



Federal Accounting Standards Advisory Board

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August 12, 2004

**TO: Members of the Board**

**THROUGH: Wendy M. Comes, Executive Director**

**FROM: Robert Bramlett**

**SUBJECT: *Objectives of Federal Financial Reporting***

#### **INTRODUCTION**

At the Board's last meeting we discussed four options:

- 1) Develop a working paper on the objectives of the Federal Accounting Standards Advisory Board (or objectives of GAAP based financial reports)**
- 2) Develop and publish "strategic objectives" for FASAB**
- 3) Develop a Statement of Federal Financial Accounting Concepts on the Objectives of the Federal Financial Accounting Standards Advisory Board (or objectives of GAAP based financial reports)**
- 4) Amend SFFAC 1 by clarifying the Board's role relative to broad objectives**

In conclusion, Mr. Mosso suggested that staff first sketch out option 1, then option 2, and ultimately come down to an addition or revision to SFFAC 1. At some point, he noted, we will need to bring into our concepts what we are doing on elements. The paper could sketch out our plan for doing that.

Initially, I had some difficulty envisioning what option 1 (the working paper on objectives) would encompass, and how option 2 would differ from the current project plan for the conceptual framework project. I therefore decided to start by reviewing and partially revising SFFAC 1 in light of our prior discussion merely as a technique to prompt some ideas about what to write for options 1 and 2.

The results of that exercise appear at Tab B-1. I do not expect that we will discuss the details of this preliminary effort, but it is included for those members who want to review it. It may suggest specific changes they would like to make in SFFAC 1 and/or topics they would like to address as we pursue items 1-3 listed above.

***Objective for the discussion:*** This memo discusses two major issues that emerged from this endeavor: “methods for narrowing down” and “reliance on users’ needs versus accountability.” I hope to get members’ general reactions to the ideas expressed and whether they should be developed further, with their input on other themes or issues that should be pursued. Members may also wish to comment on which option would be the best vehicle for developing certain ideas.

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## **NARROWING DOWN**

This section discusses some ways that the Board might further define the subset of financial reporting on which it wants to focus and how it wants to do that. Some of these methods could be done in the context of a revised SFFAC 1; others might best be accomplished in other projects or products.

### **Narrowing down with other projects**

#### *Conceptual Statement on Elements of Federal Financial Reporting*

For example, FASB relies extensively on the premise that it deals primarily with reports about certain defined elements. FASAB may wish to do the same, after it completes more work on its “elements” project. Indeed, given the dominance of FASB’s paradigm, interested parties might reasonably assume that FASAB’s approach is the same as FASB’s in this regard, unless we explicitly say something to the contrary.

#### *Conceptual Statement on communication methods or reporting model*

Another conceptual project that might help us to “narrow down” might update and revise SFFAC 2, *Entity and Display*, as well as the diagrams in the *Implementation Guide to SFFAS 7* (e.g., page 15), SFFAC 3 (page 16), and in the Basis for Conclusions in SFFAS 25 (page 17). It might be described as a project on “communication methods” or on the “reporting model.” It might elaborate on relationships with other federal reports (e.g., reports pursuant to FMFIA and GPRA, as well as the National Income and Product Accounts, et al.). And it might deal with implications of the practice of reporting via the Internet, which has revolutionized reporting since SFFAC 1 and 2 were deliberated. FASB’s 1980 *Invitation to Comment* (ITC) offers some ideas and charts that might be relevant as well (as was discussed in my memo for the Board dated November 25, 2003). FASB was at that time also concerned with “narrowing down” its focus, albeit in a different context.

### **Narrowing by focusing exclusively on the Government as an entity *per se*.**

Some of the potential opportunities for “narrowing down” involve clarifying, emphasizing, and elaborating on some themes already mentioned in SFFAC 1. For example, paragraph 42 states:

42. This Statement does not deal directly with such accounts of the economic activity of the national society. The focus of this Statement is on accounting systems and financial reports that deal with the budgetary integrity, operating performance, and stewardship of the Government as such; that is, of the

Government as a legal and organizational entity within the national society. However, to report on some aspects of the Government's performance and stewardship, economic and other information about the national society is essential. Thus, the FASAB may consider whether such economic information should be included in certain financial reports, such as general-purpose financial reports for the U.S. Government as a whole.

