Federal Accounting Standards Advisory Board

October 6, 2004

TO: Members of FASAB

THROUGH: Wendy Comes, Executive Director

FROM: Robert Bramlett

SUBJECT: Conceptual Framework--Objectives

At our June/July meeting Ms. Comes listed four options for this project, including "a working paper on the objectives of the Federal Accounting Standards Advisory Board (or objectives of GAAP-based financial reports." In August, Mr. Mosso concluded our discussion of objectives by asking for an outline of a working paper on issues that have come up recently. Our discussion in August was quite helpful in understanding the members' views; so much so that I experimented with reorganizing and editing the minutes to create a first, rough draft of such an outline. The results of that experiment appear as Appendix I, starting on page 5. That exercise, in turn, led to this outline:

I. FASAB's mission: to promulgate the "applicable standards" for federal financial statements required by the CFO Act of 1990 and other laws.

II. Issue: what objectives should guide FASAB as it deliberates standards, given the fact that federal financial statements *per se* are not generally sources of information upon which people make decisions?
   a. Exception: business-type activities
   b. Exception: potential for direct informational benefit and/or impact on public debate and deliberation

III. Fundamental objective: accountability

IV. Secondary objectives: indirect effects and benefits

a. Discipline, control, and accuracy of the more detailed information used by management
b. Ability to report cost in a comparable and consistent way in other contexts
c. Improved asset management and records
d. Accrual-based, full cost information
e. Foundation for detailed unit cost information
f. More complete, organized, and accessible records
g. Better information on improper payments
h. Better control environment
i. Guidance to systems designers
j. Incentives to develop certain information
k. Information in another structure (other than the budget)
l. Focusing management's attention on costs, risks, and other issues

V. Caveats, limitations, and/or alternative view
a. Full cost can be inappropriate for some decisions
b. Indirect effects are second order effects

VI. Implications for FASAB

These heading are largely based on members' comments during the discussion; both the wording and the sequence are, obviously, intended merely as a possible basis for discussion and revision, not as a complete and polished proposal.

I found August's discussion reminiscent of discussions the initial FASAB members had during the deliberations that led to SFFAC 1. Those discussions were perhaps somewhat less extensive than they might otherwise have been, because the members from Treasury, OMB and GAO sometimes simply alluded to a key meeting among themselves and the Executive Director. They evidently decided at that meeting to focus on setting standards for agency-level financial reports, with the understanding that the process of preparing and auditing such reports would have the kind of indirect effects and benefits we discussed at our last meeting. Perhaps this early consensus, achieved away from the Board table, contributed to a failure to articulate certain ideas at length in SFFAC 1. This in turn may have contributed to current members' questions and concerns.

Mr. Zavada clearly articulated a similar viewpoint. Some other members have at times seemed to leave open the possibility of a different approach, but I have not heard them define an alternative. Accordingly, for the purpose of preparing this outline as a basis for discussion, I assumed that the Board would continue on that path.

Some people may see the "indirect" approach, with its reliance on what Mr. Patton calls "second order effects" as a response to fundamental differences between the federal domain and the for-profit domain of the economy. If the direct or "first order" effect is the actionable information conveyed to decision makers, financial statements of a typical federal agency seem inherently less important than is the case for a privately-owned, profit-seeking enterprise.

Financial statements, as traditionally understood, can do some important things for federal agencies. They can provide information on what the Government owns and owes, information not necessarily included in the budget. They can provide information on the resources the Government devotes to various programs and purposes, measured in ways that can differ from what is budgeted. And they can do this in the context of a double entry framework that provides control and accountability that is not necessarily part of the budgetary process.

Financial statements for profit-seeking enterprises can accomplish similar things, but also can give some indication (albeit limited) about whether a corporation is adding value to society—as value is defined by its customers—and (at least when there is competition) whether it is doing so efficiently. The same financial statements may give some indication (albeit limited) about whether an investor or creditor should provide resources to the corporation in expectation of a return on the investment or loan.

Traditional financial statements hardly begin to do the same things for federal agencies like the Department of Justice, or HHS, or most others apart from business-type activities. Some people may believe that this difference in "first order" relevance of financial statements can be reduced by reporting information in different ways (e.g., by program), or by reporting different information (e.g., nonfinancial performance indicators) with the financial information.

Such additions have costs as well as benefits, and opinions may differ about the extent to which they are properly within FASAB's mission. Thus, some people may believe that FASAB should accept and focus on a more limited role for federal financial reporting. (I recall seeing accounting described, in some antique accounting text, as the "queen of information systems." One might question whether that is true today even in the private sector; for federal agencies it seems fair to say that accounting may be more of a handmaiden to the true queen, i.e., the budget, where "first order effects" are obvious.)

