



December 3, 2009

Memorandum

To: Members of the Board

From: Ross Simms, Assistant Director

Through: Wendy M. Payne, Executive Director

Subj: The Financial Reporting Model – TAB G¹

MEETING OBJECTIVES

The purpose of the meeting is to discuss: (1) Board member concerns regarding the current reporting model so that the FASAB can ensure that the scope of the reporting model project remains appropriate; (2) staff proposed plans for an education session regarding the Canadian financial reporting model so that the FASAB can gain an understanding of how one government implemented financial management practices to provide information for decision-making and reflect accountability; and (3) staff proposed plans for managerial cost accounting so that staff can utilize the FASAB's feedback to conduct additional steps for the reporting model project.

BRIEFING MATERIALS

Attachment I: Categorization of Board Member Views provides a table that summarizes and arranges the FASAB's October 2009 reporting model discussion into five areas for analysis.

Attachment II: Background Information Regarding the Canadian Financial Reporting Model provides a summary of the Canadian financial reporting model.

¹ The staff prepares Board meeting materials to facilitate discussion of issues at the Board meeting. This material is presented for discussion purposes only; it is not intended to reflect authoritative views of the FASAB or its staff. Official positions of the FASAB are determined only after extensive due process and deliberations.

Attachment III: Proposed Managerial Cost Accounting Plan provides staff's proposed plans for the managerial cost accounting component of the project.

BACKGROUND

At the October 2009 meeting the FASAB discussed the diversity of information that users are seeking and the need to begin considering financial reporting model alternatives. Members noted that other national governments may provide the FASAB with some helpful ideas to consider and the Canadian reporting model was one model that the FASAB could study.

In addition, the FASAB discussed that the federal government is under extreme budgetary pressures and there is a need to become more efficient. Cost information would be helpful in assessing efficiency and in other decisions regarding federal government operations. Thus, managerial cost accounting could be considered an integral part of the reporting model.

To ensure that the scope of the reporting model project continues to address the matters of most concern to the FASAB, staff has summarized and arranged members' October 2009 discussion into a table that shows which views express: a perceived problem with the reporting model; cause(s) of the perceived problem with the model; potential effects of the perceived problem; conceptual views or views about "what should be;" and Board member suggestions for addressing the perceived problem. Attachment I: Categorization of Board Member Views provides the table and page 5 of the attachment provides questions for members to consider.

In addition, to begin exploring reporting model alternatives, staff has provided background information regarding the Canadian financial reporting model (see Attachment II: Background Information Regarding the Canadian Financial Reporting Model) and staff plans to arrange an educational session involving Canadian government financial management officials. To enable the FASAB to learn about the Canadian financial reporting model, staff plans to invite Canadian government leaders to attend the February 2010 FASAB meeting and discuss: a brief history of their financial reporting efforts; an overview of their existing model, including a discussion of what benefits they were hoping to achieve from the model, what benefits have been observed, challenges faced in implementation, and how the challenges were overcome; and plans for the future. Particular questions that we intend to address include:

1. What factors were considered when determining the form and content of the federal government and department financial statements?

2. What basis of accounting (e.g. cash, modified cash, modified accrual,² full accrual) is used for the federal government and department financial statements and what factors were considered when determining the basis of accounting?
3. In determining the basis of accounting, were any of the following considered?
 - a. Need to provide information on intergenerational fairness or equity
 - b. Need to provide information for asset management, e.g. identifying and disposing of surplus assets and managing risk of loss, theft, or damage
 - c. Need to manage and disclose liabilities including contingent liabilities and commitments
 - d. Need to identify payments in arrears
 - e. Need to provide information for liquidity management
 - f. Need to assess sustainability of government programs
 - g. Need to provide information on the cost of programs
 - h. Need to modernize financial management systems
 - i. Information needed for better decision-making
 - j. Need to improve efficiency and effectiveness
4. It appears that the present set of financial statements articulate or are integrated. Why was this approach chosen?
5. Who are the actual users of the federal government financial statements?
6. Who are the actual users of the department financial statements?
7. How are the federal government and department financial statements used?
 - a. What types of decisions do the financial statements help address?
 - b. What information in the financial statements is considered important to decisions?
 - c. Are the financial statements discussed in Parliament?
 - d. Are the financial statements used in assessing performance?
8. What benefits have been noted from the preparation and audit of the federal government financial statements?
9. What benefits have been noted from the preparation and audit of department financial statements?
10. Are there any plans for revising the federal government and department financial statements? If so, what are the plans and why?

