



Federal Accounting Standards Advisory Board

May 10, 2006

Memorandum

To: Members of the Board

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Ross Simms, Assistant Director

Through: Wendy M. Comes, Executive Director

Subj: Concepts Project--Objectives Phase TAB **A2**¹

As we indicated in our May 4, 2006 transmittal, we are providing you with a revised Draft White Paper on the Objectives of Federal Financial Reporting. The Board last discussed the white paper at the August 2005 meeting, which was prior to the staff roundtable discussions on each of the objectives. Since that time, staff has completed the roundtable discussions and presented the results to the Board.

At the March 2006 Board meeting, the Board agreed that the broad objectives of financial reporting should be maintained. Also, the Board agreed that there would be benefit to articulating FASAB's role in relation to those broad objectives, but noted that there were various approaches for accomplishing this goal. The Board believed it would be plausible to continue developing the Draft White Paper on Objectives with an emphasis on describing FASAB's role in relation to the broad objectives. The Board discussed the possibility that the White Paper on Objectives could be used as a guiding, internal document for Board members or perhaps the Board could later determine if it should be included in a formal Board document, such as a Concepts statement or if it could be part of the strategic plan. Accordingly, the different options for articulating FASAB's role in relation to those objectives required further Board assessment and the Board determined it would be addressed in future meetings.

On May 4, 2006, we provided materials to consider for the strategic planning alternative and are now providing the revised draft white paper. As noted above, the white paper was last discussed at the August 2005 Board meeting. The major revisions/additions to the white paper since that time include the following:

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.

- Comparative Advantages of FASAB and GAAP (with an emphasis on accrual accounting) [pages 9 – 11 in the Draft White Paper]
- Summary of the Results of the Roundtables [pages 23 – 30 in the Draft White Paper]
- Board Consideration of the Roundtables [page 31 in the Draft White Paper]
- Defining FASAB's Role in Relation to the Broad Objectives of Financial Reporting [pages 32 – 34 in the Draft White Paper]
- Assessment of FASAB's Role in Achieving Each Objective [page 35 in the Draft White Paper]
- FASAB's Primary Focus Objectives in the Near-Term [pages 36 – 44 in the Draft White Paper]
- FASAB's Secondary Focus Objectives in the Near-Term [pages 44 – 53 in the Draft White Paper]

One of the main purposes of this project was to define the Board's role in achieving the broad objectives, as the nature of the Board's involvement may vary for each objective. It should be noted that this is an assessment of FASAB's role in meeting each objective and should not be considered a ranking of the broad objectives. Accordingly, staff assessed which objectives there would be more opportunity to play a direct role in developing standards to achieve the objectives in the upcoming years. Staff's assessment (based on various factors and considerations detailed in the white paper) of the objectives provides that there are two levels of focus for FASAB in the near-term as follows:

Primary Focus Objectives—Primary Focus Objectives are those objectives where there is the greatest opportunity for FASAB to play a direct role in developing standards to achieve the stated objectives, based on its comparative advantage and other factors noted above. Therefore, projects that support achieving primary focus objectives would be considered higher priorities in the near-term.

Secondary Focus Objectives—Secondary Focus Objectives are those objectives where there is not the greatest opportunity for FASAB to play a direct role in developing standards to achieve the stated objectives, based on its comparative advantage and other factors noted above. In contrast to primary focus objectives, FASAB believes that it will play an indirect role in developing standards that would meet these objectives in the near-term.

Further, based on the analysis provided in the white paper, staff suggested FASAB's Primary Focus Objectives in the near-term are the Operating Performance Objective and the Stewardship Objective and the Secondary Focus Objectives are the Budgetary Integrity Objective and the Systems and Control Objective. A detailed summary of the factors supporting this classification is detailed in the white paper.