Our discussion in August also reminded me of a phrase Tom Allen used during a "roundtable" discussion FASAB conducted during the users' needs study. The group included auditors and financial managers from the local, state, and federal levels of government. Mr. Allen, at that time the State Auditor of Utah, described federal financial statements as a "framework for accountability." Some FASAB members subsequently used the phrase on several occasions. Since that time, the "Performance and Accountability Report" has arguably evolved into a fairly comprehensive, though high-level, framework for accountability for the agencies that prepare such reports.

I heard a bit of an echo of that phrase in August, when Mr. Mosso observed that the Statement of Net Cost establishes a high-level framework for reporting information on cost. Of course, depending on context, cost information can be useful both for managerial decision-making and for accountability.

Issues for discussion:

Members may wish to consider:

1. Whether the headings in the outline on pages 1-2 of this memo describe topics they would like to see discussed in a working paper?

2. If not, which of the headings would they delete?

3. What other topics would they add?

4. What ideas about the listed and new topics would members want to see conveyed in the discussion?

5. Are the "implications for FASAB" discussed starting on page 9 (including the bracketed staff addition to the minutes) ones that the members support? Is there an alternative, e.g., to develop a "new product line" other than standards for agency-level financial statements? What other implications should be listed?

Minutes of the objectives discussion from July are attached as Appendix II (page 11) for ready reference; April's minutes are attached as Appendix III (page 15). These minutes may suggest other topics members want to discuss. Some members may also wish to review staff memos, earlier minutes, and other material provided for recent Board discussions of this topic.

Appendix I— Reorganized excerpts from minutes of August 4, 2004

Note*:** ***this appendix presents most, but not all, of the minutes of FASAB's August 2004 discussion of objectives, with paragraphs presented out of sequence. For the actual minutes, see the approved minutes. They will be posted at www.fasab.gov

I. FASAB's mission: standards for federal financial statements

Mr. Anania said he could see a broad introduction to a statement of objectives that would then narrow down to deal with FASAB. Mr. Farrell said he thinks that is what we do. Mr. Anania said it is not clear to him from our concepts statement whether that is how we should behave.

Mr. Patton asked about the implications of "Rule 203 status" for FASAB. Did it make everything we do part of GAAP? Could we produce GAAP for audited statements, and have other products outside of that? Mr. Mosso said that is an issue, part of the "broad versus narrow" debate.

Mr. Zavada said that gets to what FASAB's mission is. He would think that FASAB's mission is to **develop standards for GAAP-based financial statements**.

II. Issue: what objectives should guide FASAB as it deliberates standards for financial statements, given the fact that federal financial statements *per se* are not generally sources of information upon which people make decisions?

Mr. Patton said that a few years ago, before electronic distribution became the norm, he surveyed some federal agencies to learn how many copies of the published financial statements were produced, to whom they went, and what uses were being made of them. The number of printed reports was relatively small. Some were used to **comply** with requirements to supply them to Congress and OMB; the rest mostly went to people within the agency. It seemed that the financial statements were not being used much, due to the lack of **timeliness** and **detail,** and due to the **agency focus** of the statements versus the **program focus** of the decision makers.

Mr. Anania noted that SFFAC 1 frequently refers to users' needs. When it comes to the citizenry, he is not sure we understand what those needs are. He infers from Mr. Farrell's comments a suggestion that the idea of "users' needs" may be elevated higher in SFFAC 1 than it needs to be. He would not ignore users' needs, but would deemphasize it and talk about accountability and users' needs in broad terms.

A. Exception: business-type activities

Mr. Torregrosa mentioned that the PBGC's financial report is receiving Congressional scrutiny now because the **budget really says little about the PBGC's condition**. He wondered if this was an atypical situation. Mr. Bramlett noted that the PBGC is a Government corporation and therefore, like other Government corporations, follows FASB's standards. PBGC is not unusual in that sense. One sees the direct relevance of business-type financial statements most clearly in Government corporations.

B. Exception: potential for informational benefit or impact on public debate and deliberation

Regarding the definition and role of "general purpose financial statements," Mr. Reid acknowledged that voters and citizens generally don't read the Consolidated Financial Report, but, he said, there is **an opportunity to educate the Congress and press**. Particularly if that report has been audited, it provides **a common set of information** for use in debates and decisions. It is easier if everyone is working from the same set of information.

III. Fundamental source of value: accountability

Mr. Bramlett mentioned the idea, described by Jones and Pendlebury in a paper provided to the Board, that **the public may not be interested in governmental financial statements, but the *public interest* may nevertheless be served by the process of publishing and auditing certain information**.[1] He asked for the members' perspectives.