The original Board wanted to distinguish its focus from that of other organizations and disciplines such as economics, for which it would not set standards or prescribe reports. At the same time, the Board believed that such information is essential to report on the operating performance and stewardship of the Government. The original Board therefore wanted to leave open the possibility of incorporating such information in general purpose financial reports. I infer from our prior discussions that some current Board members may wish to emphasize the first two sentences of this paragraph, while limiting to some extent the potential implications of the last two sentences.

After he joined the Board, Mr. Calder often expressed reservations about references to reporting on the national society or economy, and some members at times have seemed to express agreement with such reservations. If a majority of the members do share such concerns, the Board may want to add language in some vehicle (whether option 1, 2, 3 or 4) that says financial statements in conformity with federal accounting principles should focus primarily on the “Government as a legal and organizational entity within the national society.” Doing so with option 2 (strategic objectives) might leave the option open to revisit this decision later, while the other options would seem to imply an attempt at a more permanent resolution now.

Whether it would be socially useful for FASAB to do this is, of course, a decision for the Board to make. The second half of this memo, particularly its conclusion, offers a rationale for doing so that some may find plausible, but counter-arguments certainly could be cited. I do not attempt in this memo to assess the desirability of “narrowing down” but merely try to offer techniques and rationales that the Board might employ if that is what it wants to do.

Regardless of the vehicle used for this purpose (i.e., which option), we might adapt a diagram from an article I wrote for *Public Budgeting and Finance* in 1991<sup>1</sup> to explain and highlight this.

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<sup>1</sup> “The Federal Accounting Standards Advisory Board: An Introduction for Non-Accountants”

Figure 1

*Accounting's Relationship to Other Kinds of Information*

Similar questions may arise about the relationship among accounting data and economic indicators, social indicators, program evaluation, and other sources of information. This author finds it helpful to plot these kinds of information in two dimensions, dealing with the scope of reporting and the scope of the entity.

	<i>Narrow entity definition</i>	>	<i>Expanded entity definition</i>
Expanded focus or reporting scope	SEA <sup>4</sup> and program performance indicators		Social indicators, program results, and effectiveness reports, expanded income accounts
^			
Limited focus or reporting scope	Transactions, assets, and liabilities of the government: traditional financial statements		Transactions, assets, and liabilities of the country: national income and product accounts

Traditionally, accountants have been concerned with the transactions, assets, and liabilities owned or controlled by a given reporting entity. Meaningful accounting and financial reporting for a sovereign government, however, would seem to require at least some consideration of the other cells in this matrix. For example, consider the question of reporting on service efforts and accomplishments.

In that article, I was not concerned with precisely delineating FASAB's role. I don't think that FASAB was particularly concerned about that either. There was at least the possibility that FASAB's standards might incorporate some nontraditional information into the audited financial statements. We had not yet articulated "RSSI" as a category, but the general notion that the scope of FASAB's standards might be broader than traditional financial statements—and might require new elements or other kinds of innovative reporting—was widely shared.

If the Board now wants to narrow down by reducing or limiting that possibility, it might communicate that decision with a four-cell matrix like this:

SEA and program performance indicators; reported by agencies pursuant to GPRA and other laws.	Social indicators, program results, and effectiveness reports, National Income and Product Accounts. Reported by agencies pursuant to GPRA and other laws.
Transactions, assets and liabilities of the Government; reported pursuant to CFO Act as amended in financial statements prepared in conformance with federal accounting principles	Transactions, assets and liabilities of the national society; National Income and Product Accounts. Reported by Bureau of Economic Analysis.

In the context of option 2 (strategic objectives) we could explain that the shaded quadrant is the Board’s immediate focus of concern. We might specify a period of time, such as 5 years, or we might say “for the foreseeable future.” In the context of options 1, 3, or 4, we could simply assert that the shaded quadrant is the Board’s primarily focus of concern.