The objective for the May 2006 meeting will be to review the revised draft white paper and the strategic planning materials and discuss the following questions:

1. Does the Board agree with the two levels of focus for FASAB in the near-term?
Meaning, does the Board agree with classifying the broad objectives among Primary Focus Objectives and Secondary Focus Objectives for the near-term?
2. If the Board does not agree, could Board members suggest other ways to define its role or classify and prioritize the objectives?
3. If the Board does agree, does the Board agree that FASAB's Primary Focus Objectives in the near-term are the Operating Performance Objective and the Stewardship Objective and the Secondary Focus Objectives are the Budgetary Integrity Objective and the Systems and Control Objective?
4. How does the Board wish to proceed on articulating its role in relation to the broad objectives of federal financial reporting? The Board could chose among the following:
 - White Paper remain an internal document and not published
 - White Paper be published as a "Report" on our website (see <http://www.fasab.gov/reports.html> for examples of reports on our website) and would be available to the public. For example, it could be published as a Report XX *FASAB Considers Its Role in Relation to the Broad Objectives and Changes in the Environment*
 - Part of a Concepts Statement of Amendment to SFFAC 1
 - Incorporate into a Strategic Plan
5. Does the Board have any other comments on the Draft White Paper?
6. Independent of how the Board would like to articulate its role in relation to the broad objectives, does the Board wish to engage in strategic planning at this time?
7. If the Board would like to engage in strategic planning, does the Board agree with the draft staff plan for strategic planning (see staff Discussion Paper on Strategic Planning, page 4, provided May 4, 2006)?

Please feel free to contact us (Melissa at 202-512-5976 or by email at loughanm@fasab.gov and Ross at 202-512-2512 or by email at simmsr@fasab.gov) to discuss any questions you may have.

DRAFT WHITE PAPER ON OBJECTIVES OF FEDERAL FINANCIAL REPORTING

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Introduction and Scope

The Board's conceptual framework ensures that federal financial accounting standards are based on a sound framework of objectives and concepts. During its initial years of operation, FASAB developed a core set of accounting standards and concepts statements. Now, after 12 years of substantial progress, the Board believes that it is time to revisit the concepts given the changes in the federal financial reporting environment since the first concepts statement was issued. The objective of the Concepts Project is 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:

- provide structure by describing the nature and limits of federal financial reporting,
- identify objectives that give direction to standard setters,
- define the elements critical to meeting financial reporting objectives and describe the statements used to present elements,
- identify means of communicating information necessary to meeting objectives and describe when a particular means should be used, and
- enable those affected by or interested in standards to understand better the purposes, content, and characteristics of information provided in federal financial reports.

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

Objectives Phase of the Concepts Project - Evaluate Objectives and Other Aspects of SFFAC 1

The Objectives phase of the overall Concepts Project relates to the evaluation of the reporting objectives and other aspects of Statement of Federal Financial Accounting Concepts (SFFAC) 1, *Federal Financial Reporting Objectives*. This phase supports the Board's efforts to improve the conceptual framework and will be accomplished through developing this white paper on objectives.¹

Evaluation of the reporting objectives will focus on (1) clarifying the broad federal financial reporting objectives (by determining if they are still valid and appropriate and whether additional ones are necessary) and (2) defining the Board's role in achieving those broad objectives as the nature of the Board's involvement may vary for each objective. This phase will address questions such as:

- As drafted, are the objectives themselves clearly stated and complete?
- Have any events or circumstances arisen since the objectives were drafted that would cause the Board to reconsider them?

¹ The Objectives Phase of the Concepts Project and this white paper focuses on providing structure by describing the nature and limits of federal financial reporting, and identifying objectives that give direction to standard setters.

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- Are certain objectives currently met by means other than GAAP financial statements? If so, how reliable (stable) are the means currently in place?
- Does FASAB have a comparative advantage over other means of meeting certain objectives?
- Are the objectives overly inclusive? Some have suggested that the objectives are so broad that they do not narrow the field of alternatives. Is it appropriate to determine “FASAB’s objectives” from among the current broad reporting objectives? Alternatively, is it appropriate to prioritize among the current objectives?
- How does the current reporting model contribute to meeting each reporting objective?