Mr. Anania asked to what extent SFFAC 1 contains that idea now. Mr. Bramlett said it is possible to read that idea into SFFAC 1, but the **notion of a hierarchy or priority of accountability vs. decision usefulness** is not explicit.

[1] "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.

Mr. Anania did not want to abandon either decision usefulness or accountability, but he agreed that **decision usefulness may not be as important as it is in standard-setting for the for-profit sector.** He would hope, however, that Congress and others would also look to financial statements for decision-useful information.

Mr. Zavada agreed, suggesting that **accountability is the more direct benefit in Governmental reporting, with decision-usefulness being more of an indirect benefit**. The **additional disciplines, control, and accuracy of information arising from preparing and auditing financial statements benefits the underlying reports that management uses day-to-day.**

IV. Secondary source of value: indirect effects and benefits

Ms. Comes, referring to Mr. Zavada's comment, said that one could broaden the way one thinks about the usefulness of information that comes from our standards. For example, reporting and auditing accounts receivable can be helpful in addressing concerns with **improper payments**. Similarly, the ability to talk **about cost in a comparable and consistent way in other contexts depends on the existence of audited financial statements**. To consider decision-usefulness in the Government one needs to look at it in a somewhat different way than is true for financial reporting by profit-seeking entities.

Mr. Mosso said another example of the "indirect effect" arose from FASAB's standard on accounting for fixed assets. Prior to the standard, the **cost of assets was largely unknown** in some agencies. Now OMB has a massive project on **asset management** underway, which really would not be possible without the **improved records.**

Mr. Zavada agreed. While recognizing the limitations of financial statements *per se* as the source of decision-useful information, he added, we don't want to forget the benefit of having **accrual-based** information and **full-cost information** available for management. The process of putting the financial statements together and having them audited provides a **foundation for more detailed unit cost** information to be developed.

"So there is **an internal value**," Mr. Anania said, "as opposed to just looking at decision-usefulness as being an external idea." Mr. Mosso agreed, saying, "maybe that is a point we ought to develop in the working paper."

Mr. Bramlett observed that the emphasis on such internal uses is clear in SFFAC 1; from his perspective, it was comments from some current Board members who are uneasy about that focus which raised the question for discussion. Mr. Anania said we should retain in the concepts the notion that there is an internal use and value.

Mr. Mosso said that cost information is an example of where the indirect effect could be substantial. For example, we have a Statement of Net Cost, which can report cost by segment or program at a high level. So we have **a framework** at whatever level an entity reports **with some cost accounting built into it**. That may be as far as FASAB needs to go; this presumably would have some effect on how the entity constructs its own management reporting system within that framework.

Mr. Anania said our current concepts don't elaborate on what may be needed for internal management, and on how what FASAB does is a piece of that. Mr. Bramlett agreed that we could further develop the discussion of the indirect nexus.

Mr. Reid said that one of the benefits for internal users is that **the records are more complete and organized**. In the past, there may have been records in various locations that were not organized and collected. A manager above those organizations would have had difficulty in making comparisons, because the information was in systems designed for each particular program. Today each of those organizations has a standard general ledger that can be consolidated with others. **Costs can be accumulated in a consistent way across the agency.** Given where we were, those are substantial indirect benefits of the standards.

Mr. Dacey said that requirements to **report things like the allowance for doubtful accounts drives a whole set of systems and processes**. The financial statements *per se* may not be useful for management, but **the standards identify types of information** that FASAB thinks are important to users, including internal users.

Mr. Anania said that it is safe to say that the accounting standards provide **a structure and discipline for improved reporting**. **"A good control environment**," Mr. Zavada added. **"And completeness**," said Mr. Reid, "and now the **information is available at all levels**, not only at the top." Mr. Mosso agreed that completeness should be an important objective.

Mr. Anania agreed, noting that he did **<u>not</u>** mean to say the product of FASAB's standards would be **the source of information for internal users**. They need a much more detailed set of reports. But we could embrace the idea that there could be a benefit for internal use.

Mr. Patton suggested that there may not be incentives in the Government comparable to those in the profit-seeking sector for management to develop certain information, so we have this indirect goal to **encourage that kind of development**.

Mr. Reid said it is also a matter of **providing guidance**. **People designing systems** often are happy to provide for certain information, but need guidance as to what is needed.

JFMIP does not initiate systems requirements, but rather it collects requirements developed by others, e.g., for property accounting. New accounting systems offered by vendors are tested against that list of requirements. Thus, for example, there should be no problem in reconciling budgetary and financial accounting with a new accounting system from an approved vendor.

Mr. Zavada said that he didn't know that it is an issue of incentives. The value is having **information in another structure**; i.e., having accrual information to supplement the information that is currently available. He sees what FASAB is doing as a supplement to existing information.