² Modified accrual accounting may be described as recognizing financial assets and liabilities on a statement of assets and liabilities regardless of when cash is exchanged, but amounts paid for physical assets are recorded as expenditures.

11. Presently, is there a difference between the basis of accounting for budgeting appropriations and the basis of accounting for financial statements? If so, are there challenges associated with presenting financial statements and budgetary information using different bases?
12. What were some of the challenges experienced in preparing financial statements for the federal government and for departments and how were the challenges addressed?

Also, staff has prepared a proposed plan for incorporating managerial cost accounting into the project. Staff designed the plan to focus on the information needs of external and quasi-external (Congress and central agency officials) users. This approach would involve developing accounting standards to provide external and quasi-external users with information to compare costs across agencies, while permitting internal users, such as program managers, the flexibility to develop the specific measures they need to manage their unique functions. Julia Ranagan will conduct the component and the plan is provided in Attachment III: Proposed Managerial Cost Accounting Plan.

Next Steps

Staff plans to continue with the reporting model project including managerial cost accounting, inventorying user needs, and determining models for FASAB consideration.

Questions for the Board

Questions that members should consider are as follows:

Board Member Views Regarding the Reporting Model

1. Do you agree with the statements of the perceived problems? If not, what do you view as the problems?
2. As a generally accepted accounting principles (GAAP) standards-setter, the FASAB offers a comparative advantage that is unique in federal financial reporting. Considering the FASAB's unique responsibility and current priorities, which perceived problem, do you believe the FASAB could have a direct role in addressing through accounting standards?
3. Which view(s), if any, do you believe state the causes of the perceived problems the FASAB should address? If not already listed, what do you believe are the causes of the perceived problem that the FASAB should address?
4. Do you agree with the potential effects of the perceived problems? If not, what do you view as the potential effects of the perceived problems?
5. Do you agree with the views about what should be? What additional views should be considered in the discussion?
6. Based on the views of the causes and what should be, which suggestions, if any, do you believe should be pursued by FASAB to resolve the perceived problems? If not

already listed, how do you believe the causes of the perceived problems should be addressed by FASAB?

Proposed Plan to Conduct an Educational Session during the February 2010 Meeting

1. Does the Board agree with staff's plans for an educational session with Canadian government officials?
2. What additional information would the FASAB want to know about the Canadian reporting model?

Plan for Incorporating Managerial Cost Accounting

1. As part of the managerial cost accounting plan, does the FASAB agree with the proposed approach to focus on external and quasi-external users?
2. Are there additional matters that should be considered as part of the managerial cost accounting plan?

If you have questions or need additional information, please contact me at 202-512-2512 or by email at simmsr@fasab.gov as soon as possible. I will be able to consider and respond to your request more fully in advance of the meeting.

Attachments

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Attachment I: Categorization of Board Member Views

Purpose

The purpose of the analysis is to arrange Board member views regarding the reporting model so that the Board agrees and focuses on issues to address the perceived concerns with the existing model.

Scope and Methodology

Based on the October 2009 FASAB meeting, staff summarized and arranged Board member views into the following categories: perceived problem with the reporting model; cause(s) of the perceived problem; potential effects of the perceived problem; conceptual views or views about “what should be;” and Board member suggestions for addressing the perceived problem.

