b. Omitting required disclosures or RSI that would otherwise reveal classified information
7. There may be organizations that according to SFFAS 47, *Reporting Entity*, should be included in a particular component reporting entity's GPFFR. In the instance when an organization² cannot be included in the particular component reporting entity GPFFR without revealing classified information, that organization may be included in another reporting entity.³
 8. The Board may issue Interpretations of existing Statements permitting other unclassified presentations and disclosure options as needed. The other options would protect specific financial statement elements from unauthorized disclosure in an unclassified GPFFR. Such options may modify net results of operations and net position.
 9. Recorded amounts related to classified information must reconcile in aggregate to schedules or other documentation subject to audit. Documentation must be retained in the appropriate environment and/or domain to adequately support classified information.

COMPONENT REPORTING ENTITY DISCLOSURES

10. Component reporting entities may choose to consistently disclose that certain presentations may have been modified. For example, the summary of significant accounting policies may indicate:

In accordance with accounting standards, certain presentations may have been modified to protect classified information.

11. Alternatively, the component reporting entity may omit disclosure of the fact that modifications⁴ in accordance with this Statement and related Interpretations were made.
12. Other disclosure modifications, including omission of information otherwise required, are permitted if needed to protect classified information.

² Decisions to exclude an organization from a particular component reporting entity to protect classified information may be evidenced by approval or concurrence from an oversight organization such as the Office of Management and Budget.

³ SFFAS 47, *Reporting Entity*, provides guidance regarding identifying organizations to include any associating organizations with a particular component reporting entity.

⁴ Modifications include those changes to presentation permitted by paragraphs 6 through 9.

13. If applicable, the financial report of the U.S. Government should disclose that certain presentations may have been modified to protect classified information. The financial report of the U.S. Government may omit disclosures related to specific Interpretations that may have been applied.
14. Other disclosure modifications, including omission of information otherwise required, are permitted if needed to protect classified information.

EFFECTIVE DATE

15. This Statement is effective upon issuance.

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

APPENDIX A: BASIS FOR CONCLUSIONS

This appendix discusses some factors considered significant by Board members in reaching the conclusions in this Statement. It includes the reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others. The standards enunciated in this Statement—not the material in this appendix—should govern the accounting for specific transactions, events, or conditions.

This Statement may be affected by later Statements. The FASAB Handbook is updated annually and includes a status section directing the reader to any subsequent Statements that amend this Statement. The authoritative sections of the Statements are updated for changes. However, this appendix will not be updated to reflect future changes. The reader can review the basis for conclusions of the amending Statement for the rationale for each amendment.

PROJECT HISTORY

- A1. In August 2016, the Department of Defense (DoD or the Department) identified several areas for the Federal Accounting Standards Advisory Board's consideration where the application of general accepted accounting principles may result in the exposure of classified information. As the DoD was preparing to commence full-scope financial statement audits, it identified specific accounting standard requirements that could conflict with its responsibility to prevent the unauthorized disclosure of information in accordance with Executive Order (EO) 13526 of December 29, 2009, "Classified National Security Information."
- A2. Specifically, EO 13526 recognizes, "Our democratic principles require that the American people be informed of the activities of their Government. Also, our Nation's progress depends on the free flow of information both within the Government and the American people. Nevertheless, throughout our history, the national defense has required that certain information be maintained in confidence in order to protect our citizens, our democratic institutions, our homeland security, and our interactions with foreign nations. Protecting information critical to our Nation's security and demonstrating our commitment to open Government through accurate and accountable application of classification standards and routine, secure, and effective declassification are equally important priorities."
- A3. Executive Order 13526, SEC 1.4 authorizes classification of information regarding the following types :
- military plans, weapons systems, or operations;
 - foreign government information;
 - intelligence activities (including covert actions), intelligence sources or methods, or cryptology;
 - foreign relations or foreign activities of the United States, including confidential sources;
 - scientific, technological, or economic matters relating to the national security;
 - United States Government programs for safeguarding nuclear materials or facilities;

- vulnerabilities or capabilities of systems, installations, infrastructures, projects, plans, or protection services relating to the national security; or
- the development, production, or use of weapons of mass destruction.

