



Federal Accounting Standards Advisory Board

CLASSIFIED ACTIVITIES

Statement of Federal Financial Accounting Standards 56

October 4, 2018

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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SUMMARY

The objective of this Statement is to balance the need for financial reports to be publicly available with the need to prevent the disclosure of classified national security information or activities in publicly issued General Purpose Federal Financial Reports (GPFRRs). This Statement allows financial presentation and disclosure to accommodate user needs in a manner that does not impede national security.

This Statement permits modifications that do not affect net results of operations or net position. In addition, this Statement allows a component reporting entity to be excluded from one reporting entity and consolidated into another reporting entity, and the effect of the modification may change the net results of operations and/or net position.

Further, Interpretations of this Statement, which may themselves contain classified information, will address the requirements of this and other standards and permit other modifications when needed to prevent the disclosure of classified information. Modifications permitted by this Statement and future Interpretations may affect the net results of operations and/or net position of those entities applying the Interpretations.

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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STANDARDS

SCOPE

1. This Statement applies to federal entities that issue unclassified 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*.
2. 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 component reporting entity GPFFRs. This Statement does not apply to classified GPFFRs provided to cleared personnel, including elected officials. This does not relieve reporting entities from their requirements and responsibilities to comply with other accounting standards in the appropriate classified environment.

DEFINITIONS

3. **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.
4. **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.
5. **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

6. Classified information is prohibited from public release. Classified information is determined by an Original Classification Authority (OCA) or by applying derivative classification.
7. Reporting entities are expected to comply with other accounting standards in the appropriate classified environment. Reporting entities should apply this Statement when an OCA concludes, or others determine by applying derivative classification, that the information is classified and, therefore, cannot be presented without modification in unclassified GPFFRs. Component reporting entities have the discretion to apply this Statement at the program or transaction level.
8. This Statement permits certain modifications to prevent the disclosure of classified information in an unclassified GPFFR. This Statement permits the following:
 - a. An entity may modify information required by other standards if the effect of the modification does not change the net results of operations or net position.
 - b. A component reporting entity is allowed to be excluded from one reporting entity and consolidated into another reporting entity. The effect of the modifications may change the net results of operations and/or net position.
 - c. An entity may apply Interpretations of this Statement that allow other modifications to information required by other standards, and the effect of the modifications may change the net results of operations and/or net position.

The above modifications allowed by this Statement are discussed in more detail in paragraphs 9-11 below.

PRESENTATION AND DISCLOSURE MODIFICATIONS

9. The entity should modify unclassified financial statement presentations, disclosures, required supplementary information (RSI), and required supplementary stewardship information (RSSI) required by other Statements to prevent the disclosure of classified information if the effect of the modification does not change the net results of operations or 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 the modification.
 - b. Omitting required disclosures, RSI, or RSSI that would otherwise reveal classified information.

CONSOLIDATION MODIFICATIONS

10. An organization may be excluded from a particular reporting entity to prevent the disclosure of classified information and consolidated into another reporting entity. According to SFFAS 47, *Reporting Entity*, there are organizations¹ that should be included in a particular component reporting entity's GPFFR. Such organizations may be excluded from the particular component reporting entity's GPFFR to prevent the disclosure of classified information and consolidated into another reporting entity.² If a reporting entity consolidates an organization that is excluded from another reporting entity's GPFFR to prevent the disclosure of classified information, that consolidation modification may affect one or both reporting entities' net results of operations and/or net position.

INTERPRETATIONS

11. The Board may issue Interpretations of this Statement that affect other Statements. Such Interpretations may permit other unclassified GPFFR presentation and disclosure modification options, as needed. These modification options would prevent unauthorized disclosure in an unclassified GPFFR. Modifications that affect the entity's net results of operations and/or net position may be allowed by Interpretations of this Statement.

COMPONENT REPORTING ENTITY DISCLOSURES

12. All federal component reporting entities must include the following in the summary of significant accounting policies.
- Accounting standards require all reporting entities to disclose that accounting standards allow certain presentations and disclosures to be modified, if needed, to prevent the disclosure of classified information.
- Component reporting entities must not disclose application of this Statement, including any Interpretations of this Statement.

FINANCIAL REPORT OF THE U.S. GOVERNMENT DISCLOSURES

13. The financial report of the U.S. Government (government-wide financial report) must include the following in the government-wide summary of significant accounting policies.
- Accounting standards allow certain presentations and disclosures to be modified, if needed, to prevent the disclosure of classified information. Accordingly, modifications may have been made to certain presentations and disclosures.
- The government-wide financial report must not disclose specific Interpretations of this Statement that may have been applied.

¹ Decisions to exclude an organization from a particular component reporting entity to prevent the disclosure of classified information may be evidenced by, for example, approval or concurrence from an oversight organization, such as the Office of Management and Budget.

² SFFAS 47, *Reporting Entity*, provides the framework for determining what organizations (for example, component reporting entities or sub-components) should be included in the reporting entity's GPFFRs for financial accountability purposes. A reporting entity may be the government as a whole, another component entity, or a subcomponent reporting entity.

EFFECTIVE DATE

14. 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 would 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 would 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.