Results

See Table 1: Categorization of Board Member Reporting Model Views

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Table 1: Categorization of Board Member Reporting Model Views

	PERCEIVED PROBLEM	CAUSE(S) OF PERCEIVED PROBLEM	POTENTIAL EFFECTS OF PERCEIVED PROBLEM	VIEWS ABOUT "WHAT SHOULD BE"	MEMBER SUGGESTIONS TO ADDRESS THE PERCEIVED PROBLEM	STAFF COMMENTS
1.	<p>Constituents are not using the audited financial statements of agencies or the financial report of the U.S. government.</p>	<ul style="list-style-type: none"> Financial systems do not [provide information to] answer the questions coming from the President and Vice President, major media outlets, the Congress, the Government Accountability Office (GAO), and others. Statements do not provide useful metrics. The current statement of net cost amount is a deficit type measure rather than a measure to answer the question of what does it cost to operate agencies. Everyone wants data presented differently. Users' needs are diverse. Citizens may not care about internal control, but CFOs do. Also, while citizens want information on intergenerational equity, agency management may not. Constituents can see information by agency or by a particular fund, but they cannot see that they received value for their money. Websites such as recovery.gov and spending.gov give examples of the level of information they would like to have. 	<p>Costs are being incurred to present information that is not used</p>	<ul style="list-style-type: none"> The public wants to know where their money is going (see Recovery.gov). However, the managerial utility of this information is not clear. The bottom line of an agency operating statement should show the value of some of their operating efficiency efforts. If one says where the accruals are most important, it would be at the government-wide level. Information on intergenerational equity cannot be determined at the individual payment level, it must be an accumulation of resources generated versus spent by period or generation. 	<ul style="list-style-type: none"> Although there may not be a "bottom line," in agency financial statements, there may be significant "line items." Move away from agency-level financial statements and focus on line items that are material to the government-wide financial statements. Financial reporting is an aggregation of information reported at the Recovery.gov level and displays will need to be designed to facilitate capturing the needed data at the beginning of the transaction. A decision must be made to define a unified taxonomy at the highest level and then build a data warehouse where individuals can pull the information the way they need. Continue with user needs study. Add Managerial cost accounting to the project. 	<p>Consider that Statement of Federal Financial Accounting Concepts (SFFAC) 1, paragraph 21 states, "...the processes of preparing and auditing financial reports can enhance the government's overall accountability structure by providing greater assurance that transactions are recorded and reported accurately, that consistent definitions are used to describe the transactions, etc."</p> <p>Also, consider that staff's citizens user needs study noted that citizens have difficulty locating and understanding financial reports.</p>

	PERCEIVED PROBLEM	CAUSE(S) OF PERCEIVED PROBLEM	POTENTIAL EFFECTS OF PERCEIVED PROBLEM	VIEWS ABOUT "WHAT SHOULD BE"	MEMBER SUGGESTIONS TO ADDRESS THE PERCEIVED PROBLEM	STAFF COMMENTS
2.	Financial statements are costly to prepare and audit.	<ul style="list-style-type: none"> • Preparing and auditing the balance sheet, primarily asset valuation efforts, contribute to the costs. • The balance sheet is used in part to allocate costs between reporting periods. 	Impacts the amount of resources that could be utilized providing information of value.	<ul style="list-style-type: none"> • If one says where the accruals are most important, it would be at the government-wide level. • Net position is only important at the government-wide level. At the agency level, Congress can move funds from one agency to another. • Accountability does affect the dynamic of whether we want accrual basis of accounting for fixed assets. 	<ul style="list-style-type: none"> • Treasury could produce all the financial statements for the federal government rather than each agency producing them. Agencies can provide trial balances. • Move away from agency-level financial statements and focus on line items that are material to the government-wide financial statements. • Agencies could continue preparing balance sheets, but the statement would not be subject to the same level of precision that it is today. • Others have solved the problem. Consider the model of other countries like Canada or state governments. 	The FASAB considers the cost and benefits of each accounting standard.