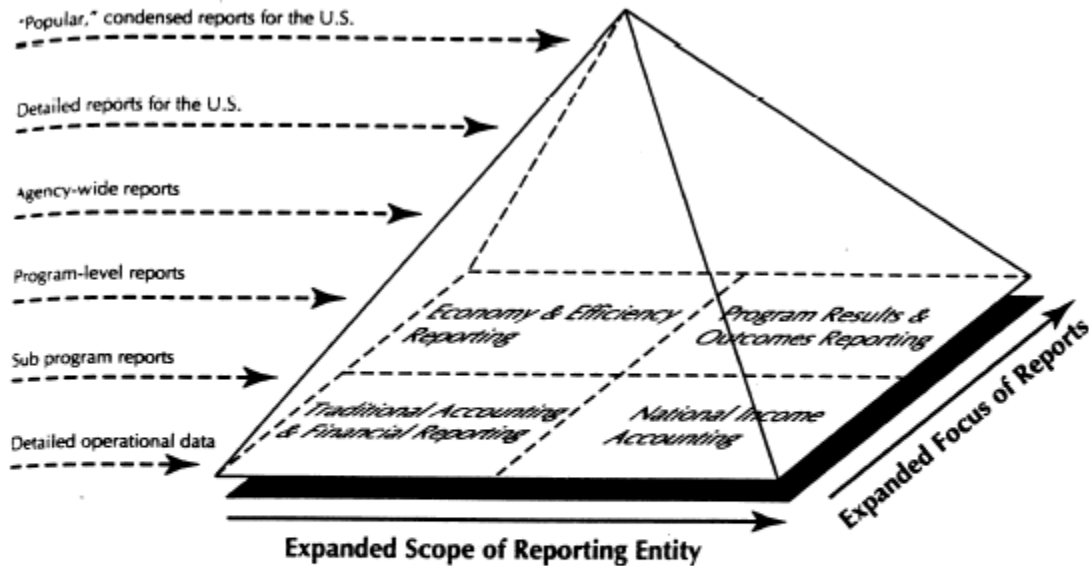
Regardless of the vehicle chosen to communicate this narrowing, the Board could say that laws passed since SFFAC 1 was deliberated--such as GPRA and FFMIA--and the subsequent development of reports like the Performance and Accountability Report, mean that mechanisms are in place to assure comprehensive federal financial reporting without action by FASAB. At the same time, the Board might want to retain the option to designate certain information in the three unshaded cells as “required supplementary information,” while indicating that they are not within the scope of the “basic financial statements” defined by federal accounting principles published by FASAB.

If the Board wants, such a discussion could be extended into three dimensions and related to contemporary federal reporting practice. In the AGA Report<sup>2</sup> that described and recommended

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<sup>2</sup> *Toward a Report to Citizens on the State of Their Nation and the Performance of Their Government: A Report by the AGA Task Force on a Report to Citizens on the State of the Nation.* The final version of this report was published by AGA in November, 1994; however, a draft version with the key conclusions and recommendations was presented at the AGA’s 1993 Professional Development Conference. According to some observers, the report significantly influenced the evolution of the “Accountability Report.”

an “Accountability Report to Citizens,” I used the matrix shown above as the base of the “federal accountability reporting pyramid” to portray such reports in a three dimensional space:



To support effective accountability and decision-making, a national government’s accounting and accountability reporting system should include a broader scope of analysis and reporting than is necessary for competitive, profit-seeking companies. That is, accountability reports must deal with non-financial as well as financial data, and must report on conditions of the national economy and society as well as on the government itself as a legal entity. The accountability reporting system must provide information that is relevant to the different concerns of program managers, top executives, elected officials, and citizens. To do so effectively, it must provide reports on programs, agencies, the government as a whole, and the national society.

In that AGA report, we were not concerned with delineating FASAB’s role within that space. But we could do so now, if the Board wants, by shading the cell marked “Traditional Accounting & Financial Reporting.”

We could explain that the **Performance and Accountability Reports** issued by most large federal reporting entities include information from each quadrant, that the reports arise from different requirements, and that different sections of the reports are guided by different sources (FASAB, OMB, the Bureau of Economic Analysis, etc.).

These diagrams help to describe the federal reporting environment, and might help explain FASAB’s role within it, but they are so general that they do not (in my view) impinge on the kind of subjects we might want to address in a separate project on communications methods or reporting model.