Mr. Mosso noted that when FASB required accrual accounting for retiree healthcare **cost**s, it **focused management's attention** on these benefits. Similarly, there was incomplete **risk management** in many companies until FASB's standard on accounting for derivatives was issued. One can also point to other standards in the private sector that focused attention on managing; again it is an indirect effect.

V. Caveats, limitations, and/or alternative view

Mr. Patton said that **full cost can be dangerous** for decision making when incremental or marginal cost would be the relevant cost. **Tolerance for subjectivity** is greater in internal reports. The focus of internal decision makers seems to be on **programs**, not usually on agencies. Management needs **detailed** information for internal decision-making, and needs it **timely.** For reasons such as these, he worries about our product being accounting standards for GAAP, versus information for some other uses. It occurs to him that we may need **different product lines**.

[Note, paragraphs are not in sequence.] Mr. Anania asked if that helped to address Mr. Patton's concerns. Mr. Patton said that our premier product is standards for audited financial statements. Trying to rationalize the existence of the Board based on indirect effects seems like a **second or third order effect compared to the direct effects**; he would hope we have more direct effects as the rationale.

VI. Implications for FASAB

Mr. Bramlett agreed that "concepts" have "conceptual primacy," and observed that they could have implications for planning as well as conducting the standard-setting endeavor. For example, we **might first seek accountability, then try to address users' information needs to the extent that doing so seems cost/beneficial**. That might be a reasonable priority and sequence -- both among projects and within the context of a given project -- given the limited number of external users identified thus far.

[In doing so, FASAB would be mindful that numerous sources of information exist, and would accordingly focus on areas where the Board perceived standards for audited financial statements to possess a comparative advantage. FASAB also would be mindful of opportunities to enhance the direct informational benefit to Congress and to information intermediaries, and the potential for official, audited, financial statements to influence public perceptions and deliberations about the Government's activities and policies.**]**

In response to a question, Mr. Bramlett said that ultimately, the Board's process might lead to a revision of SFFAC 1, or it might lead to additional documents in a conceptual framework. We are currently working on elements, which could become a statement of concepts. Other possibilities [for narrowing down] have been mentioned, e.g., a conceptual statement on reporting model or communications methods. Today's discussion may suggest that further developing the notion of "indirect effect" of reporting standards might help to address concerns some members have expressed about getting too far into managerial issues and roles.

Appendix II--Objectives Minutes from July 1, 2004

Ms. Comes opened the discussion by discussing her memo, which presented four options:

> **1) Develop a working paper on the objectives of the Federal Accounting Standards Advisory Board (or GAAP based financial reports)**
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> This document would have status similar to the "blue" and "pink" papers relied on internally by GASB in addressing elements and communications methods. These papers were developed by GASB staff and deliberated by the GASB but not issued for public comment or published. They have been relied upon in internal deliberations for some time. Currently, GASB is working to formalize these papers in its conceptual framework.
>
> 2) **Develop and publish "strategic objectives" for FASAB (or GAAP based financial reports)**
>
> This document would be publicly available and refreshed periodically. It would identify the objectives from SFFAC 1 that most influence FASAB's choice of projects for the period with a stated goal of updating the strategic objectives periodically (perhaps every 3 to 5 years).
>
> 3) **Develop a Statement of Federal Financial Accounting Concepts on the Objectives of the Federal Financial Accounting Standards Advisory Board** (or **GAAP- based financial reports)**
>
> The Board would explain the nature of SFFAC 1 and propose a subset of the SFFAC 1 objectives that are "Objectives of the Federal Financial Accounting Standards Advisory Board."
>
> 4) **Amend SFFAC 1 by clarifying the Board's role relative to broad objectives**
>
> The Board would explain the nature of SFFAC 1 and propose changes to each chapter of SFFAC 1 to explain the (expected) role or contribution of FASAB towards meeting the objectives.

Initially she was neutral on whether the project resulted in a published product; she has subsequently concluded that the work should be preserved.

Mr. Mosso said there is a choice between objectives of FASAB or of GAAP-based financial reports: the basic issue was broad versus narrow. The options could apply to either approach.

Ms. Robinson asked whether the "objectives of FASAB" equal "the role of the financial statements," as opposed to something broader? She equates them, but sometimes we talk about all of federal financial reporting, which encompasses many other things, most notably the Budget. She asked how other Board members see it?

Mr. Mosso noted that GAAP-based financial statements include the Statement of Budgetary Resources (SBR). Ms. Comes agreed that FASAB standards say that a set of financial statements is not in conformance with GAAP unless it includes a report on the budget (the SBR), although FASAB does not promulgate the standards for budgetary accounting. Similarly, the Board might in theory say that a set of GAAP-based financial statements was not complete without certain performance measures, or certain assertions from management on internal control. The notion of GAAP-based reports is somewhat elastic.