Questions for FASAB Members

1. Do you agree with the statements of the perceived problems? If not, what do you view as the problems?
2. As a generally accepted accounting principles (GAAP) standards-setter, the FASAB offers a comparative advantage that is unique in federal financial reporting. Considering the FASAB's unique responsibility and current priorities, which perceived problem do you believe the FASAB could have a direct role in addressing through accounting standards?
3. Which view(s), if any, do you believe state the causes of the perceived problems the FASAB should address? If not already listed, what do you believe are the causes of the perceived problem that the FASAB should address?
4. Do you agree with the potential effects of the perceived problems? If not, what do you view as the potential effects of the perceived problems?
5. Do you agree with the views about what should be? What additional views should be considered in the discussion?
6. Based on the views of the causes and what should be, which suggestions, if any, do you believe should be pursued by FASAB to resolve the perceived problems? If not already listed, how do you believe the causes of the perceived problems should be addressed by FASAB?

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Attachment II: Background Information Regarding the Canadian Financial Reporting Model

Overview of Canadian System of Government

The Queen is the formal head of the Canadian state and she is represented federally by the Governor General, and provincially by the Lieutenant-Governors.³ Canada's Parliament consists of three parts: the Queen; the appointed Senate; and the elected House of Commons. The Parliament decides on policies and laws and holds the government accountable.⁴

The Governor General calls Parliament together, after every general election, reads the Speech from the Throne which discusses the government's objectives, and approves all bills passed by the Senate and the House of Commons. Also, the Governor General, on the advice of the Prime Minister, appoints Senators to represent regions, provinces or territories and the Senate has 105 members. Conversely, members of the House of Commons are elected to represent the people and have 308 members.⁵

A Parliament cannot last longer than five years, after which a general election must be held. The Constitution authorizes Parliament to make laws in certain areas of jurisdiction, such as criminal law, defence, international trade and broadcasting.⁶

Senators and Members of Parliament both study, debate, and often amend legislative proposals or "bills." Bills are usually proposed by the government and introduced in the House of Commons. The Senate also initiates legislation, but any bills to collect or spend public funds must originate in the Commons. Both Houses must approve bills in identical form before they can become law and bills become law when they receive Royal Assent, on a date specified in the bill or on a date set by Order-in-Council.⁷

The Prime Minister is appointed by the Governor General and selects the members of the Cabinet. All Cabinet members must be or become members of the Queen's Privy Council for Canada. The Privy Council Office advises the Prime Minister and Cabinet on priorities. The Governor General on the advice of the Prime Minister appoints the Privy Councillors who are members for life, unless dismissed by the Governor General on the advice of the Prime Minister. Custom calls for almost all Cabinet members to be members of the House of Commons. If not already members, they must win seats.

³ See http://www2.parl.gc.ca/Sites/LOP/AboutParliament/Forsey/institutions_02-e.asp.

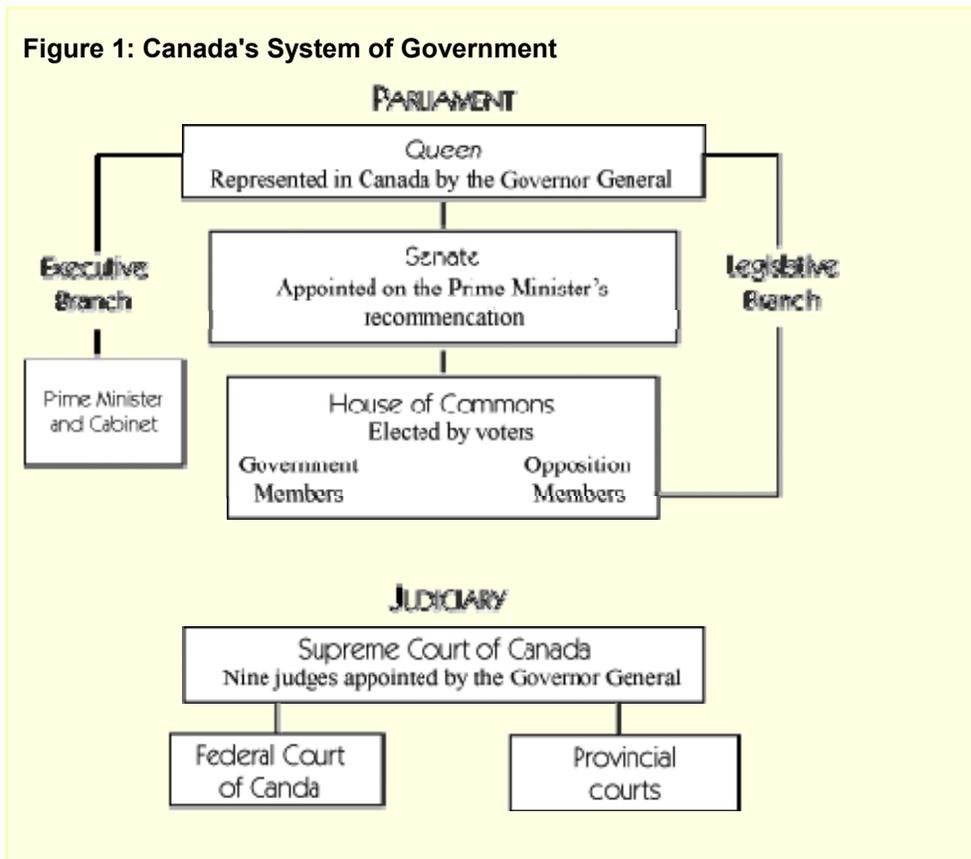
⁴ See <http://www2.parl.gc.ca/Sites/LOP/AboutParliament/Misc/DemocracyInAction/Democracy-e.asp>.

