Federal Accounting Standards Advisory Board

June 10, 2005

Memorandum

To: Members of the Board

From: Melissa Loughan, Assistant Director

Through: Wendy M. Comes, Executive Director

Subj: Concepts Project--Objectives, TAB A[1]

At the March 2005 Board meeting, the Board approved an outline for a White Paper for the Objectives phase of the Conceptual Framework project. As you are aware, there has been much background and educational information presented over the past two and a half years. The approach for the Concepts team will be to utilize that information in drafting the white paper.

Although staff has just started drafting the white paper, we did want to share a portion of the "Draft White Paper on Objectives" in an effort to get feedback from the Board and input on the continued direction of the white paper. As you will note, sections *A--SFFAC 1 Status* and *B--Evolution in FASAB's Role* of the paper have been drafted and contain discussions questions for the Board on page 8 of the paper.

Staff has also started drafting section *C. Nature and Limits of Federal Financial Reporting*. Staff has included that early draft, along with the outline of the remainder of the paper for the Board's reference. Staff views the white paper as a 'moving' or 'in-progress' document as there is a strong possibility that as later sections of the white paper are complete, there may be a need to add additional language to previous sections.

In addition, staff also prepared a brief write-up on the issue regarding whether concepts are for the Board or for the Board and the profession. Questions on this topic appear on page 3.

The objective for the June meeting will be to discuss these documents and gain feedback and further direction from the Board. Please feel free to contact me on 202-512-5976 or by email at loughanm@fasab.gov to discuss any questions you may have.

[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.

Concepts--Are they for the Board or for the Board <u>and</u> the profession?

I am sure the Board is in agreement that a Conceptual Framework is needed to provide direction and structure to financial accounting and reporting. Without the guidance provided by a framework, standard setting becomes based on the 'concepts' held by individual Board members. Therefore, it is easy to see that the Concepts are for the Board. However, does the Board believe the concepts are for the profession as well?

Statement of Federal Financial Accounting Concepts (SFFAC) 1, *Objectives of Federal Financial Reporting* includes the following language in par. 2 of the Introduction:

> Instead, **statements on concepts**, after approval by the Board's sponsors, **provide general guidance to the Board itself as it deliberates on specific issues. They also help others to understand federal accounting and financial reports.**

As you are aware, the FASB and the IASB have begun a new joint agenda project to revisit their conceptual frameworks for financial accounting and reporting. In a paper issued in May 2005, *Revisiting the Concepts*, the following described their current frameworks:

> **The IASB Framework is intended to assist not only standard setters but also preparers of financial statements** (in applying international financial reporting standards and in dealing with topics on which standards have not yet been developed), **auditors** (in forming opinions about financial statements), **and users** (in interpreting information contained in financial statements). Those purposes also are better served by concepts that are sound, comprehensive, and internally consistent. (In contrast, **the FASB Concepts Statements state that they do not justify changing generally accepted accounting and reporting practices or interpreting existing standards based on personal interpretations of the concepts, one of a number of differences between the two frameworks.**)

An article in the December 28, 2004 *The FASAB Report--"The Project to Revisit the Conceptual Framework"* included the following discussion regarding who benefits from a framework:

> **Who Benefits from the Framework?**
> The FASB is the most apparent beneficiary of the framework. The framework provides concepts for the Board to use as tools for resolving accounting and reporting questions, as well as a basic reasoning on which to consider the merits of alternatives. Although the framework does not provide all the answers, it points the way. It also reduces the influence of individual Board member views and biases, as well as political pressures in making accounting judgments. For that reason, it has become an indispensable part of the FASB's standard-setting process. In reflection of that, each new standard the Board issues, now includes (in the basis for conclusions and in the summary) a discussion of the concepts utilized in developing the standard.
>
> The FASB's constituents also benefit from the framework. The use of objectives and concepts to help develop standards enhances the credibility of financial reporting by producing a body of standards that is more internally consistent and less ad hoc. That

> structure helps users of financial reporting information to better understand that information and its limitations. It also is useful to preparers who apply those standards, auditors who examine the resulting reports, and faculty and students who study accounting.
>
> **How Does the Framework Affect Practice?**
> Concepts Statements do not affect practice directly. They do not require a change in GAAP; amend, modify, or interpret existing accounting or disclosure standards; require changes in accounting procedures; or require disclosure of practices that might be in conflict with the concepts. Concepts Statements are not intended to invoke application of Rule 203 or 204 of the AICPA's Rules of Conduct of the Code of Professional Ethics. The framework affects practice only by means of its influence in the development of new accounting standards.

An attachment to this paper provides the views of other standard setting bodies on this issue and includes excerpts from their respective documents. It appears that other standard setters are consistent with noting that the purpose of the conceptual framework is to guide the Board in the standard setting process, while noting that knowledge of the concepts should assists others (such as preparers and auditors). However, there was a variation in the level of detail regarding how the concepts assist other users. Additionally, it appears that IASB appears to put almost equal importance on the framework assisting the standard setters and others.

Questions for the Board

Does the Board agree that the purpose of the Conceptual Framework is to guide the Board in the standard setting process and that the knowledge of the concepts does assist others?

Does the Board agree with the language included in SFFAC 1 that Concepts "provide general guidance to the Board itself as it deliberates on specific issues. They also help others to understand federal accounting and financial reports."?

Does the Board believe that additional language needs to be added about how the framework helps others?