## **Narrowing down by focusing on comparative advantage**

Narrowing down by focusing on comparative advantages is an approach we have discussed before. One could simply assert that the lower left quadrant corresponds to the relevant comparative advantages, but it may be possible to say more on this topic. This idea is related to the next major topic, reliance on “users’ needs versus accountability” to define federal accounting standards. That discussion may begin to provide a conceptual basis for the kind of narrowing discussed in the previous section of this memo, and for further discussion of “comparative advantage.”

## **RELIANCE ON USERS’ NEEDS VERSUS ACCOUNTABILITY**

### **Background**

Appeals to “users’ needs” occupy much of the first four chapters of SFFAC 1. The goal of providing decision-useful information is asserted to be one of the two fundamental objectives of federal financial reporting, the other being accountability.

FASAB’s initial members and Executive Director all wished to invoke the objective of meeting “users’ needs” that FASB, the SEC, and others emphasize. The idea is not new, of course. In 1973 AICPA’s “Trueblood” Report stated, “the basic objective of financial statements is to provide information useful for making economic decisions.” But in 1936 the American Accounting Association also stated, in “Accounting Principles Underlying Corporate Financial Statements”:

The most important applications of accounting principles lie in the field of corporate accounting, particularly in the preparation of published reports of profits and financial position. On the interpretation of such reports depend so many vital decisions of business and government that they have come to be of great economic and social significance.<sup>3</sup>

So it was hardly surprising that FASAB would aspire to useful reporting. This was true even though it was not entirely clear that there were external users who need a federal standards board to mandate production of information on their behalf.<sup>4</sup> It was clear, however, that investors and

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<sup>3</sup> *The Accounting Review*, June, 1936, page 187-191.

<sup>4</sup> Before Congress passed the CFO Act of 1990, testimony and reports to Congress from AICPA, AGA, and the General Accounting Office all suggested that the Act’s provisions would provide better information for federal managers to make decisions, but the focus was primarily on internal users. Furthermore, some observers suggested that ultimately the key impetus for Congressional action was a desire for better internal control to reduce fraud, waste and abuse.



creditors do not use accounting numbers (at least as traditionally defined in corporate accounting) to assess the credit-worthiness of the Government, so many notions about “users’ needs” that are relevant for FASB would not necessarily be relevant for FASAB. If decision-usefulness was to be a guiding objective, therefore, something would need to be specified about who the decision makers were, and what information they needed.

Accordingly, staff did considerable work on a “users’ needs” study to learn more about actual or potential decision makers and decision models that would be relevant. The study included, among other things, interviews, focus group meetings, a “roundtable” discussion, and meetings with a users’ needs taskforce comprised of federal and nonfederal members. Staff started work on a draft statement of objectives based in part on that work. A form of cluster analysis called “concept mapping” was employed to group the functions served or potentially served by accounting under a manageable number of headings.

OMB then called for creation of a new taskforce of federal members, which OMB would chair. OMB’s taskforce crafted the statement of objectives printed in bold italic font in chapter 4 of SFFAC 1. That taskforce had available to it some of the results of the users’ needs study, but it is not clear to what extent that study was actually used in the OMB-led taskforce’s deliberations. Staff then interwove the users’ needs material with the objectives. Reading chapters 1-4 of SFFAC 1 now, one can see how these two threads were interwoven, perhaps not entirely seamlessly.

FASAB has not done much systematic research in recent years on “users’ needs.” Had we really needed to use that goal to organize our work, one might have expected further user needs studies or even experiments. For example, Granof and Kachelmeier published interesting results of an experiment on how decisions may be affected by presenting information about capital assets in various ways, including with and without depreciation expense.<sup>5</sup> We might have done or sponsored similar research during our years of deliberation on asset or resource accounting. One can readily imagine similar experiments to assess the impact on users’ decisions of alternative ways of reporting liabilities or responsibilities. In fact, however, deliberation about accounting alternatives often can and does proceed without more than intuitive appeals to users’ needs.

### **Users’ needs is open-ended**

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<sup>5</sup> "Depreciation and Capital Investment Decisions: Experimental Evidence in a Governmental Setting" Michael Granof and Steven J. Kachelmeier, *Journal of Accounting and Public Policy*, Vol. 12 (Winter 1993), 291-333. A commentary on the use of such experiments to inform accounting policymakers’ decisions may be found in “Using Laboratory Experiments to Evaluate Accounting Policy Issues,” Steven J. Kachelmeier and Ronald R. King, *Accounting Horizons*, Vol. 16 No. 3, September 2002, pp. 219-232.