⁵ Ibid.

⁶ Ibid.

⁷ Ibid.

Also, by custom, every province must have at least one Cabinet minister.⁸ Figure 1: Canadian System of Government provides an overview of the Canadian system of government.



Source: http://www2.parl.gc.ca/Sites/LOP/AboutParliament/Forsey/institutions_01-e.asp

Fiscal Operations

Canada is a federation of 10 provinces and three territories. The provincial governments have considerable power and are legally equal to the federal government. The constitution establishes areas of responsibility. For example, health and education are under provincial authority while the federal government is responsible for defense and

⁸ See <http://www2.parl.gc.ca/Sites/LOP/AboutParliament/Forsey/index-e.asp>.

immigration. Most of federal spending involves transfer payments to provinces and territories for social services (e.g. post secondary education and health care) and to persons for old-age security and employment insurance.⁹ A summary of some key elements and responsibilities in the Canadian fiscal structure is provided in Table 1: Summary of Key Elements and Responsibilities.

TABLE 1: Summary of Key Elements and Responsibilities

Element	Responsibility
Holds the government to account, approves all spending on an annual basis.	Parliament
Developing an annual budget and a multi-year fiscal framework.	Minister and Department of Finance
Establishing annual departmental reference levels (the ongoing programme resource base), considering the renewal of existing programmes, setting results management policies.	Treasury Board (a committee of the Cabinet supported by the Treasury Board Secretariat).
Approval of new policies and development of new programmes.	Cabinet supported by the Privy Council Office and the Department of Finance.
Allocating and reallocating to ensure alignment with priorities and aggregate expenditure control.	Departments routinely – plus the three central agencies (The Privy Council Office, Department of Finance, and The Treasury Board Secretariat) in special cases.
Seeking parliamentary approval of spending plans through the Estimates process.	President of the Treasury Board – supported by the Treasury Board Secretariat.
Reporting to Parliament on spending plans, actual expenditures and results achieved.	Ministers supported by the Treasury Board Secretariat and departments.

Source: McCormack, Lee, *Performance Budgeting in Canada*, OECD Journal on Budgeting, Volume 7, No. 4, OECD 2007, p.6.

The Receiver General (RG) for Canada, President of the Treasury Board, and Minister of Finance prepare the annual report of the Government of Canada entitled, *Public Accounts of Canada*.¹⁰ The report is prepared utilizing data from centralized summaries of revenue, expense, asset, and liability transactions (accounts of Canada) maintained by the RG and detailed records maintained by departments and agencies. Departments and agencies are responsible for reconciling their accounts to the RG's control accounts and for maintaining detailed records of the transactions in their accounts. The financial statements of the Government of Canada are intended to reflect the financial position of

⁹ McCormack, Lee, *Performance Budgeting in Canada*, OECD Journal on Budgeting, Volume 7, No. 4, OECD 2007, p.4.