Does the Board wish to expand upon this in the white paper?

Attachment – Views from Other Standards Setting Bodies

Governmental Accounting Standards Board (GASB)

The GASB Concepts Statements provide the framework within which the GASB develops standards of financial reporting for governmental entities. In the Summary to the Concepts Statements, the GASB states:

> Concepts Statements **provide the GASB with the basic conceptual foundation for considering the merits of alternative approaches to financial reporting and help the GASB develop well-reasoned financial reporting standards**. These statements also **assist preparers and users in better understanding the fundamental concepts underlying financial reporting standards**.

Financial Accounting Standards Board (FASB)

The FASB described its series of *Statements of Financial Accounting Concepts* as follows:

> The purpose of the **series is to set forth fundamentals on which financial accounting and reporting standards will be based**. More specifically, Statements of Financial Accounting Concepts are intended to establish the objectives and concepts that the **Financial Accounting Standards Board will use in developing standards of financial accounting and reporting.**
>
> The **Board itself is likely to be the major user and thus the most direct beneficiary** of the guidance provided by the new series. However**, knowledge of the objectives and concepts the Board uses should enable all who are affected by or interested in financial accounting standards to better understand the content and limitations of information provided by financial accounting and reporting**, thereby furthering their ability to use that information effectively and enhancing confidence in financial accounting and reporting. That knowledge, if used with care, may also **provide guidance in resolving new or emerging problems** of financial accounting and reporting in the absence of applicable authoritative pronouncements.

International Accounting Standards Board (IASB)

The IASB Framework **assists the IASB** in:

- the **development of** future **International Accounting Standards** and in its review of existing International Accounting Standards; and
- in promoting the harmonization of regulations, accounting standards and procedures relating to the presentation of financial statements by **providing a basis for reducing the number of alternative accounting treatments** permitted by International Accounting Standards.

The Framework may also **assist**:

- **preparers of financial statements in applying** International Accounting Standards and in dealing with topics that have yet to form the subject of an International Accounting Standard;
- **auditors in forming an opinion** as to whether financial statements conform with International Accounting Standards;
- **users of financial statements in interpreting the information** contained in financial statements prepared in conformity with International Accounting Standards; and
- **those who are interested in the work of IASB**, providing them with information about its approach to the formulation of accounting standards.

United Kingdom's Accounting Standards Board (ASB)

The ASB developed a *Statement of Principles for Financial Reporting*. The primary purpose of the statement was to provide a frame of reference to **assist the ASB in developing new accounting standards** and reviewing existing ones. The ASB states that:

> Although the statement's **main impact on accounting practice will be through its influence on the standard-setting process**, **it may also influence practice by helping preparers and auditors faced with new or emerging accounting issues** to carry out an initial analysis of the issues involved.

Australian Accounting Standards Board (AASB)

The AASB developed *Statements of Accounting Concepts*. The AASB describes those statements as follows:

> The primary purpose of *Statements of Accounting Concepts* is to **guide the AASB and the Urgent Issues Group (UIG) when developing and reviewing Accounting Standards** and other authoritative documents. For the AASB, this is consistent with its statutory obligation to develop a conceptual framework, not having the force of an Accounting Standard, for the purpose of evaluating proposed Accounting Standards and international standards.
>
> **Knowledge of the concepts** the AASB and UIG use in developing Accounting Standards and other authoritative pronouncements **should assist preparers, auditors and other parties with an interest in financial reporting to understand better the general nature and purpose of information reported in general purpose financial reports**. The concepts also may provide **guidance for preparers and others in analyzing new or emerging issues** in the absence of applicable Accounting Standards and other authoritative documents.

I. Concepts Project Objective:

A. To ensure that federal financial accounting standards are based on a sound framework of objectives and concepts regarding the nature of accounting, financial statements, and other communications methods. The framework should:

1. **provide structure by describing the nature and limits of federal financial reporting,**

2. **identify objectives that give direction to standard setters,**

3. define the elements critical to meeting financial reporting objectives and describe the statements used to present elements,

4. identify means of communicating information necessary to meeting objectives and describe when a particular means should be used, and

5. enable those affected by or interested in standards to understand better the purposes, content, and characteristics of information provided in federal financial reports.

B. The conceptual framework will refine and build on the current concepts promulgated by FASAB.

II. White Paper Objective:

A. The Board's white paper expresses its views on selected aspects of a sound conceptual framework. The white paper focuses on the bolded text above (items I.A.1 and 2.). The white paper draws from the existing Statement of Federal Financial Accounting Concepts (SFFAC) 1, *Federal Financial Reporting Objectives*, concepts promulgated by other accounting standards setters, and other literature as needed. Ultimately, the white paper informs the Board in its efforts to (1) amend or augment concepts statements regarding objectives of federal financial reporting in the future and (2) develop a strategic plan. This will be accomplished by updating SFFAC to cover developments in federal financial reporting since its issuance and clarifying the Board's role relative to each reporting objective.

III. White Paper Outline:

A. SFFAC 1 Status

1. The Board relies on SFFAC 1 to support its deliberations on financial reporting issues. Briefly, SFFAC 1 provides:

a) Background information on federal financial reporting, its environment, and the role of the Board, *b) User needs*

c) Objectives (Chapter 4)

d) Cost and benefit considerations

e) Qualitative characteristics of information in financial reports

f) Relationships between accounting and financial reporting including operating performance

2. SFFAC 1 acknowledges that many information sources other than financial statements help to attain the stated objectives. Further, SFFAC 1 does not assert that the Board will attempt to meet all the stated objectives. It simply states that "FASAB will consider where new accounting standards could make a useful and cost-effective contribution to improving the extent to which these objectives are attained."