SUMMARY OF OUTREACH EFFORTS AND RESPONSES

- A4. FASAB issued the ED, titled *Classified Activities* on December 14, 2017, with comments requested by March 16, 2018. Upon release of the ED, FASAB provided notices and press release to the FASAB email listserv, the Federal Register, *FASAB News*, the *Journal of Accountancy*, Association of Government Accountants *Topics*, the *CPA Journal*, *Government Executive*, the *CPA Letter*, the Chief Financial Officers Council, the Council of the Inspectors General on Integrity and Efficiency, the Financial Statement Audit Network, and committees of professional associations generally commenting on ED's in the past (for example, the Greater Washington Society of CPAs, Association of Government Accountants Financial Management Standards Board).
- A5. FASAB followed up this broad announcement with direct mailings of the ED to the following relevant congressional committees:
- a. House Homeland Security Committee: Full Committee
 - b. House Homeland Security Committee: Sub-committee on Oversight and Management Efficiency
 - c. House Homeland Security Committee: Sub-committee on Counterterrorism and Intelligence
 - d. Senate Select Committee on Intelligence
 - e. House Permanent Select Committee on Intelligence
 - f. Senate Armed Services Committee
 - g. House Armed Services Committee
 - h. House Oversight and Government Reform Committee
 - i. Senate Homeland Security and Governmental Affairs Committee
 - j. Senate Appropriations Committee
 - k. House Appropriations Committee

- A6. FASAB received 17 responses from preparers, auditors, and professional associations. Many respondents had concerns with how to inform readers of GPFFRs regarding the potential modifications given the classified nature of the modifications themselves. The Board has revised the disclosure requirements to address the respondents' concerns. The Board has also incorporated revisions proposed by some respondents to clarify this Statement or address issues in the basis for conclusions.
- A7. The Board did not rely on the number in favor of or opposed to a given position. Staff provides the Board information about the respondents' majority view only as a means of summarizing the comments. The Board considered each response and weighed the merits of the points raised.

STANDARDS ON CLASSIFIED ACTIVITIES

- A8. There are many component reporting entities engaged in classified activities. In the recent past, information regarding the total amount budgeted for such classified activities was not publicly disclosed. However, in the last decade, changes were made so that highly aggregated 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 disaggregated funding details would harm national security interests.
- A9. Similarly, disaggregated detailed financial reporting could also harm national security interests. To address the issue of classified information being revealed by applying the requirements of SFFAS 47, *Reporting Entity*, this Statement permits certain modifications and disclosures at both the component reporting entity level and at the government-wide level.
- A10. The Board had several discussions with national security experts and stakeholders that allowed the Board the opportunity to evaluate the available options for presenting classified information in unclassified GPFFRs without jeopardizing national security, including the specific options suggested by respondents. The Board determined that options other than those permitted in this Statement may not always adequately resolve national security concerns. Therefore, based on the evaluation of the options, the Board concluded that this Statement and future related Interpretations provide the optimal solution. This option would allow reporting entities to issue unclassified, publicly 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.
- A11. Some respondents suggested that the Board require component reporting entities to only disclose that certain presentation and disclosure modifications have been made when the entity has applied this Statement to prevent the disclosure of classified information. The Board, in consultation with national security stakeholders, concluded that the identification by a component reporting entity that this Statement has been applied would reveal classified information. Doing so would allow GPFFR users to identify component reporting

entities with and without modifications. Further, users could identify changes among component reporting entities over time if modifications are disclosed in some reporting periods but not others. Therefore, the Board is requiring a more neutral disclosure for component reporting entities and the government-wide entity to prevent specific identification of component reporting entities applying this Statement. This neutral disclosure

- a. protects the identity of those component reporting entities that have made modifications to prevent the disclosure of classified information, and
- b. avoids implying that a component reporting entity has made a modification when they have not.

A12. This Statement and future Interpretations would be applied as needed based on an assessment of the need to prevent the disclosure of classified information or to assist other departments and agencies by including an organization as described in paragraph 10. During the audit, the preparer would inform the properly cleared auditor whether and how this Statement and related Interpretations were applied. GPFRR modified pursuant to this Statement and related Interpretations would be considered in accordance with generally accepted accounting principles.

A13. Some respondents questioned the proposal to require documentation retained in the appropriate environment to adequately support classified information and modifications. Such documentation was intended to allow recorded amounts modified to prevent the disclosure of classified information to reconcile in aggregate to unmodified schedules or other documentation subject to audit. Upon review, members noted that the proposed requirement related to systems, controls, and audit procedures. This proposed level of detail regarding documentation exceeded that of other financial accounting standards.

A14. The Board believes that standards regarding the underlying documentation of modifications are unnecessary and has removed the proposed requirement. The Board expects that – as with other aspects of financial statements – the preparer will maintain sufficient documentation to support modifications. Such documentation is an important aspect of management control over financial reporting. The documentation will be available during the audit but in an environment appropriate to classified information.

A15. Modifications may not be needed to prevent the disclosure of certain classified information. Therefore, this Statement permits, rather than requires, modifications on a case-by-case basis.

PROCESS FOR FUTURE CLASSIFIED INTERPRETATIONS

A16. The Board anticipates issuing classified Interpretations of this Statement to address specific issues raised by affected component reporting entities. The Board has established 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.

A17. 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.³ 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 varied perspectives and appropriate clearances are engaged. The Board expects to seek input from elected representatives of the public and appointed

³ The Board does not have specific original classification authority. The classification level of all work products will be determined by those with that authority.

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.

A18. This approach balances the public's interest in financial information with the need to prevent the disclosure of classified information. The Board's role in promulgating classified Interpretations is to appropriately guide the modifications used in preventing the disclosure of classified information.

A19. The Board may issue Interpretations and implementation guidance in the classified environment. The issuance of classified Interpretations and guidance by the Board will be publicly announced in the Federal Register and on the FASAB website. The public will be made aware of the guidance's existence and the unclassified title of the guidance. All classified guidance will be made available only to those individuals who have been designated as having a need to know and who hold the proper clearances.

PROCESS FOR FUTURE CLASSIFIED INTERPRETATIONS

A20. This Statement was approved unanimously. Written ballots are available for public inspection at FASAB's offices.

APPENDIX B: ABBREVIATIONS

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| 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 |
| RSSI | Required Supplementary Stewardship 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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