¹⁰ See <http://www.tpsgc-pwgsc.gc.ca/recgen/txt/72-eng.html> for the *Public Accounts of Canada* for 2009.

the government, results of operations, accumulated deficit, change in net debt, and cash flow for the year then ended.¹¹

The Office of Auditor General (OAG) of Canada audits the financial statements and issues an opinion to the House of Commons. The financial statements are tabled in the House of Commons and referred to the Standing Committee on Public Accounts. This committee reports to the Parliament on the results of its examination regarding the financial statements and audit opinion.¹² Some features of the Canadian federal government financial statements include:

- Net Debt Position. This amount is often referred to as the government's future revenue requirements because it seeks to measure future revenue required to pay for past transactions and events. It is calculated as the difference between financial assets and liabilities.¹³
- Accumulated Surplus/Deficit Position. This amount indicates the net recognized economic resources (net assets) of the government. Nonfinancial assets, which provide future services, are added to net debt to calculate net assets. Net assets provide an indicator of the government's ability to provide future services.
- Annual surplus/deficit. The amount measures whether the government has maintained its net assets during the period and shows whether revenues were sufficient to cover the costs of that period.
- Change in Net Debt. This amount shows whether revenue raised was sufficient to cover spending in the year. Increases in net debt indicate that more future revenue will be needed to pay for the effects of past transactions and events. If spending was on capital, the statement of changes in net debt would draw attention to this activity.
- Cashflow statement. The statement shows the change in cash in the year and the sources and uses during the period. Capital activity would be highlighted.¹⁴

Recent Initiatives

In March 2004, the Treasury Board announced that the financial statements of all departments and agencies would be audited.^{15, 16} Departmental management is

¹¹ *Public Accounts of Canada 2009*, Volume I, Summary Report and Financial Statements, p. 2.9

¹² *Ibid.*

¹³ In November 1991, the FASAB proposed the concept of net financial resources for federal entities. Net financial resources referred to an entity's total financial resources less total funded liabilities. The concept was intended as a general measure of an entity's financial sufficiency. However, respondents did not believe that the concept was useful and that the measure was not well defined. They believed that one element, unfunded liabilities, was missing from the concept. See Statement of Federal Financial Accounting Standards 1, *Accounting for Selected Assets and Liabilities*, paragraphs 87-89.

¹⁴ Denning, Martha Jones, *Multi-Message Model: PSAB wants Financial Statement Readers to Look at more than just a Government's Annual Surplus/Deficit*, CA Magazine, April 2003, p. 43.

¹⁵ Audit committees were also established at departments and agencies. The audit committees report directly to deputy heads of federal departments and agencies and they provide advice on and oversight of department management, control, and accountability processes. See <http://www.tbs-sct.gc.ca/iac-cvi/index-eng.asp>.

responsible for preparing the departmental financial statements and for the integrity and objectivity of all information contained in them. The audit of the departmental financial statements will be controls based. This approach would enable the OAG to audit the departments' financial statements with limited substantive testing.¹⁷

Subsequently, in 2005, the Office of the Comptroller General (OCG)¹⁸ began a tiered approach to the departmental financial statements initiative and proposed that the financial statements of the 22 largest departments (over \$1 Billion of expenditures on average) be the first to be audited. The expenses of these departments represented approximately 90% of total government expenses. Also, the OCG asked the 22 departments to perform an assessment of their readiness to endure a controls-based audit and, based on the assessments, develop and implement an action plan. The 22 departments completed their readiness assessments and are developing and/or implementing their action plan. The OCG monitors the progress of the departments on an on going basis.¹⁹

In addition, the Canadian government has plans to implement accrual-based budgeting. The approach will be implemented in phases.²⁰

Questions for FASAB Members

1. Does the Board agree with staff's plans for an educational session with Canadian government officials?
2. What additional information would the FASAB want to know about the Canadian reporting model?