Unauthorized disclosure of classified information is prohibited by Title 18 U.S. Code, Section 798.

- A4. There are many federal departments and agencies engaged in classified activities such as those described above. In the recent past, information regarding the total amount budgeted for classified activities was not publicly disclosed. However, in the last decade, changes were made so that the topline budget numbers for such activities would be made available. Details remain classified including the amount of funding for particular components within the intelligence community and other departments or agencies. Disclosure of the funding details at lower levels of detail may harm the national security interests.
- A5. The affected departments and agencies thoroughly evaluated available options and determined that other options would not adequately resolve national security concerns. Based on input from stakeholders having national security expertise, the Board concluded that this Statement and future related Interpretations provide the optimal solution. This option would allow reporting entities to issue unclassified, publically available financial statements that comply with accounting standards. Without this Statement, there is a risk that reporting entities may need to classify their entire financial statements to comply with existing accounting standards which would likely result in the need to classify a large portion of the government-wide financial statements.
- A6. This Statement does not apply to the reporting of financial information within the GPFFR in the classified environment and only applies when the information is presented in the unclassified environment such as publicly available agency financial reports. This does not relieve reporting entities from their requirements and responsibilities to comply with existing accounting standards in the appropriate environment as it relates to internal records and non-public reports.
- A7. This Statement and future Interpretations would be applied as needed based on an assessment of the need to protect classified activities or to assist other departments and agencies by including an organization as described in paragraph 7. During the audit, the preparer would inform the properly cleared auditor whether and how this Statement and related Interpretations were applied. GPFFR modified pursuant to this Statement and related Interpretations would be considered in accordance with generally accepted accounting principles.

PROPOSED APPROACH TO REPORTING ON CLASSIFIED ACTIVITIES

- A8. This proposed Statement permits certain techniques for protecting information within the GPFFR related to classified activities. Certain other techniques are expected to be addressed through classified guidance issued as Interpretations of this Statement. The Board will establish a process to engage cleared stakeholders in due process regarding classified Interpretations of this Statement. The process will engage users of information related to classified activities.

- A9. The six-step process established in the "Memorandum of Understanding among the Government Accountability Office, the Department of the Treasury, and the Office of Management and Budget, on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board" will be followed in developing classified Interpretations. Appropriate protections will be applied to classified information, consistent with federal law applicable to federal advisory committees and their activities involving information classified pursuant to Executive Order. The six-step process for classified Interpretations and related protections are described below.
- a. Identification of accounting issues and agenda decisions
 - i. The Board will carry out this step by consulting with cleared stakeholders in secure facilities. Stakeholders - including preparers, auditors, and users of classified information - will be informed regarding the process for raising issues for Board consideration.
 - b. Preliminary deliberations
 - i. Preliminary deliberations will engage all members of the Board. Deliberations will occur during closed meetings. Closed meetings will be approved and announced in the Federal Register consistent with the process established in the Federal Advisory Committee Act.
 - c. Preparation of initial documents (issues papers and/or discussion memoranda)
 - i. We expect that all initial documents will contain classified information and will therefore be subject to federal requirements pertaining to classified information. Initial documents will be prepared by cleared individuals of FASAB staff and representatives of affected organizations who have original or derived classification authority.⁵ Such documents will be shared with members in a setting appropriate to the classification level of the documents. Members will be afforded adequate time to review the materials, ask questions, and deliberate over the materials before making decisions regarding the issues raised.
 - d. Release of documents to the public, public hearings, and consideration of comments
 - i. Members of the public will have an opportunity to comment on the proposed Statement. The public will be able to comment on the general subject matter discussed in the proposed Statement and the existence of classified Interpretations. The Board will consider all comments provided.
 - ii. Also, because we expect that all documents related to Interpretations will contain classified information, release will be limited to cleared individuals and organizations that have signed a non-disclosure agreement and have a need-to-know, in accordance with federal requirements pertaining to classified information. The Board will ensure a representative group of stakeholders with

⁵ The Board does not have original classification authority. The classification level of all work products will be determined by those with that authority.

varied perspectives and appropriate clearances are engaged. The Board expects to seek input from elected representatives of the public and appointed government officials to ensure the needs of citizens are balanced against national security interests. The Board will consider all comments and input received from the representative group of stakeholders.