3. Currently the Board is evaluating the objectives presented in chapter 4 of SFFAC 1 because the broad nature of the objectives makes it difficult to assess alternative accounting standards and prioritize the Board's technical agenda options. Thus, the ultimate focus of this white paper is on narrowing down the four reporting objectives presented in SFFAC 1, chapter 4 so that Board objectives are clearly identified. The white paper presents the consensus views of the Board regarding specific objectives or sub objectives established in SFFAC 1, chapter 4, which are not to be addressed through federal financial accounting standards.

4. Objectives or sub objectives may be excluded because they were determined to be poorly aligned with the Board's mission or not a high priority for the Board in the near-term (five to ten years). Potential reasons for excluding objectives or sub objectives in the near term include the fact that others have made or are making progress in meeting the objective or sub objective, the Board's structure, processes and authorities do not support meeting the objective or sub objective, or other objectives or sub objectives are deemed to be more important.

5. Before considering the four reporting objectives, the Board believes it is useful to develop further its views regarding FASAB's role as well as the nature and limits of federal financial reporting. Given the changes in the federal financial reporting environment since SFFAC 1 was issued in 1993, the Board believes an up to date statement of views on these matters is helpful.

B. Evolution in FASAB's Role

FASAB Created

1. The Chief Financial Officers Act of 1990--as amended by the Government Management Reform Act of 1994--for the first time required annual, audited financial statements for the United States Government and its component entities, referred to as federal reporting entities. The Act also established the position of Chief Financial Officer in each department to ensure the development of integrated agency accounting and financial management systems, including financial reporting and internal controls, which comply with applicable accounting principles, standards, and requirements, and internal control standards.
2. In October 1990, three officials responsible for federal financial reporting established the Federal Accounting Standards Advisory Board (FASAB or "the Board") as a federal advisory committee. The officials were the Secretary of the Treasury, the Director of the Office of Management and Budget, and the Comptroller General of the United States. In conjunction with the CFO Act of 1990, they created FASAB to develop accounting standards and principles for the newly required financial statements of the United States Government.
3. Chapter 1 of SFFAC 1 provides that "any description of federal financial reporting objectives should consider the needs of both internal and external report users and the decisions that they make."[2] FASAB considers the information needs of both internal and external users because the distinction between them is in many ways less significant for the federal government than for other entities.
4. As stated above, FASAB was created to advise OMB, Treasury and GAO on accounting standards for federal agencies and programs in order to improve financial reporting practices. The text in Chapter 1 preceding par. 23 details FASAB's mission as *"The mission of the FASAB is to recommend accounting standards [for the federal government] after ... considering the financial and budgetary information needs of congressional oversight groups, executive agencies, and the needs of other users of federal financial information."*[3]

[2] SFFAC 1 par. 23
3 From the FASAB Mission Statement, approved by the Board and by the Secretary of the Treasury, the Director of OMB, and the Comptroller General of the United States in l991.

GAAP Status Attained

5. In October 1999, the American Institute of Certified Public Accountants' (AICPA) Council designated the Federal Accounting Standards Advisory Board (FASAB) as the accounting standards-setting body for Federal government entities under Rule 203 of the AICPA's Code of Professional Conduct. Rule 203 provides, in part, that an AICPA member shall not (1) express an opinion or state affirmatively that the financial statements or other financial data of any entity are presented in conformity with generally accepted accounting principles (GAAP) or (2) state that he or she is not aware of any material modifications that should be made to such statements or data in order for them to be in conformity with GAAP, if such statements or data contain any departure from an accounting principle promulgated by bodies designated by Council to establish such principles, that has a material effect on the statements or data taken as a whole.

6. Until the AICPA action, the Federal Government did not have a Rule 203 designated accounting standards-setter[4]. With this designation, Federal Government reporting entities obtain audit opinions that indicate that the financial statements are presented in conformity with GAAP rather than an "other comprehensive basis of accounting" (OCBOA).

7. This designation came after extensive work by two AICPA Task Forces. The first Task Force was charged with establishing criteria for Rule 203 recognition. The Council approved the following criteria to be used in designating accounting standards-setting bodies under Rule 203: Independence; Due Process and Standards; Domain and Authority; Human and Financial Resources; and Comprehensiveness and Consistency.

8. The AICPA Board Chair appointed a task force to assess the FASAB against the Council -approved criteria, and to provide recommendations to assist the Board and Council regarding Rule 203 designation for FASAB. The Board task force had very broad representation from the AICPA Board, the private sector, and government.

9. The Board task force evaluated the mission and process of the FASAB based on the Council-approved criteria, recommended changes in FASAB procedures, and assisted in incorporating those changes in

[4] The AICPA Council designated the Financial Accounting Standards Board (FASB) as the standards-setter for the private sector in 1973 and the Governmental Accounting Standards Board (GASB) as the standards-setter for states and local governments in 1986. These are authoritative standard-setting bodies under Rule 203.

FASAB's Memorandum of Understanding and Rules of Procedure. The most significant changes were:

a) creation of an Appointments Panel to assist in selecting non-federal members,

b) opening Steering Committee meetings to the public, and

c) establishing that FASAB would issue final standards following a review period.