¹⁶ Treasury Board of Canada, *Audited Departmental Financial Statements Initiative*, accessible at <http://www.tbs-sct.gc.ca/fm-gf/ktopics-dossiersc/gapr-pcrg/overview-apercu-eng.asp>.

¹⁷ Ibid.

¹⁸ The OCG is responsible for providing functional direction for financial management and internal audit in the federal government. The OCG ensures that sound financial management and internal audit practices are in place.

¹⁹ See <http://www.tbs-sct.gc.ca/fm-gf/ktopics-dossiersc/gapr-pcrg/overview-apercu-eng.asp>.

²⁰ *Public Accounts of Canada 2008*, Volume I, Summary Report and Financial Statements, p. 2.35.

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Attachment III: Proposed Managerial Cost Accounting Plan

SFFAS 7 addressed presentation of gross and net cost on the statement of net cost and SFFAS 4 established one concept and five standards on managerial cost accounting. These standards influence not only presentation of information on the statement of net cost but also the development of cost accounting systems internally. To date, the Board has not undertaken a comprehensive review of the outcome resulting from these general standards. In late 2008, the Board considered undertaking a project entitled “linking cost to performance.” Based on roundtable discussions and review of agency reports, questions to explore included:

1. Why are agencies selecting the cost objects, programs, or goals, and responsibility segments presented on the statement of net cost?
2. For what Federal uses have agencies found cost accounting most cost effective?
3. How does or might Congress use cost information?
4. Is there evidence that requiring agencies to develop systems—rather than conduct periodic cost finding studies—would accelerate improvement of cost information?

Staff believes the project should exclude consideration of the needs of users internal to each agency. Such needs are unlikely to be met directly through external financial reports and consideration of the many and varied needs would not be useful in the context of the cost portion of the reporting model project. However, addressing questions such as the following would inform discussions about the model:

1. Can the dis-aggregation of gross and net cost on the statement of net cost be improved to align better with user needs?
2. How diverse are costing methods and are some methods more appropriate than others? If so, under what conditions?
3. Is there a need for greater consistency in tracing, allocating or assigning costs that are common across agencies (e.g., agency-wide policy and oversight functions, contract administration, human capital support services)?
4. Where cost measures are included in performance reports is terminology consistent (e.g., are terms such as “cost” or “full cost” applied to similar measures)?
5. For performance reporting, is “full cost” as defined in SFFAS 4 the most appropriate measure of cost in most cases?

The proposed project plan presented below begins with research on both existing practices and user needs. Ultimately, the project might result in changes to the reporting model and/or to cost accounting standards.

Proposed Project Plan

- I. Background - Obtain an understanding of current practices utilizing existing research where available.
 - a. Survey agencies to determine the costing methods (e.g., ABC, Total Ownership Cost) used. Note that some agencies may use multiple methods. For instance, the DoD may use Total Ownership Costs for acquisitions but ABC for other purposes.
 - b. Determine how the costing information is used and its frequency.
 - c. Determine the types of decisions taken as a result of using costing information.
 - d. Inquire of management and determine views of overall success. In particular, determine if they believe that benefits derived measure up to efforts invested.
 - e. For those considered successful, inquire of management views on critical success factors.
 - f. Review studies on cost accounting usage in the federal government.
 - g. Determine experiences of other governments in using managerial cost information
 - h. Determine benefits observed and how challenges were overcome.

Estimated completion April 2010

- II. Determine information needed
 - a. As part of reporting model inventory of user needs
 - i. Identify external and quasi-external user decisions requiring cost metrics
 - ii. Determine metrics to address decisions
 - b. Develop task force to evaluate information needed

Estimated completion August 2010

- III. Incorporate results into reporting model

Estimated completion October 2010

Questions for FASAB Members

1. As part of the managerial cost accounting plan, does the FASAB agree with the proposed approach to focus on external and quasi-external users?
2. Are there additional matters that should be considered as part of the managerial cost accounting plan?