- e. Further deliberations, exposure draft, and consideration of comments
 - i. This step will occur in closed sessions as noted above. The Board will seek input from cleared individuals, including elected and appointed officials, and organizations to the greatest extent possible given the classified nature of the materials and deliberations. The Board will consider all comments and input received from the representative group of stakeholders.
- f. Vote to approve proposed Interpretations
 - i. Consistent with the Board's established procedures for consideration of proposed Interpretations, final classified Interpretations will be those approved by a majority of the members and not objected to by a member representing the Comptroller General, the Secretary of the Treasury, or the Director of OMB during a 45-day review period. Final classified Interpretations will be maintained by FASAB. Component reporting entities should contact FASAB to arrange access to the classified Interpretations as needed. FASAB will provide access to any relevant Interpretations following appropriate security procedures.

A10. This approach balances the public's interest in financial information with the need to protect classified information. Further, the Board's process will be adhered to as closely as possible given the classified nature of the Interpretations. The Board's role in promulgating classified Interpretations will appropriately guide the techniques used in protecting classified information.

A11. While the modifications approved as GAAP will be applied to publicly available GPFRRs, internal records and non-public financial reports will continue to be subject to adequate internal controls. This Statement does not apply to classified and unclassified financial information provided to cleared personnel, including elected officials, in non-public financial reports. Hence, GPFRR not made publicly available will conform to GAAP without the application of this Statement and related classified Interpretations.

A12. The Board may issue Interpretations and implementation guidance in the classified environment.

APPENDIX B: ABBREVIATIONS

CFR	Consolidated Financial Report of the U.S. Government
ED	Exposure Draft
EO	Executive Order
DoD	Department of Defense
FASAB	Federal Accounting Standards Advisory Board
GAAP	Generally Accepted Accounting Principles
GPFFR	General Purpose Federal Financial Report
OCA	Original Classification Authority
OMB	Office of Management and Budget
RSI	Required Supplementary Information
SFFAS	Statement of Federal Financial Accounting Standards

APPENDIX C: GLOSSARY

Classified National Security Information, also known as "classified information," is any information that has been determined pursuant to Executive Order (E.O.) 13526, as amended; or any successor orders, to require protection against unauthorized disclosure and is marked to indicate its classified status. Information may be classified at one of the following three levels:

- a. **TOP SECRET**, which is applied to information, the unauthorized disclosure of which reasonably could be expected to cause exceptionally grave damage to the national security that the original classification authority is able to identify or describe;
- b. **SECRET**, which is applied to information, the unauthorized disclosure of which reasonably could be expected to cause serious damage to the national security that the original classification authority is able to identify or describe; and
- c. **CONFIDENTIAL**, which is applied to information, the unauthorized disclosure of which reasonably could be expected to cause damage to the national security that the original classification authority is able to identify or describe.

Original classification authority is an individual authorized in writing, either by the President, the Vice President, or by agency heads or other officials designated by the President, to classify information in the first instance.

Derivative Classification is incorporating, paraphrasing, restating, or generating in new form information that is already classified, and marking the newly developed material consistent with the classification markings of the source of the information. Derivative classification includes the classification of information based on classification guidance. The duplication or reproduction of existing classified information is not derivative classification.

Net results of operations – The term "net results of operations" describes the excess (or the deficit) of the "net cost of operations" over "financing sources." ... The net result of operations is also the current period's change in the cumulative results of the entity's operations since its inception, except to the extent that there are prior period adjustments. (*Implementation Guide: Accounting for Revenue and Other Financing Sources*, par. 63. Also, see SFFAC 2, *Entity and Display*, Appendix 1-C for an illustration of the calculation of net results of operations.)

Net position – Net position or its equivalent, net assets, is the arithmetic difference between the total assets and total liabilities recognized in the federal government's or a component entity's balance sheet. Net position may be positive (assets greater than liabilities) or negative (assets less than liabilities). (SFFAC 5, *Definitions of Elements of the Accrual Basis Financial Statements*.)

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