Mr. Zavada noted that the standards for preparing the SBR are provided in OMB Circular A-11.

Ms. Robinson said one might ask, “does the Board consider in its deliberations the objectives for the entire portfolio of federal financial reporting,” or is it saying, “What is the role of the financial statement as it coexists with all the other financial reports?” If something is disclosed in the Budget, should FASAB consider that? The question becomes, “what is your goal for requiring disclosure in another way?” That is how she perceives the Board’s role. Mr. Zavada continued her thought: “looking at accountability in a broader context, not looking at the financial statements in a vacuum.”

Mr. Mosso suggested that we have always looked at it as “financial reporting,” not just “financial statements.” He would orient the concepts to help FASAB in setting standards.

Mr. Anania said that he feels the objectives are stated more broadly than FASAB is currently functioning. He has suggested that the output of this should be for FASAB to communicate where people should look to find all the information needed to meet the objectives, and also more explicitly narrow down to indicate what FASAB is trying to do. If that were the approach, it could be an amendment to SFFAC 1, or it could be a new statement of concepts. In any event, we need a formalized output.

Mr. Mosso agreed, observing that we might want to test it before finalizing an amendment or new statement of concepts. Mr. Anania noted that GASB has been doing this for years.

Mr. Zavada agreed with the idea of testing some concepts on a preliminary basis.

Mr. Calder observed that GAO believes that the objectives should be viewed broadly. Mr. Walker believes that the financial reporting model is broken and does not tell enough. Looking at net income and net assets alone is not sufficient. Assertions about internal control and performance measures are needed. In the 21st century, more current and more detailed information can be reported on the Internet than was feasible when reporting on paper in the 20th century.

Mr. Mosso agreed, but said he does not know what parts of the SFFAC 1 mean. Mr. Calder said he agreed with that.

In response to a question, Ms. Comes observed that option 2 would not foreclose going back to our SFFAC 1 model and picking up something else as progress, priorities and resources change over time. Option 4 would be somewhat draconian if it said that FASAB should not say anything globally about government accountability. Options 1 and 3 could work together – that is, option 1 leading to option 3 over time. There could be some strategic advantages to option 2, if one takes a long view.

Mr. Anania said the amendment to SFFAC 1 he envisioned would add, for each of the objectives, information about where functions and reporting are performed that inform against the objective. Then it would say where FASAB fits into that.

Ms. Comes said this could be a large undertaking, especially given the evolutionary nature of federal reporting. Would the Board undertake to keep such a document current in the future? It has been suggested before, and we could explore ways to accomplish it, if that is what the Board wants.

Mr. Farrell agreed in concept with the broader view Mr. Calder had articulated, but said practically that goal must be viewed in the context of FASAB's resources. We could be criticized for having broad objectives and not addressing them.

Ms. Robinson suggested that we could proceed on options 1, 2 and 3 simultaneously, with thought papers. When and if we become sufficiently comfortable with them, we could elevate them to the status of a published document.

Mr. Patton said that we should strive for option 3 as a goal, but we could get there via 1 and 2. He thinks there should be a permanent or definitive statement eventually, because every new Board member struggles with this.

Mr. Mosso said that he does not want to throw out SFFAC 1, but it does need to be updated and modified.

Ms. Comes said staff should start working on a draft white paper that would express the Board's views. Mr. Anania asked whether the paper would state what the Board had decided as it went along, rather than what it was trying to do? In other words, would it state our draft definition of assets and characteristics of other elements? Ms. Comes said it would focus on objectives. Mr. Anania asked, do you mean the objectives of the project, or the outcomes of our deliberations? Is the paper to explain what we are trying to do, or giving interim information on the decisions we have made? Ms. Comes said it would give information on the decisions on objectives.

"But in order to deal with objectives, we are looking at definitions of elements," Mr. Anania said. He does not want to waste time on a paper that is only trying to explain what we are trying to do. He would rather have the paper incorporate something brief about the objective, and then tell the world what we have decided.

Mr. Reid said we might be able to incorporate that into option 2. If you are thinking strategically, you would go through a process that focuses on the environment and what is being done, then reach a logical conclusion about where to focus your energy. This could allow us to keep all the objectives in SFFAC 1, but also to say, "Here are some directions we are going, based on where we stand now." That might imply taking action on some things now, while taking a wait-and-see approach on others.

Mr. Anania said he wants to develop a closer look at what we are doing, as opposed to the whole federal reporting community. This would include an explanation of why we are revisiting elementary things, such as the definition of an asset. We could mention PCAOB and the things Mr. Walker has been saying about the need for a more robust model.