This white paper draws from the existing SFFAC 1 and other literature as needed. Ultimately, the white paper will inform 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 may be accomplished by updating SFFAC 1 to cover developments in federal financial reporting since its issuance and clarifying the Board’s role relative to each reporting objective.

Following completion of the white paper, the Board may wish to develop a concepts statement that clarifies or assesses the previously stated objectives and presents any clarifying language related to other fundamental topics covered in SFFAC 1. The statement may address the current reporting environment (including non-GAAP reporting initiatives), how the original (broader) reporting objectives not retained (or no longer primary) are met, reasoning behind including additional reporting objectives and the Board’s role in meeting the revised objectives.

The nature of the Board’s involvement may vary for each objective. For example, 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. Additionally, the Board’s involvement may be varied based on the type of documents issued--specifically, FASAB could issue products other than standards and concepts that would contribute to meeting objectives.

The clarification of the objectives and defining the Board’s role relative to those objectives should (1) enhance the Board’s selection of standards projects by making explicit the objectives attainable through GAAP financial reports and (2) communicate to users the Board’s objectives. In addition, the white paper may support a strategic planning effort.

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SFFAC 1 Status

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

- Background information on federal financial reporting, its environment, and the role of the Board,
- User needs
- Objectives
- Cost and benefit considerations
- Qualitative characteristics of information in financial reports
- Relationships between accounting and financial reporting including operating performance

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.”

As noted above, the Board is currently evaluating the objectives presented in chapter 4 of SFFAC 1 as part of its Concepts Project. The objectives as included in SFFAC 1 are as follows:

Objective 1--Budgetary Integrity

Federal financial reporting should assist in fulfilling the government's duty to be publicly accountable for monies raised through taxes and other means and for their expenditure in accordance with the appropriations laws that establish the government's budget for a particular fiscal year and related laws and regulations. *Federal financial reporting should provide information that helps the reader to determine:*

- 1A. How budgetary resources have been obtained and used and whether their acquisition and use were in accordance with the legal authorization.
- 1B. The status of budgetary resources.
- 1C. How information on the use of budgetary resources relates to information on the costs of program operations and whether information on the status of budgetary resources is consistent with other accounting information on assets and liabilities.

Objective 2--Operating Performance

Federal financial reporting should assist report users in evaluating the service efforts, costs, and accomplishments of the reporting entity; the manner in which these efforts and accomplishments have been financed; and the management of the entity's assets and liabilities. *Federal financial reporting should provide information that helps the reader to determine:*

- 2A. The costs of providing specific programs and activities and the composition of, and changes in, these costs.
- 2B. The efforts and accomplishments associated with federal programs and the changes over time and in relation to costs.
- 2C. The efficiency and effectiveness of the government's management of its assets and liabilities.

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Objective 3--Stewardship

Federal financial reporting should assist report users in assessing the impact on the country of the government's operations and investments for the period and how, as a result, the government's and the nation's financial condition has changed and may change in the future. *Federal financial reporting should provide information that helps the reader to determine:*

3A. Whether the government's financial position improved or deteriorated over the period.

3B. Whether future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due.

3C. Whether government operations have contributed to the nation's current and future well-being.

Objective 4--Systems and Control

Federal financial reporting should assist report users in understanding whether financial management systems and internal accounting and administrative controls are adequate to ensure that:

4A. Transactions are executed in accordance with budgetary and financial laws and other requirements, consistent with the purposes authorized, and are recorded in accordance with federal accounting standards;

4B. Assets are properly safeguarded to deter fraud, waste, and abuse; and

4C. Performance measurement information is adequately supported.

The ultimate focus of this white paper is on clarifying the four reporting objectives listed above and defining the Board's role in achieving those broad objectives.