10. With the changes completed, the task force deemed the FASAB to have satisfied such criteria. Accordingly, the AICPA Board recommended that Council adopt a resolution to designate FASAB under Rule 203. On October 19, 1999, the AICPA Council approved the resolution.[5]

11. As stated above, the recognition also affected the operations of the Board. Specifically, FASAB changed how it issued accounting concepts and standards. Prior to the recognition, FASAB issued recommended statements of accounting concepts and standards for approval by its three principals, the Secretary of the Treasury, the Director of the Office of Management and Budget, and the Comptroller General. Since the recognition, FASAB no longer produces recommended standards for approval. Instead, FASAB forwards final standards to the sponsors for a 90-day review. FASAB also forwards final statements that set standards for capital asset accounting to the Congress for the mandatory 45-day review. If there are no objections during these respective review periods, the statements are considered final and FASAB publishes them on its website.

12. Additional changes prompted by the October 1999 AICPA recognition of FASAB as the standard setting body for the Federal Government are reflected in its operating documents. Major changes included the following:
    - Minutes posted to the website (see http://www.fasab.gov/meeting.htm)
    - Briefing materials available in advance of the meetings via the website (draft Board issuances are not posted).
    - Procedures for issuing Technical Bulletins established.
    - Exposure drafts are now published electronically. Hard copies are available on request.
    - Publish any dissents and identify the authors in final statements.

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[5] On May 23, 2003 the American Institute of Certified Public Accountants' (AICPA) Council unanimously voted to continue for a second five-year period designation of the Federal Accounting Standards Advisory Board (FASAB) as the accounting standards-setting body for Federal government entities under Rule 203 of the AICPA's Code of Professional Conduct.

- Press releases have been improved and a broader list of press contacts is maintained.
- Agenda setting process now includes a call for comments on proposed projects and permits identification of other project proposals.

Enhancements to Independence – 2002

13. In 2002, the Board's sponsors again revised the Board's operations. The sponsors' actions were intended to enhance the independence of the Board and ensure its continued status as the GAAP standard setter for federal entities.

14. The sponsors altered the Board's structure to provide a supermajority of non-federal members. In addition, the Secretary of the Treasury relinquished his authority to object to standard during the 90-day review period. Thus, only GAO and OMB may object to the issuance of a new standard or concept by FASAB.

Conclusion on Evolution of FASAB's Role

15. A key change in the role of FASAB is its designation and continued status as the Rule 203 standard-setting body for federal reporting entities. This change enhances the Board and may be perceived as creating special responsibilities for the Board.

16. The GAAP designation enhances the Board in these respects:

    a. *Credibility*

       GAAP recognition, with continued monitoring by the accounting profession, indicates that the Board meets the minimum requirements for a GAAP body. These are Independence, Due Process and Standards, Domain and Authority, Human and Financial Resources, and Comprehensiveness and Consistency.

    b. *Ability to set a common framework for debate and offer a forum for consideration of financial reporting issues*

       GAAP status demands comprehensiveness and consistency. Thus, GAAP standards setters endeavor to establish a sound conceptual framework, address critical issues in a timely manner, and introduce discipline to financial measures. Through development of, continual improvement in, and application of financial accounting concepts and standards, GAAP governs the terms used in financial discussions and the financial representation given to transactions and events.

Due process is a requirement of both Rule 203 and the Federal Advisory Committee Act. Thus, the Board must conduct outreach and consider the views of those interested in federal financial reporting. This is both a responsibility and an opportunity. Because of due process, the Board is challenged to produce concepts and standards that are defensible and understandable. Further, the Board may use due process as a means to engage members of the various professions having an interest in federal finances. Through the Board's efforts, public policy and budget experts may engage in financial accounting/reporting deliberations. This creates the opportunity to produce more useful and understandable concepts and standards.

c. *Impact on external decision makers through ability to require unbiased information (to send "bad news") due to independence*

Independence has been identified as the most significant criterion for a GAAP body. With an independent standard setter it is more likely that government organizations will be required to provide a complete financial report including "bad news."

17. GAAP designation may be perceived as creating special responsibilities as well. The criteria for a Rule 203 body place a greater emphasis on the public interest than FASAB's mission statement. The 1991 mission statement lists users as congressional oversight groups, executive agencies, and other users but also addresses the need to be publicly accountable. The AICPA criteria and related recommendations placed a premium on the public interest. Some have suggested that Rule 203 recognition implies a need to emphasize the needs of external users.

18. In addition, some may believe that the traditional view of the GAAP standards setters' role constrains the Board. For example, whether a GAAP standard setter may address performance measures is debatable.