Mr. Bramlett suggested that this sounded a bit like a paper that addressed the conceptual framework project as a whole. Ms. Robinson said it sounded as if we were talking about different things. There is a mission statement for the Board, and a strategic plan. Someone reading SFFAC 1 might ask, "is this FASAB's mission statement?" Nowhere in it is there a statement of FASAB's mission.

Mr. Anania said he thinks the mission statement and strategic plan are apart from concepts for the work we do. The concepts should define what our role is and the role of financial reporting that comes out of our standards. The strategic plan should state our plan to do things better, faster, brighter, etc.

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

Appendix III—Objectives minutes from April

Mr. Bramlett opened the discussion by reviewing the Board's conclusions in March, when the tentative discussion had indicated that some members would like to amend the "Systems and Control" objective to preclude any inference that the Board should or would define certain assertions about systems and control to be an integral part of the basic financial statements. The March discussion had concluded as follows:

> 1. Mr. Mosso concluded that at the next meeting staff should further describe the alternatives for the Board, with examples of language to implement the alternatives. 2. Mr. Anania referred to his earlier comment that Objectives should refer to the broad range of needs and what is being done to achieve them in a general preamble, and then scope down to what we see our role to be, both for stewardship and for systems and control. 3. Mr. Reid asked for more discussion of the purpose of Objectives: are they to guide the Board or to describe something broader? 4. Ms. Robinson said that when we consider stewardship, she would like more discussion about the relationship and difference between financial reporting and the budget.

Pursuant to that discussion, the staff memo for April presented three alternatives for amending paragraph 150 of SFFAC 1, with several hypothetical rationales for the third alternative.[2]

Mr. Zavada reported that the CFO Council is surveying existing requirements regarding systems and control reporting. The Council's next step will be to look at the existing audit coverage and assess the appropriate level of coverage. Also, proposed legislation for the Department of Homeland Security would define a process in which GAO would have an opportunity to weigh in.

Mr. Bramlett pointed to paragraph 7 of SFFAC 1 (and similar language elsewhere) as an example of language that might need to be modified, or interpreted differently now than when it was written, in light of changed relationships among the Board and its sponsors

[2] The three alternatives were: (1) minimal change to clarify current status of management's assertions on systems and control, without implication about future status; (2) preserve option to elevate status of management's assertions on systems and control; (3) eliminate option to elevate status of management's assertions on systems and control. The hypothetical rationales for alternative 3 were: (1) nature of "basic" information required by accounting standards limited to recognition and measurement on the face of the financial statements; (2) nature of "basic" information required by accounting standards limited to what has been customary business practice; (3) pre-emption by law; (4) comparative advantage; (5) definition of "general purpose" financial reporting; (6) essential relationship to an organizing concept such as financial condition, financial position, specified elements of financial reporting, specified decision models, legal mandates or organizational needs, members' personal expertise, etc

and the current Board members' perspectives on the role of FASAB and the role of *Objectives*.[3]

Mr. Anania said that the Board should consider what its role should be, and then see how the language should be modified or adjusted. Regarding internal controls, one way of looking at it is to say, "If existing requirements and procedures are adequate, what more is there for FASAB to do?" Another way of looking at it would be to say that we have to be the AICPA and Sarbanes-Oxley of federal reporting. Currently, he sees things the first way and wonders what more there is for FASAB to do.

Mr. Mosso said there might be a middle ground. We could let the objectives stand. Mr. Reid said that the area is changing rapidly; depending on where it winds up, there might be some positions we might want to take in the future, if we have concerns about fair presentation.

Mr. Schumacher said that he thinks FASAB should play a role. In the private sector, the governing bodies did not act, with results that were obvious. He agrees with leaving us an option to take a stand if it seems desirable. That is why he likes alternative 2 [preserve option to elevate status of management's assertions on systems and control].

Mr. Reid observed that such hypothetical future action might be something specific, rather than a global requirement for management's assertions on internal control. We might want to address certain deficiencies on a standard-by-standard basis. In general, however, he believes that it is management's responsibility to assure adequate controls to assure fair presentation.

Mr. Zavada said he was thinking more along the lines of alternative 1 [minimal change to clarify current status of management's assertions on systems and control, without implication about future status] or alternative 3 [eliminate option to elevate status of management's assertions on systems and control]. This would be more along the lines of traditional financial reporting as prescribed by FASB and GASB. Reporting on internal control seems to go beyond the role of FASAB. In light of that consideration, coupled with the activities to address the issue currently underway, he does not see a need for FASAB to get into the issue.

Mr. Patton said, "Wouldn't an alternative be to just drop the objective? If you say there is no reason for FASAB to get into it, it seems more of a distraction than anything else."