The Board also believed it would be beneficial to get feedback from the community on the reporting objectives in light of these changes. FASAB staff conducted separate roundtable discussions on each of the four reporting objectives. The primary purpose of the discussions was to determine how the objectives might be improved to facilitate their use as a means for guiding the board in developing standards of financial accounting and reporting and in developing solutions to financial accounting and reporting issues. A brief summary of the results or main discussion issues of the roundtables are provided in this white paper.

Evolution in FASAB's Role

FASAB Created

In October 1990, the Secretary of the Treasury, the Director of the Office of Management and Budget, and the Comptroller General of the United States established the Federal Accounting Standards Advisory Board (FASAB or "the Board") as a federal advisory committee.

The nine member FASAB consisted of representatives from the three principles, one Congressional Budget Office representative, one representative from the defense and international agencies, one representative from civilian agencies, and three representatives from the private sector. FASAB issued recommended statements of accounting concepts and standards for approval by its three principals. In developing the statements, the FASAB adhered to Federal Advisory Committee Act requirements and engaged a seven-step due process approach that included public participation.

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1. Identification of accounting issues and agenda decisions.
2. Preliminary deliberations.
3. Preparation of initial documents (issue papers, and/or discussion memorandums).
4. Release of documents (e.g., exposure drafts) to the public, public hearings, and consideration of comments.
5. Further deliberations and consideration of comments.
6. General consensus (at least a majority vote) reached among Board members and final documents submitted to the Treasury, OMB, and GAO for approval.
7. The Principals provide for implementation guidance through the FASAB's Accounting and Auditing Policy Committee.

Shortly after FASAB was established, the Chief Financial Officers Act of 1990 became law. The Act 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. The CFO Act also required some executive agencies to have agency-wide audited financial statements and other agencies to have more limited statements. The Government Management Reform Act of 1994 for the first time required annual audited financial statements covering the entire executive branch as well as agency-wide statements for each agency covered by the CFO Act.

GAAP Status Attained

In October 1999, the American Institute of Certified Public Accountants' (AICPA) Council designated the 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.

Until the AICPA action, the Federal Government did not have a Rule 203 designated accounting standards-setter². With this designation, Federal Government reporting entities obtain audit opinions that indicate that the financial statements are presented in

² 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.

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conformity with GAAP rather than an “other comprehensive basis of accounting” (OCBOA).

This designation came after an AICPA task force evaluated FASAB against the following criteria 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.

The task force recommended some enhancements in FASAB’s procedures, and assisted in incorporating them in FASAB’s Memorandum of Understanding and Rules of Procedure. The most significant enhancements were:

- creation of an Appointments Panel to assist in selecting non-federal members,
- opening Steering Committee meetings to the public, and
- establishing that FASAB would issue final standards following a review period.

With the enhancements 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 for an initial five year period. On October 19, 1999, the AICPA Council approved the resolution.³

Subsequent to the Rule 203 recognition, the FASAB changed how it issued accounting concepts and standards. Previously, standards developed by FASAB did not become final until the sponsors explicitly approved them for issuance. With the change, FASAB forwards standards to the sponsors for a 90-day review. FASAB also forwards capital asset accounting standards to the Congress for the mandatory 45-day review. If there are no objections during these respective review periods, the standards are considered final and FASAB publishes them on its website.

Additional enhancements following the October 1999 AICPA recognition of FASAB as the standard setting body for the Federal Government are reflected in its operating documents. These enhancements 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.

³ On May 23, 2003 the AICPA Council unanimously voted to continue for a second five-year period designation of the FASAB as the accounting standards-setting body for Federal government entities under Rule 203 of the AICPA’s Code of Professional Conduct.

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- 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

In 2002, the Board's sponsors altered the Board's structure to increase the level of non-federal representation to enhance the perceived independence of the Board. The nine-member board would now have six non-federal members and three federal members. In addition, the Secretary of the Treasury relinquished his authority to object to any 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.

In 2003, the Board was expanded to provide for additional legislative branch input. The Board grew to ten members with the addition of a representative from the Congressional Budget Office. The Board now has six non-federal members and four federal members.