Questions for the Board

1. **In discussing changes in the role of the Board, do you believe Rule 203 status is the key change?**
2. **Do you agree with the enhancements identified above? Are there additional enhancements you believe should be added?**
3. **Do you believe GAAP status requires a greater emphasis on the public interest?**
4. **Do you believe GAAP status limits the Board's role?**

Potential Changes to SFFAC 1

- **Role of FASAB updated to reflect GAAP status.**
- **Update how documents are issued--FASAB no longer produces recommended standards for approval. Instead, FASAB forwards final standards to the sponsors for a 90-day review.**
- **Is it appropriate to include FASAB's mission in SFFAC 1 document if the ultimate goal is to produce a strategic plan?**
- **May want to consider other changes after consideration of the next section--specifically, after considering other developments it may warrant additional explanation here to define the role of FASAB in federal financial reporting.**
- **Confirm that members prefer inclusion of both external and internal users.**

<u>C. Nature and Limits of Federal Financial Reporting</u>

Post CFO-Act Laws and Regulations

As mentioned above, FASAB was created concurrently with the CFO act and was a key component of the strategy to implement the requirements of the CFO Act. The CFO Act could be considered the first of a series of major legislation passed to increase federal accountability through financial management reform. Briefly, the purposes of the CFO Act were to (1) bring more effective financial management practices to the Federal government, (2) improve agency systems of accounting, financial management, and internal controls, and (3) provide for the production of complete, reliable, and consistent financial information for use in management and evaluation of Federal programs. The CFO Act created 24 chief financial officers for the major executive departments and agencies. It also required those agencies to prepare and submit audited financial statements for each revolving and trust fund and for accounts that performed substantial commercial functions.

SFFAC 1 was issued in September 1993. Since then, and following in the steps of the CFO Act, Congress has enacted a series of laws to reform and improve financial management in the federal government. Along the lines of the three purposes of the CFO Act described in the previous paragraph, the legislations and regulations since 1993 can be considered to broadly fall into the three areas:

- **Effective Financial Management Practices**--Legislation to bring more effective financial management practices to the Federal government,
- **Internal Controls**--Legislation to improve agency systems of accounting, financial management, and internal controls, and
- **Performance Measurement**--Legislation to provide for the production of complete, reliable, and consistent financial information for use in management and evaluation of Federal programs.

Accordingly, it would be appropriate to consider these and the related changes in the federal financial reporting environment since SFFAC 1 was issued. A brief summary and analysis of implications for pertinent laws and regulations is presented below. Additional detail for each law and regulation can be found in Appendix TBD.

Effective Financial Management Practices

- Government Management Reform Act of 1994 (GMRA)

GMRA substantially expanded the requirements in the CFO Act by requiring audited financial statements covering all accounts in the 24 CFO agencies. In addition, GMRA also required the preparation of the consolidated government-wide financial statement.

During FASAB's early years, it focused more on financial statements for components or segments of the federal government than it did on the government-wide statements. It was understood that some differences would be appropriate at the government-wide level (e.g., with regard to reporting on budgetary execution and financing). It was expected that—in the absence of specific guidance from FASAB—OMB, GAO and Treasury would determine how to report at the government-wide level. Arguably, GMRA's requirement for audited financial statements at this level and AICPA's recognition of federal accounting principles published by FASAB as GAAP (in SAS 91*, Federal GAAP Hierarchy*, April 2000), created a need for FASAB to define the applicable standards and to consider whether additional or different concepts were needed. FASAB has done so in **SFFAC 4,** *Intended Audience and Qualitative Characteristics for the Consolidated Financial Report of the United States Government*, and in SFFAS 24, *Selected Standards for the Consolidated Financial Report of the United Statements Government*.

- Reports Consolidation Act of 2000

This Act builds on a pilot program authorized in 1994. It allows an agency to combine its audited financial statement, as required by GMRA, and its performance reports, as required by GPRA, to provide a more comprehensive and useful picture of the services provided. More specifically, the Act authorizes the head of an agency to (1) adjust the frequency and due dates of, and consolidate into an annual report to the President, Director of OMB, and Congress, certain statutorily required reports (including financial and performance management reports) and (2) submit such a consolidated report not later than 150 days after the end of the agency's fiscal year.

The law requires such a consolidated report:

(1) That incorporates the agency's program performance report to be referred to as a *Performance and Accountability Report*;

(2) [Or, for a report] that does *not* incorporate the agency's program performance report, to contain a summary of the most significant portions [of its program performance report], including the agency's success in achieving key performance goals;
(3) To include a statement by the agency's inspector general that summarizes the agency's most serious management and performance challenges; and
(4) To include a transmittal letter from the agency head containing an assessment of the completeness and reliability of the performance and financial data used in the report.

- Accountability of Tax Dollars Act of 2002

The Accountability of Tax Dollars Act extended the requirements for preparation of audited financial statements to most executive branch agencies. OMB may exempt agencies with budgets under $25 million in a given year. The newly covered agencies are subject to OMB Bulletin 01-09, *Form and Content of Agency Financial Statements*. (Note that FFMIA reporting requirements were not applied to these newly covered agencies.)

In nonfederal domains, accounting standards setters have sometimes considered whether different standards should be imposed on small entities than are applicable for large entities. The GASB, for example, has devoted much effort to develop an alternative to a formal actuarial valuation for small OPEB plans that offer healthcare benefits to retirees of state and local governmental entities. Because the Accountability Act extends the requirement to produce and audit financial statements to some relatively small federal entities, some members may believe that FASAB should consider this question while deliberating future standards. Some may also believe that FASAB should consider whether some existing GAAP should be modified for smaller reporting entities.

- Improper Payments Information Act of 2002

This Act requires federal agencies to identify programs vulnerable to improper payments and to estimate annually the amount of underpayments and overpayments made by these programs. OMB has directed agencies to report this information in the MD&A section of the Performance and Accountability Report.[6]

Some may believe that this law suggests a need for FASAB to focus on this topic, much as FASAB focused on accounting for direct loans and loan guarantees after the Credit Reform Act was passed, and as FASAB focused on government-wide reporting after GMRA was passed. Others may believe that existing standards adequately address this topic, and/or that other sources of guidance exist.