As Ling Zhou has noted, in a review of *Ijiri's Theory of Accounting Measurement*, "It is hard to separate accounting information from all other heterogeneous information used in decisions to establish the specific characterization of accounting."<sup>6</sup> Reading chapters 1-4 of SFFAC 1 now, one finds many places where assertions about users' information needs seem to go well beyond where some current members' comments imply they want FASAB standards to go, e.g., regarding managerial accounting. If those comments represent the majority's viewpoint, at least two options are possible.

1. We could "narrow down" in some fashion (via option 1, 2, 3 or 4), to explain the roles of **audited financial statements and FASAB** within the broader context of financial reporting, or
2. We could eliminate much of the language about users' needs, and rely on some alternative explanation for federal accounting, such as accountability.

Of course, these are not necessarily mutually exclusive options. We might end up doing some of both to some extent. We might assert a primary focus on some other objective, such as accountability, while suggesting that we would remain alert to opportunities to serve users' needs where this could be done in a cost/beneficial manner. In fact, this is to some extent how I have understood SFFAC 1, but the message is, perhaps, not sufficiently explicit for current members.

### **Core data and comparative advantage**

Conceptually, chapter 7 is in some ways a key chapter of SFFAC 1, and it may be time to focus more attention on it. One of the things I offer for consideration in the attached draft revision of SFFAC 1 as a way to "narrow down" is an expansion on the implications of the idea that the transaction-driven accounting system provides the "core" data of concern to accountants. This idea seemed spontaneously to appeal to the initial Board members, but we did not discuss it extensively in our deliberations or in SFFAC 1. I have started to illustrate how we might lay the groundwork for this with some revisions to Chapter 7 (see page **Error! Bookmark not defined.**); however, before we consider issuing a revised SFFAC 1, similar ideas could be developed more extensively via options 1, 2, and/or 3 as listed on page 1 of this memo.<sup>7</sup>

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<sup>6</sup> [www.som.yale.edu/faculty/Sunder/PhdAccountingControl/IjiriZhou.doc](http://www.som.yale.edu/faculty/Sunder/PhdAccountingControl/IjiriZhou.doc)

<sup>7</sup> Those who have time and interest to pursue some academic commentary I find relevant to this theme may want to read "Some Thoughts on the Intellectual Foundations of Accounting," by Joel Demski, John Fellingham, Yuji Ijiri, and Shyam Sunder, *Accounting Horizons*, Vol. 16 No. 2, June 2002, pp. 157-168. For those with less time, I would point in particular to the comments from Shyam Sunder on "Decision Making and Control: An Accounting Duality," on page 159-161 and from John Fellingham on "The Core and the Superstructure of Accounting in the Curriculum," on pages 163-164. Board members will find this at **tab B-2**, along with a somewhat fuller (if still cryptic) exposition of Fellingham's ideas in "An

This has implications, if accepted, for how one understands the “comparative advantage” of accountants, audited financial statements, and FASAB. Implications, some might say, for how we distinguish the subset of “information needs” that are our primary concern. (Note: in the attached draft, I offer some language that expands on the idea of “comparative advantage on page **Error! Bookmark not defined.** I am not sure whether this would be the best location for it, but it seems premature to worry much about that.)

## Conclusion

The AGA report cited earlier included several recommendations, including this from page 29:

**Reduce the expectations gap by explaining what purely accounting-based reports can and should accomplish, and by directing those reports to the right audience.**

A couple of years ago the Department of the Treasury surveyed federal managers who had experience producing general purpose audited financial statements. More recently, FASAB staff interviewed additional federal managers and other users or potential users of federal financial information.

In both cases, the results implied the same conclusion, confirmed by the interviews conducted by this Task Force. At least for now, there is little demand for, or interest in, “general purpose” financial reports for federal agencies like those traditionally prepared by accountants for companies – at least not as a source of information. Many of the people involved do see merit in producing audited financial statements of this sort, however, because of the added discipline, control and reliability the process imparts.