Dual Focus on Internal and External Reporting

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."⁴ 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.

The FASAB's dual focus is a result of factors such as its mandate. As stated earlier, 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 (when created) 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.⁵

When addressing concerns regarding the size and complexity of the government-wide consolidated financial report (CFR), the Board reaffirmed the categories of users of Federal financial information described in SFFAC 1 and clarified the intended audience for more highly summarized information. Some constituents had believed that the CFR

⁴ SFFAC 1 par. 23

⁵ 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 1991.

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attempted to satisfy too many audiences with different needs and that identifying the primary users might better focus the report. The Board determined that designating the intended audience for the CFR would be beneficial⁶ and issued SFFAC No. 4: *Intended Audience and Qualitative Characteristics for the Consolidated Financial Report of the United States Government*, March 2003.

In SFFAC 4, the Board agreed that users of Federal financial information generally fall into the four categories identified in SFFAC 1: Citizens, Congress, Executives, and Program Managers.⁷ However, for the highly summarized government-wide or consolidated report level, the Board divided these four groups into two major groups: external users (Citizens), and internal users (Congress, Executives, and Program Managers). The Board believed that citizens should be the primary audience for the CFR because, compared to other groups, citizens lack ready access to more detailed Federal financial reports on which to make decisions. Also, citizens preferred to review a more summarized report for highlights of interest rather than taking time to understand more sophisticated reports.⁸

During staff roundtable meetings on the objectives of financial reporting, participants often raised the issue of who is the intended audience for federal financial reports and information. Certain participants believed that the FASAB standards and resulting reports are geared more towards external users, and the benefit to internal users comes from the audit process itself. Specifically, auditing the financial statements has served to improve the accounting and underlying data that the agencies use in managing programs. The internal users' needs are met through the preparation and the integrity of the system. Further, participants believed that the financial reports themselves are not the end; rather they are the means to improving data that managers actually use. These views were consistent with the Board's views noted in SFFAC 1. Particularly, paragraph 21 states,

...the processes of preparing and auditing financial reports can enhance the government's overall accountability structure by providing greater assurance that transactions are recorded and reported accurately... Thus, federal financial reporting helps to fulfill the government's duty to manage programs economically, efficiently, and effectively and to be publicly accountable.

Advantages of a GAAP Standards Setter

FASAB's designation as a GAAP standards setter does offer a comparative advantage that is unique in federal financial reporting. Accrual accounting, broadly described as generally accepted accounting principles (GAAP), starts with raw cash flows and varies the timing of their recognition to coincide with the events that cause the cash flows.

⁶ SFFAC 4, paragraphs 4 and 5.

⁷ SFFAC 1, par. 75

⁸ SFFAC 4, paragraphs 14 and 15.

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1 Accrual accounting is concerned with measuring costs and revenues for a period and
2 measuring asset and liability positions at the beginning and end of the period and
3 analyzing the reasons for change from one period to another.⁹ It offers benefits such
4 as:

- 5 ▪ *Prediction and Feedback.* Accrual accounting informs an entity where it stands
6 financially at the end of each period. Knowledge of the current position provides
7 a starting point for planning and predicting future actions.
- 8 ▪ *Disciplined GAAP Framework.* Accrual accounting leads to an independently
9 testable discipline in the measurement process and all of an entity's existing
10 assets and liabilities can be assessed in relation to one another and to
11 aggregates and to changes over time. It also assists in reporting on
12 accountability and decision making.¹⁰

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15 The GAAP designation confirms that the FASAB has established proper rules and
16 procedures and enhances the Board in these respects:

- 17 ▪ *Credibility--GAAP* recognition, with continued monitoring by the accounting
18 profession, indicates that the Board meets the minimum requirements for a
19 GAAP body. These are Independence, Due Process and Standards, Domain and
20 Authority, Human and Financial Resources, and Comprehensiveness and
21 Consistency.
- 22 ▪ *Ability to set a common framework for debate and offer a forum for consideration*
23 *of financial reporting issues--*While it does not limit the Board's role, GAAP status
24 demands comprehensiveness and consistency. Thus, GAAP standards setters
25 endeavor to establish a sound conceptual framework, address critical issues in a
26 timely manner, and introduce discipline to financial measures. Through
27 development of, continual improvement in, and application of financial accounting
28 concepts and standards, GAAP governs the terms used in financial discussions
29 and the financial representation given to transactions and events.