- President's Management Agenda (PMA)--*Improved Financial Performance Initiative*

In addition to the above legislations and regulations, the President's Management Agenda represents an ongoing effort in the executive branch for improving management and performance in the Federal government. The President's Management Agenda, announced in the summer of 2001, is an aggressive strategy for improving the management of the Federal government. It focuses on five areas of management weakness across the government where improvements and the most progress can be made.

Improved Financial Performance is one of the five government-wide initiatives. The financial management initiative seeks to enhance the quality and timeliness of financial information. This initiative also focuses on improving assets management and reducing improper payments.

A "Management Scorecard" is used to measure progress on the Agenda initiatives. The scorecard uses a traffic light system for rating agencies--green for success, yellow for mixed success, and red for unsatisfactory. For each initiative, there are core criteria that the agency must meet in order to get a green rating. OMB updates the scorecard on a quarterly basis.

The core criteria for "getting to green" on the improving financial performance initiative are: 1. Financial management systems meet federal financial management system requirements and applicable federal

[6] "Agencies shall include the reporting requirements of this guidance in the Management Discussion and Analysis section of their Performance and Accountability Report for fiscal years ending on or after September 30, 2004. The annual estimate of erroneous payments reported in the Performance and Accountability Report can be based on data from a year other than the fiscal year the Performance and Accountability Report covers. Progress under the requirements of Section 57 of OMB Circular A-11 shall be reported in the FY 2003 Performance and Accountability Reports."

accounting and transaction standards as reported by the agency head; 2. Accurate and timely financial information; 3. Integrated financial and performance management systems supporting day-today operations; and 4. Unqualified and timely audit opinions on the annual financial statements and no material internal control weaknesses.

Performance Measurement

- Government Performance and Results Act of 1993 (GPRA)

Briefly, the purposes of the GPRA include: (1) improved management of federal programs, (2) increased accountability and better assessment of results, (3) improved communication with Congress and the public, (4) better information for Congressional and agency decisions, and (5) increased public confidence in the government.

GPRA requires agencies to prepare strategic plans, annual performance plans, and annual performance reports. The annual performance report examines whether goals (as discussed in the annual performance plan) were met and what was accomplished with the resources expended. It should be noted that OMB Bulletin 01-09 now requires agencies to consolidate their audited financial statements and other financial and performance reports into combined Performance and Accountability Reports.

SFFAC 1 includes the heading “operating performance” as one of the four major headings in discussing objectives of federal financial reporting. Also, chapter 8 discusses “How Financial Reporting Supports Reporting on Operating Performance.” Some may believe that these references to performance are sufficient and that no change is needed as a result of GPRA, but others may believe that an amplification of these sections of SFFAC 1 would be in order now that GPRA has led to performance reporting on a comprehensive basis while the Reports Consolidation Act and OMB action (Bulletin 01-09) have led agencies to include performance information with the audited financial statements in “Performance and Accountability Reports.”

However, other people may believe that no amplification of the concepts is needed, but that one or more statements of standards may be needed to address performance reporting. Some people may believe that provisions of existing standards, such SFFAS 4 and 7, adequately respond to these laws.

Alternatively, other people may believe that GPRA and OMB action pursuant to GPRA have effectively ended any need for FASAB to act in this area.

- President's Management Agenda (PMA)--*Budget and Performance Integration Initiative*

In addition to the above legislations and regulations, the President's Management Agenda represents an ongoing effort in the executive branch for improving management and performance in the Federal government. As stated above, the President's Management Agenda, announced in the summer of 2001, is an aggressive strategy for improving the management of the Federal government. It focuses on five areas of management weakness across the government where improvements and the most progress can be made.

Another initiative under the PMA is Budget and Performance Integration. The Budget and Performance Integration initiative seeks to formally integrate performance review with Budget decisions. A "Management Scorecard" is used to measure progress on the Agenda initiatives. The scorecard uses a traffic light system for rating agencies--green for success, yellow for mixed success, and red for unsatisfactory. For each initiative, there are core criteria that the agency must meet in order to get a green rating. OMB updates the scorecard on a quarterly basis.

The core criteria for "getting to green" on this initiative include: agency demonstrates improvement in program performance and efficiency in achieving results; annual budget and performance documents incorporate measures identified in the PART; agency reports the full cost of achieving performance goals accurately in budget and performance documents and can accurately estimate the marginal cost (+/ - 10%) of changing performance goals; has at least one efficiency measure for all PART programs; and uses PART evaluations to direct program improvements, and PART ratings and performance information are used consistently to justify funding requests, management actions, and legislative proposals.

- OMB's PART Analysis

The Administration began (in the 2004 Budget) to assess Federal programs by a method known as the Program Assessment Rating Tool (PART). The primary purpose of the PART is to improve program performance in the federal government and is a key tool in the budget and performance integration initiative mentioned above.

The Administration set a target of assessing all Federal programs over five years. The PART system assesses each program in four components--

purpose, planning, management, and results/accountability--and gives a score for each of the components. The scores for each component are weighted and the program is given an overall score. A program is rated effective if it receives an overall score of 85 percent or more, moderately effective if the score is 70 to 84 percent, adequate if the score is 50 to 69 percent, and inadequate if the score is 49 percent or lower. The program receives a rating "Results Not Demonstrated" if it does not have a good long-term and annual performance measure or does not have data to report on its measures.