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The second, and more important, part of our prescription is to:

**Expand the traditional definition of the accounting and financial reporting disciplines to address the same kinds of questions in government that accounting and financial reporting address for competitive, profit-seeking businesses.**

This implies that we combine nonfinancial information about inputs, processes, outputs and outcomes (including impacts) with financial information in our reports. Then, the reports will actually help to answer questions like those addressed by traditional financial reports from competitive, profit seeking businesses. That is, such questions as:

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Academic Curriculum Proposal,” by Anil Arya, John Fellingham, and Douglas Schroeder, *Issues in Accounting Education*, Vol. 18 No. 1, February 2003. These are abstract, descriptive discussions of accounting as a discipline, rather different from the kind normative conceptual framework for financial reporting we see from FASB. They may, therefore, appear of limited relevance to us. On the other hand, some have suggested that FASAB’s role and task are—or should be—rather different from FASB’s. If that is so, revisiting fundamental concepts may be useful.

- *How well did we accomplish our goals this year?*
- *What were the results of our efforts?*
- *To what extent are the owners of the government, i.e., the citizens, better off or worse off as a result of these efforts?*

When that was written, it was not clear to what extent FASAB might play a role in the second of these recommendations, but at least some Board members assumed that FASAB's standards would go well beyond FASB's in this regard. At least some Board members believed that FASAB's role and task were fundamentally different from FASB's. Of course, at that time most FASAB members were federal employees; there was an open focus on the information needs of federal managers and Congress. In light of comments from some current Board members, it may be that a majority of our members are now ready explicitly to undertake the first recommendation:

... by explaining what purely accounting-based reports can and should accomplish, and by directing those reports to the right audience.

While explicitly leaving to others the second:

Expand the traditional definition of the accounting and financial reporting disciplines to address the same kinds of questions in government that accounting and financial reporting address for competitive, profit-seeking businesses.

This would not be unprecedented, or without some intellectual support. A.C. Littleton, for example, one of the most influential academic accountants during the middle 20<sup>th</sup> century:

...upon observing the evolution of accounting practice over a considerable period of time, concluded that the accountant endeavors to help readers of financial reports understand the business enterprise by confining his measures to objectively verifiable transactions to which the firm is a part. By a largely implicit argument of a normative variety, Littleton maintained that accounting reports can best serve the needs of those who contemplate future actions by reporting factually on the immediate consequences of actions previously taken by the firm.<sup>8</sup>

More recently, Yuji Ijiri:

... concludes that accounting practice may best be interpreted in terms of accountability, which he defines as economic performance measurement that is not susceptible to manipulation by interested parties. Unequivocal and unambiguous measures are viewed as the sine qua non of accountability.<sup>9</sup>

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<sup>8</sup> *Statement on Accounting Theory and Theory Acceptance*, American Accounting Association Committee on Concepts and Standards for External Financial Reports, 1977, page 9.

<sup>9</sup> *Ibid*, p. 10.

Recently two academic accountants, Jones and Pendlebury, cited Ijiri's theory to help support their explanation of the role of audited financial statements from local governmental entities in the United Kingdom. The abstract for their paper reads:

Extant theory and practice suggest that there are no external users of a local authority's published accounts. Over the past thirty years, the major theme for such financial reporting has been increasingly to associate with company financial reporting. We rehearse the similarities but also the crucial differences between company and local authority financial reporting. Previous studies of the published accounts of local authorities, for 1977/78 and 1987/88, demonstrated that there was significant non-compliance with promulgated accounting policies. We report on how this conclusion has not changed for 1997/98 (despite changes in policy-making and in policies) and how the non-compliance has been accompanied by clean audit opinions. We then offer a theory, based on Ijiri's (1975) theory of accounting measurement, that the published audited accounts of local authorities are the means by which the preparers provide implicit assurance of the underlying accounting: they legitimate the internal accounting.<sup>10</sup>

Their conclusion (pp. 321-323) includes the following statements:

The main conclusion of this paper is that the published audited accounts of local authorities enable preparers to provide implicit assurance of the underlying accounting. The particular corollaries of this conclusion are that publication is not addressed to external users (i.e., the decision-usefulness criterion is in practice irrelevant), that non-compliance with some recommended accounting policies is acceptable, and that, as the current institutional arrangements of local authorities stand, it is acceptable for preparers and auditors to use a technical accounting language that is not necessarily understood by those to whom accountability is owed.