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33 Due process is a requirement of both Rule 203 and the Federal Advisory
34 Committee Act. Thus, the Board must continue to conduct outreach and consider
35 the views of those interested in federal financial reporting. This is both a
36 responsibility and an opportunity. Because of due process, the Board is
37 challenged to produce concepts and standards that are defensible and
38 understandable. Further, the Board may use due process as a means to engage
39 members of the various professions having an interest in federal finances.
40 Through the Board's efforts, public policy and budget experts may engage in
41 financial accounting/reporting deliberations. This creates the opportunity to
42 produce more useful and understandable concepts and standards.
43

⁹ David Mosso, "Social Security: Reliance on Cash Flow Accounting and Projections Disguises an Inherent Upside Cash Flow Bias," *Public Budgeting & Finance*, Spring 2006, p.143, 151 and 155.

¹⁰ Ibid. p.155.

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- *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.”

FASAB’s influence on federal financial reporting is unique. The Board determines financial reporting concepts and standards through an extensive and widely participative due process. Federal entities follow these standards in preparing financial statements subject to independent audit. Independent auditors determine whether the financial statements are presented fairly in accordance with GAAP which encompasses those concepts, standards, and practices required to define accepted accounting practices at a particular time.

Audited financial statements based on GAAP have an advantage in meeting users’ needs in several ways. For example, the discipline introduced through audited financial statement preparation and through established definition, recognition, and measurement guidance can lead to enhanced systems and processes, and ultimately more reliable information. Also, internal reporting and analyses are enhanced along with focusing attention on areas of concern. Consequently, users can gain a level of assurance that the information they utilize is accurate.

In addition, knowledge that certain information will be made publicly available can have behavioral consequences, such as deterring fraud, waste, and abuse. It also may lead reporters, analysts, and others to expect certain information (outside of the Budget) on a routine schedule. Also, managers may desire to inform Congress of information that is not included in the Budget. Consequently, accrual-based information can be made available to demonstrate accountability and that can be useful for decision-making.

In addition, GAAP reports provide an advantage because the information in such reports must possess certain characteristics. To effectively communicate information to users, SFFAC 1 describes six characteristics that the information must possess-- Understandability, Reliability, Relevance, Timeliness, Consistency, and Comparability.¹¹

All of the foregoing adds a degree of credibility and acceptability to FASAB’s standards that may not exist elsewhere in the federal jurisdiction. Although there may be other reporting requirements (other than financial statements) that are achieving or are contributing to achieve certain objectives, information required by a FASAB standard brings a level of assurance about the reliability of the information because it is subject to audit.

¹¹ See SFFAC 1 par. 156-164 for discussion of the Qualitative Characteristics of Information in Financial Reports.

Evolution in Federal Financial Management and Reporting Laws and Regulations since the CFO Act of 1990

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) provide for the production of complete, reliable, and consistent financial information for use in management and evaluation of Federal programs, and (3) improve agency systems of accounting, financial management, and internal controls. The CFO Act created 24 chief financial officers for the major executive departments and agencies. In addition to requiring those agencies to prepare and submit audited financial statements for each revolving and trust fund and for accounts that performed substantial commercial functions, the CFO Act required some agencies to have agency-wide financial statements.

As mentioned above, FASAB was established shortly after passage of the CFO Act. 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,
- **Performance Measurement**--Legislation to provide for the production of complete, reliable, and consistent financial information for use in management and evaluation of Federal programs, and
- **Internal Controls**--Legislation to improve agency systems of accounting, financial management, and internal controls.