Internal Controls

- Federal Managers' Financial Integrity Act of 1982[7] (FMFIA)

Congress has long expressed concerns about controls in various laws, dating back to include the Budget and Accounting Procedures Act of 1950. More recently, the Federal Managers' Financial Integrity Act of 1982 required comprehensive reporting on internal control two decades before audited financial statements were required from most agencies. These requirements remain in effect. They are not necessarily equivalent to reporting on controls over financial reporting. Some would say that the scope of controls contemplated by FMFIA may be broader, including operational and legal compliance issues as well as financial reporting. Furthermore, judgments about materiality may be different as well.

The Act requires GAO to prescribe standards of internal accounting and administrative control and agencies to comply with them. Internal control is to provide reasonable assurance that (1) obligations and costs comply with applicable law (2) assets are safeguarded against waste, loss, unauthorized use, or misappropriation, and (3) revenues and expenditures are recorded and accounted for properly so that accounts and financial and statistical reports may be prepared and the accountability of assets may be maintained.

It requires that the internal control standards include standards to ensure the prompt resolution of all audit findings. It also requires OMB to establish guidelines for agency evaluation of internal control to determine compliance with the internal control standards.

It requires agency heads to (1) annually evaluate their internal control using the OMB guidelines, and (2) annually report to the President on whether the agency's internal controls comply with the standards and objectives set forth in the Act. If they do not fully comply, the report must

[7] Although FMFIA came before the CFO Act of 1990, staff believed it would be appropriate to include as it is relevant for the Board in understanding how the objective Systems and Controls is met.

identify the weaknesses and describe plans for correction. The report is to be signed by the head of the agency.

- <u>Federal Financial Management Improvement Act of 1996 (FFMIA)</u>

The Act requires each agency to implement and maintain financial management systems that can comply substantially with system requirements, applicable federal accounting standards, and the Standard General Ledger. For each agency required to have audited financial statements under the provisions enacted by GMRA, FFMIA requires that each agency's annual audit report state whether the agency's financial management systems comply with the requirements.

Some may believe that the legal requirement for reporting on accounting systems' compliance with accounting standards adds a new factor for FASAB to consider. However, others may believe that compliance with law is a matter for others to assess--meaning whether an entity is in compliance with the provisions of FFMIA is a legal determination and would not affect the opinion on the financial statements. More specifically, some have argued that compliance with accounting standards (e.g., with SFFAS 4) for FFMIA may imply something different than conformance with GAAP for the purpose of expressing an opinion on financial statements. That is, some would say that an agency might be able to publish financial statements in conformance with GAAP, but not be in compliance with SFFAS 4 for purposes of FFMIA.

- <u>Information Technology Management Reform Act of 1996 (ITMRA)</u>

The ITMRA requires the head of each executive agency to establish policies and procedures that will ensure that (1) the accounting, financial, and asset management systems and other information systems of the agency are designed, developed, maintained, and used effectively to provide financial or program performance data for financial statements; (2) the financial and related program performance data are provided on a reliable, consistent, and timely basis to agency financial management systems; and (3) the agency financial statements support assessments and revisions of mission-related processes and administrative processes and performance measurement for agency investments in information systems.

- <u>Sarbanes-Oxley Act of 2002 (SOX)</u>

This Act contains numerous provisions affecting publicly owned companies and public accountants. Of particular interest is Section 404, "Management Assessment of Internal Controls" that requires management to assess the effectiveness of internal control and an audit attestation on the assessment made by management.

Section 404: Management Assessment Of Internal Controls
Requires each annual report of an issuer to contain an "internal control report", which shall:
(1) State the responsibility of management for establishing and maintaining an adequate internal control structure and procedures for financial reporting; and
(2) Contain an assessment, as of the end of the issuer's fiscal year, of the effectiveness of the internal control structure and procedures of the issuer for financial reporting.
Each issuer's auditor shall attest to, and report on, the assessment made by the management of the issuer. An attestation made under this section shall be in accordance with standards for attestation engagements issued or adopted by the Board. An attestation engagement shall not be the subject of a separate engagement.

Some have suggested that the public would expect federal practice to be comparable in this regard to what is now required of SEC registrants, and that action by FASAB to require management assertions about internal control, or at least controls over financial reporting, as an integral part of the basic financial statements would be one way to assure this. Others have suggested that existing requirements of FMFIA, FFMIA, and Government Audit Standards already accomplish a comparable or superior result.

- <u>OMB Circular A-123 (REVISED December 2004) *Management's Responsibility for Internal Control*</u>

In light of the new internal control requirements for publicly-traded companies (see SOX discussion above), OMB re-examined the existing internal control requirements for Federal agencies. As a result, OMB Circular A-123 which implements FMFIA, was revised to significantly strengthen the requirements for conducting management's assessment of internal control over financial reporting. The Circular is effective in fiscal year 2006.

The revised A-123 requires an assessment of internal control by management. Specifically, management is required to assert to the effectiveness of internal controls via an assurance statement "as of June

30." A-123 does not require a separate audit. However, Agencies may secure a separate audit opinion on internal controls over financial reporting. In those situations, the "as of" reporting date of June 30 may be adjusted to align better with the "as of" date of the audit opinion.