Mr. Zavada agreed. Mr. Patton said that the fundamental question is the one posed by Mr. Reid about the purpose of *Objectives*: to guide the Board or to describe something broader? To leave the objective in would leave us where we started. We have enough

[3] "7. The Department of the Treasury, the Office of Management and Budget, and the General Accounting Office expect that, to the extent possible, their reporting requirements will be aligned with the Board's objectives and standards."

trouble setting standards for general purpose financial reporting, without delving into areas where others have more skill, more experience, and an incentive to do a good job.

Mr. Anania said that, rather than eliminate the discussion entirely, he would acknowledge the importance of sound internal control, but not to make it part of our responsibility.

Mr. Bramlett said that he understood the reference to "skill set" as part of the rationale articulated for the change. He asked whether one could infer from the members' comments that they also perceived another rationale, i.e., some concept of what constitutes a "general purpose financial report" or some concept of the proper domain of FASAB's activity? Did it have to do with "fairly presenting" financial position, or net assets, or some other financial concept? Put another way, is there a reason, other than the current members' experience and knowledge, why reporting on internal control is inherently not part of FASAB's concern?

Mr. Patton said that FMFIA and FFMIA have been around for some time, so there is already someone doing that. It is not clear why we need be involved. Mr. Mosso observed that in light of continued deficiencies, it might not be clear whether someone is already taking care of it. Mr. Anania said that is why it is dangerous for us to have such a broad statement of objectives: it implies that FASAB is to some extent responsible for fixing such problems. It sounds as if the problem is covered; yet we don't deal with it directly.

Mr. Bramlett asked, "conceptually, what is the reason that leads Board members to say that by definition reporting on internal control is outside the scope of the Board's activity?"

Mr. Reid said it goes back to a distinction between what is derived versus what is explicit. Internal controls are necessary to achieve accuracy in the numbers presented. Without internal controls, managers cannot be certain that they have achieved fair presentation. If, as a manager, I need to report this number, then I know that to be comfortable with its accuracy I need to do certain things. That is a management concern.

Mr. Reid can envision a standard being a straightjacket that would not make sense from a business standpoint; the standard might upset the balance of prioritization. Therefore, because concern with internal control is a derived concern, it is not a direct, explicit objective for the Board.

At the same time, he can see how one could make an argument the other way. Because Sarbanes-Oxley means that auditors will be attesting to controls over financial reporting when they audit the financial statements of SEC registrants, one could say that the [federal] standard setter should set standards that cover this too. If the CFO Council project leads to a conclusion that we need to have an auditor's opinion on controls, how do the auditors determine that? Is there then a need for an accounting standard? Perhaps we might need to say something about it. Thus, he would like to see how the project evolves, before making a final judgment.

Mr. Zavada observed that there are some standards for internal control now, in the form of GAO's "Green Book."[4] He reminded the Board that at the last meeting we discussed the "indirect approach" to dealing with the systems and control objective. He did not see anything in the staff memo about the indirect approach. Mr. Bramlett explained that the "systems and control" objective SFFAC 1 already includes some language about the indirect effect; he had understood the Board's concern to relate to possible inference that FASAB might also directly deal with the objective by requiring management assertions about systems and control as an integral part of the financial statements.

Mr. Mosso said that perhaps he had not focused adequately on some of the language in SFFAC 1 that suggests the *Objectives* might describe objectives for, and guide actions of, agencies other than FASAB. Perhaps we could emphasize that more, explain what else is going on regarding direct reporting on systems and control, and make it clear that we need not necessarily do any thing more than that.

Mr. Patton said *Objectives* is to guide the Board in developing standards. If systems and control is an objective, you cannot give it a zero weight. But it would seem a sidebar to ask, in FASAB's deliberations, whether a standard would improve understanding of systems and control. Board members would invoke the systems objective to support something they supported anyway for other reasons. . He recalls assertions about effects on internal control during deliberations, but not evidence.

Mr. Anania said for Stewardship and for Systems and Controls, he would like Objectives to scope down to what we see our role to be. He does not object to stating the broader notion, but would scope down. He does not want to rely on the indirect effect. We need to be more specific. It is troubling to have broad objectives that sound like we should be doing more. We can say that based on current laws in place, current requirements that exist, this is how we see our role. Mr. Patton agreed.

Mr. Schumacher asked Mr. Anania, "What is our role?" Mr. Anania asked, "Isn't it our role to be aware of what is being done, but not to take responsibility for the fact that systems and control deficiencies remain year after year?" "We observe, we talk about it, but I don't see us taking any actions to deal with ongoing control weaknesses at large agencies."