The conclusion also implies that some of the resources consumed in providing audited published financial statements are wasted: specifically, those resources that do not relate to implicit assurance of the underlying accounting are wasted.

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However, in terms of the costs, the choice between codifications may be more important. Business financial reporting standards often do focus on a "bottom line" . . . in an environment in which the bottom lines are used and the policies are controversial. . . . The costs of using such policies in an environment in which there are no lines that are being read – at the top, middle, or bottom – are probably too high.

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<sup>10</sup> "A Theory of the Published Accounts of Local Authorities," Rowan Jones and Maurice Pendlebury, *Financial Accountability and Management*, Vol. 20 No. 3, August 2004, pp. 305-325. Board members will find a copy at tab **B-3**. The finding that there are "no external users" is less surprising when one understands that in the UK: "Almost all of local [governments'] debt is now held by a central government agency. There is some debt (in previous decades, the amount was much higher) that is in the form of bonds but this is considered to be what [in the U.S. is] called 'general obligation' debt and the market for it (such as it is) has never judged the debt capable of default. Local government does not have, and has never had, the equivalent of special revenue bonds." [Rowan Jones, personal communication.]

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Finally, our use of Ijiri's theory of accounting measurement has produced only a limited theory of the published accounts of local authorities. Because it relates to accounting technique it is capable of rebutting the decision-usefulness criterion, which has tended to dominate the rhetoric of the publication of financial statements, if not the practice. By focusing on technique, the theory at least suggests ways that technical accounting and auditing resources might not be wasted. But a social or institutional theory, even political theory, might offer a fuller explanation and may thereby provide richer proposals for improving local authority accountability.

Some people may discern similarities with the role of current U.S. audited financial statements. (See tab B-3.)

Implementation Guide to SFFAS 7

CATEGORIES OF INFORMATION AND AUDITOR'S NORMAL ROLE IN CURRENT AND NEW STANDARDS

Basic Information	Accompanying Information	
Basic Financial Statements and Notes [highest level of audit work]	Required Supplementary Information (RSI) [limited audit procedures]	Other Accompanying Information (OAI) [not audited]
<p><b>Fieldwork:</b> The auditor examines the basic information and expresses an opinion whether it is fairly presented in accordance with relevant accounting standards. Each line in the statements, and each number in the statements and notes, is a separate "assertion" to be tested, but the auditor's tests are performed, and the auditor's opinion is expressed, in light of the auditor's judgment about materiality (whether a user's decision would be influenced). The judgment about materiality is influenced by the objectives of the financial statement or report and the uses contemplated for the information in it.</p> <p><b>Reporting:</b> If basic information is missing or materially misstated the auditor expresses an adverse or "qualified" opinion (or, in some cases, disclaims an opinion).</p>	<p><b>Fieldwork:</b> The auditor performs limited procedures specified by professional standards to review the RSI. These procedures are mainly inquiry and limited analytical procedures such as comparing information obtained for consistency with the auditor's knowledge and the evidence collected in connection with the examination of the basic information. <b>Reporting:</b> If RSI is missing or materially misstated, the auditor notes an unqualified opinion on the basic financial statements, if warranted.</p>	<p><b>Fieldwork:</b> The auditor reads the other accompanying information to see whether it appears materially inconsistent with the financial statements, but does not audit the information.</p> <p><b>Reporting:</b> The auditor notes any material inconsistency with the financial statements, but may still express an unqualified opinion on the basic financial statements, if warranted.</p>
<p><b>Required Supplementary Stewardship Information (RSSI):</b> Fieldwork: to be defined by the GAO and OMB; varies for each item. Reporting: same as for "basic" information--i.e., auditor must qualify or disclaim if RSSI is missing or materially misstated.</p>		

FIGURE 1: SCHEMATIC DIAGRAM OF A SAMPLE GENERAL PURPOSE FEDERAL FINANCIAL REPORT

Agency Head's Letter					
Management's Discussion and Analysis (MSI)					
-----Other Elements of the General Purpose Federal Financial Report----->					
1. Basic financial statements and notes, with auditor's report if audited	2. Required Supplementary Information (RSSI)	3. Required Supplementary Information (RSI)	4. Performance Information	5. Other Accompanying Information (OAI)	6. Management's assertions and reports on controls, compliance, & corrective actions under FMFIA and FFMA (or portions of these assertions and reports)

The GPFRR is represented by MD&A plus columns 1-6 of the diagram. (The agency head's letter is part of the GPFRR by general practice, though it is not required by federal accounting principles.) This is not a literal depiction of the organization of a report. Information should be presented in a logical arrangement. MD&A will address major issues that are typically reported in more detail in the discrete sections of the GPFRR or in other publicly available reports that the GPFRR incorporates by reference. Incorporating another report by reference does not, by itself, mean that the separate report is subject to audit.