- **COMPARISON BETWEEN A-123 AND SOX**

	A-123	**SOX**
Management Assessment	Requires management assessment as of June 30[8], and update the report for any new issues coming to their attention before Sept. 30.	Requires management assessment as of the end of the company's fiscal year.
Audit Attestation	Does not require a separate audit attestation of controls over financial reporting. Note-Agencies are allowed to obtain an opinion. Also, OMB may require a separate audit if management is not achieving progress in correcting control weaknesses.	Requires audit attestation on the assessment made by management.
Framework	Provides a framework for evaluating internal controls and requires a reference to this in the management's report.	Requires management to identify the framework used to evaluate the effectiveness of controls.
Effectiveness of Controls	Precludes management from concluding internal controls are effective if there are one or more material weaknesses.	Precludes management form concluding that internal controls are effective if there are one or more material weaknesses.
Material Weaknesses	Require management to disclose all material weaknesses as of June 30.	Requires management to disclose any material weaknesses.

[8] Unless an audit is done, at which time the report may be dated the same as the auditors report.

- **Department of Homeland Security Financial Accountability Act**

The Act requires the Department of Homeland Security management to provide an assertion on the effectiveness of internal control over financial reporting for fiscal year 2005 and requires an auditor's opinion on internal controls over financial reporting for fiscal years beginning after 2005. The Act also required the CFO Council and the President's Council on Integrity and Efficiency study the potential costs and benefits of requiring other CFO Act agencies to obtain audit opinions on their internal control over financial reporting.

------------------------CONTINUATION OF OUTLINE---------------------------------

2. SFFAC 1, Figure 1 (Chapter 4, preceding par. 167) depicts how accounting contributes to information used by internal and external users.

   a) *This figure will be updated for any changes due to post-SFFAC 1 laws and regulations.*

   b) *Chapter 7 asserts that it "explains the focus of FASAB's concern by showing how accounting supports financial reporting and thus how accounting standards [promulgated] by the FASAB can influence federal financial reporting." A summary statement of the key points in Chapter 7 with updates as needed to reflect the current thinking of the Board will be provided.*

3. SFFAC 3, *Management's Discussion and Analysis*, FIGURE 1: Schematic Diagram of a Sample General Purpose Federal Financial Report (preceding par. 9) depicts the content of a general purpose federal financial report.

   a) *This figure will be updated for any changes post-SFFAC 1.*

   b) *An explanation or statement regarding the relationship of GAAP and GAAS to the contents of the GPFFR.*

   c) *Benefits of the relationship of GAAS and GAAP to the GPFFR*

      (1) Independent standards for independent audit

      (2) Audit is against GAAP developed through an accepted and monitored process: The underpinning of both GAAP and GAAS is independence. Independence is never total, but FASAB is relatively independent in its charter, structure and composition.

      (3) The fundamental principles of accounting definition, recognition, display, and disclosure have evolved

through centuries of application to the economic activities of business, government and not-for-profit entities and, in recent decades, through extensive and widely participative due process.

(4) All of the foregoing adds a degree of credibility and acceptability to FASAB's standards that does not exist elsewhere in the federal jurisdiction.

4. Audited financial statements based on GAAP have an advantage in meeting users' needs due to:

a) Reliance on core financial data inherent in the financial transaction processing system,

b) Impact of mandated periodic public reporting that is independent of the budget,

c) Potential for regular audit, indirect advantages are created by the discipline introduced through established definitions, recognition and measurement guidance carrying over to internal reports and analyses.

d) Qualitative Characteristics lead to Fair Presentation –

(1) "GAAP is founded on the concept of "fair presentation." Fair presentation in turn is based on fundamental principles of accounting [enhanced by independent audit in accordance with GAAS. FASAB does not set standards for GAAS, but it determines the presentations that are subject to GAAS."

(2) Discussion of each qualitative characteristic:

(a) Completeness (not included in current SFFAC 1)

(b) understandability, reliability, relevance, timeliness, consistency, and comparability (included in current SFFAC 1)

e) Use of non-monetary information

f) Limits of financial reporting

C. <u>Objectives</u>

1. Fundamental objectives – A discussion of the notion of decision useful information as well as accountability as foundations would be included here.

a) Key points made in SFFAC 1 highlighted here

b) Additional discussion of the varying meanings/uses of "accountability

c) Discussion based on current Board views

2. For each of the four objectives, we would review and make an assertion regarding the Board's role in meeting the objective. I envision a discussion of each objective that includes identification of relevant developments and how they impact the Board's role or priorities in working towards that objective. While this is the shortest of my subheadings – I expect it will be one of the longer sections. It will be important to distinguish "narrowing down" that is based on poor alignment with the Board's comparative advantages (likely permanent narrowing down) from de-emphasis of an objective due to the current efforts of others (room to return if and when needed). Justification of any staff proposals can come from the views expressed in earlier sections of the white paper.

a) Budgetary Integrity – state the objective, draw from the paper from December 2003 meeting, and make a staff proposal regarding any strategic or permanent changes.

b) Operating Performance - state the objective, discuss any changes in the environment since 1991, summarize what we've done so far that furthers operating performance, and make a staff proposal regarding any strategic or permanent changes

c) Stewardship - I would state the objective, discuss any changes in the environment since 1991, summarize what we've done so far that furthers stewardship , and make a staff proposal regarding any strategic or permanent changes.

d) Systems and controls -I would state the objective, discuss the indirect approach versus the direct approach, summarize current direct approaches from other sources (e.g., A-123, FFMIA and FMFIA), make a staff proposal regarding any strategic or permanent changes.