Mr. Calder said, "What they are doing is not adequate."

Mr. Reid said he would argue that the fact a weakness is disclosed shows that the system or requirement is effective. Mr. Anania said, "We didn't have anything to do with that disclosure." "Depending on how you look at it, in some cases we did," Mr. Reid said. "The accounting standard is something against which the agencies accounting can be measured; our job is done." He would be more concerned about problems that have not been disclosed. That is a difficult thing to do.

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[4] *Standards for Internal Control in the Federal Government.* GAO/AIMD-00-21.3.1 November 1999

Mr. Zavada said that accelerating the reporting schedule to 45 days would force changes and improvements in accounting systems, with a reduction in material weaknesses. Mr. Reid noted that, in addition to the acceleration, quarterly statements would be required; this will improve the quality of the numbers. "It is a real change in business process," Mr. Zavada said.

Mr. Patton said that he salutes that development, but he was trying to make the link back to FASAB and *Objectives*. How does that help him choose among possible accounting standards?

Mr. Anania mentioned some past GAO audits of IRS. In some years, in some areas, GAO abandoned its effort because they could not find supporting documentation. One such area was accounts payable. You can have a system that makes necessary payments and generates an amount to report for year-end closing, but have 20% duplicate payments. If so, the fact that you have an amount to report does not mean that you have good internal accounting control. You need assurance that the payments were made for good and valid reasons, that the goods were received, etc. He is not sure whether the Board has a common definition of internal accounting control. If we have something in our objectives, we need a common understanding of it. He does not know how the Board can take that on and be responsible for how that works in the federal government.

Mr. Reid said that was what he meant when he talked about management setting priorities. This becomes very difficult for FASAB to get involved with. On the other hand, the existence of the accounting systems itself is a control.

Mr. Mosso said that he didn't think FASAB had had anything to do with GAO's "Green Book." Mr. Calder agreed.

Mr. Schumacher said that he agreed with what had been said, but at the same time, he did not see how FASAB could entirely carve itself out of the process. That goes back to "alternative 2." What if the Board wanted to issue a standard to elevate or elaborate on the MD&A requirement to discuss internal control?

Mr. Anania said that the FASB has been around for 30 years without addressing internal control in its objectives; yet the FASB is viewed is being one of the premier accounting standard setters. Mr. Bramlett suggested that perhaps government is different in this regard. In the for-profit world, before Sarbanes-Oxley, it was widely assumed that shareholder and management's interests were aligned; it was assumed management had an incentive to make cost/beneficial decisions regarding systems and control on behalf of shareholders. Regardless of whether those assumptions were appropriate for the profit-seeking sector, the situation might be different in government.

Mr. Anania said that he didn't mind FASAB taking on broader responsibilities, if we could meet those goals.

Mr. Jacobson asked whether the role of the standard setter changes, once the preparer of the financial statement becomes subject to a requirement to include an assertion about controls, and once the auditor of the financial statement is required to express some kind of opinion on controls? The 1982 FMFIA requirement regarding internal control reporting was crafted at a time when agencies were not preparing audited financial statements. The language of the Act refers to internal accounting and administrative controls, but as implemented over the past 20 years, the scope of FMFIA reporting is certainly broader than controls over financial reporting. The guidance from OMB, with GAO's concurrence, has referred to "management controls." Sarbanes-Oxley refers to internal controls over financial reporting, suggesting a focus on a subset of the overall controls management is interested in. He quoted from OMB's guidance implementing FMFIA.

Mr. Bramlett observed that the authors of FASAB's systems and control objective were aware of the difference in scope, and did not perceive an inconsistency with the OMB guidance, merely a focus on a subset.

Mr. Jacobson suggested that it may be a mistake to assume that the kind of management reporting that has evolved over the years pursuant to FMFIA deals with something synonymous with reporting on controls over financial reporting, or that an auditor can deal with that reporting in the same way.

"But someone else has a stick," Mr. Anania said. "There is no real stick," said Mr. Calder. Mr. Farrell suggested there might be a question about whether the auditor's report would deal with conformance with the internal control standards per se, or with the management's assertions. Mr. Jacobson agreed, noting that GAO's standards are at quite a high level.

Mr. Reid observed that there are constitutional and statutory authorities at one or more agencies that underlie almost everything the Board does. This is not any different in that sense from accounting standards. Mr. Zavada said that part of the CFO Council research project is to look at developments since 1982.

> Conclusion: Mr. Mosso asked Mr. Bramlett whether he could write up something based on the Board's discussion. It would not close the door, but would narrow the focus. Mr. Bramlett said he could attempt to do so, but would need to get input from the members before the next meeting. Possibly a synthesis would be feasible, possibly more than one formulation would be necessary.