Unless law or managerial action requires more extensive audit review or examination of the material incorporated by reference, the FASAB expects that the auditor of the financial statements will treat the material incorporated by reference as other accompanying information, although it does not physically accompany the GPFRR. OMB has authority to provide specific guidance on the auditor's minimum responsibility regarding this material. OMB may, for example, direct auditors to treat the material incorporated by reference as if it were other accompanying information in an auditor-submitted document.

SFFAC 2 (paragraphs 106-111 and Appendix 1-F) calls for a "Statement of Performance Measures" as part of the GPFRR, but FASAB has not yet recommended standards for it. Other titles may be used for this section of the GPFRR. Performance indicators

included in the GPFRR will either be those in the entity's annual performance report under the Government Performance and Results Act of 1993 (GPRA or the Results Act) or a subset of them. Alternatively, that report may be incorporated by reference. Until further guidance is available, the agency should select the indicators to report in consultation with OMB.

The assertions and report on control called for by the Federal Managers Financial Integrity Act (FMFIA or Integrity Act) would not be stated in full in MD&A. They would be reported in a discrete section of the GPFRR or incorporated in the GPFRR by reference. They are within the scope of MD&A because highly important aspects of systems, compliance, and internal controls should be discussed in MD&A. "Highly important" in this context may imply a higher threshold than "materiality" for the financial statements.

If the report also includes financial statements for component entities (bureaus, responsibility segments, etc.), management should use its judgment in organizing the report. The component entities' financial statements may be discussed in separate sections of the report or as subsections of MD&A of the consolidated entity.



Figure 2 from SFFAS 25

**Figure 2**

- Low (implies RSI) <<<<<<< <<<<<<<>>>>>>>>>>>>>>>>>> +High (implies basic)**
- <Relevance to fair presentation>
  - < Connection with elements of financial reporting >
  - < Use of historical financial data or financial transaction data >
  - <Preparers' discretion in preparing and presenting the information>
  - < Strength of signal Board wishes to be sent in the financial report >
  - < Significance, relevance or importance of the item in light of *Objectives* >
  - < Strength of the signal the Board wishes to be sent in the auditor's report >
  - < Relevance to measuring financial position or changes in financial position >
  - <Extent to which the information interests a wide audience (rather than specialists)>
  - <Extent to which there are not alternative sources of reliable information>
  - < Agreement on criteria that permit comparable and consistent reporting >
  - < Experience among users, preparers, and auditors with the information >
  - <Extent to which the information is aggregated (lacking in detail)>
  - < Benefit/cost ratio of using resources to ensure accuracy >
  - < Connection with basic financial statements >
  - < Reliability and/or precision possible >
  - < Reliability and/or precision needed >
- Low (implies RSI) <<<<<<<<<<<<< >>>>>>>>>>>>>>>>>> +High (implies basic)**

## LIST OF ATTACHMENTS

- Tab B-1 Annotated SFFAC 1 (including an excerpt from Ijiri's *Theory of Accounting Measurement* as a new Appendix D, on page **Error! Bookmark not defined.**)
- Tab B-2 "Some Thoughts on the Intellectual Foundations of Accounting," by Joel Demski, John Fellingham, Yuji Ijiri, and Shyam Sunder, *Accounting Horizons*, Vol. 16 No. 2, June 2002, pp. 157-168.
- "An Academic Curriculum Proposal," by Anil Arya, John Fellingham, and Douglas Schroeder, *Issues in Accounting Education*, Vol. 18 No. 1, February 2003
- Tab B-3 "A Theory of the Published Accounts of Local Authorities," by Rowan Jones and Maurice Pendlebury, *Financial Accountability and Management*, Vol. 20 No. 3, August 2004, pp. 305-325.