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.

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 Secretary of the Treasury to prepare a consolidated financial statement for the executive branch. From its inception, the resulting Financial Report of the United States Government has also included financial information for the legislative and judicial branches.

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Impact/Analysis: 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. 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 States Government*. In addition, FASAB now includes a separate section detailing requirements for the Government-wide financial statement in applicable standards.

Reports Consolidation Act of 2000--This Reports Consolidation Act builds on a pilot program authorized in GMRA that allowed 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.

The Reports Consolidation Act requires that a consolidated report:

- Shall be referred to as a *Performance and Accountability Report* if it incorporates the agency's GPRA program performance report;
- Contain a summary of the most significant portions of the agency's program performance report, including the agency's success in achieving key performance goals, if the program performance report is not incorporated;
- Include a statement by the agency's inspector general that summarizes the agency's most serious management and performance challenges; and
- 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.

Impact/Analysis: With the Reports Consolidation Act, agency audited financial statements are included in a combined Performance and Accountability Report that contain other financial and performance reporting requirements.

Accountability of Tax Dollars Act of 2002--The Accountability of Tax Dollars Act extended the requirements for preparation of audited financial statements to virtually all executive branch agencies. OMB may exempt agencies with available budget authority

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under \$25 million in a given year, if OMB determines that audited financial statements are not warranted due to an absence of risk. 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.)

Impact/Analysis: The Accountability of Tax Dollars Act extends the requirement to produce and audit financial statements to some relatively small federal entities.

Improper Payments Information Act of 2002--The Improper Payments Information 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.¹²

Impact/Analysis: 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 OMB action in this area and related guidance is sufficient.

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 PMA, 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

¹² "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."

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1 mixed success, and red for unsatisfactory. For each initiative, there are core criteria
2 that the agency must meet in order to get a green rating. OMB updates the scorecard
3 on a quarterly basis.

4
5 The core criteria for “getting to green” on the improving financial performance initiative
6 are: 1. Financial management systems meet federal financial management system
7 requirements and applicable federal accounting and transaction standards as reported
8 by the agency head; 2. Accurate and timely financial information; 3. Integrated financial
9 and performance management systems supporting day-to-day operations; and 4.
10 Unqualified and timely audit opinions on the annual financial statements and no material
11 internal control weaknesses.

12
13 A basic tenet of the PMA calls for improving financial performance by providing timely,
14 reliable, and useful information. As a result, OMB amended OMB Bulletin 01-09 *Form*
15 *and Content of Agency Financial Statements* to significantly accelerate financial
16 reporting due dates. Specifically, beginning with FY 2004, Performance and
17 Accountability Reports were due to the President, OMB, and the Congress by
18 November 15th. Additionally, Treasury was required to issue the Financial Report of
19 the United States Government to the President and the Congress by December 15th.
20 In addition, beginning with the quarter ending March 31, 2004, agencies were required
21 to prepare and submit to OMB its quarterly unaudited financial statements 21 days after
22 the end of each quarter. OMB recently issued Circular A-136, *Financial Reporting*
23 *Requirements*, which reiterates and incorporates the accelerated financial reporting and
24 form and content requirements.

25
26 *Impact/Analysis:* The PMA has resulted in more timely financial reports and additional
27 oversight by OMB and other agency initiatives to address these important areas related
28 to improving financial performance.

29 30 **Conclusion on Effective Financial Management Practices Legislation and Linkage** 31 **to Objectives**

32 The legislation noted in this area focused on extending the requirements of the CFO
33 Act--specifically audited financial statements, to other agencies as well as the
34 consolidated government-wide financial statement. The legislation also focused on
35 streamlining reporting requirements by allowing agencies to produce a Performance
36 and Accountability Report. Additionally, agencies are issuing more timely financial
37 reports due to the accelerated due dates. It appears that the items in this area may
38 indirectly contribute to meeting all of the reporting objectives, but do not appear to
39 significantly contribute to meeting any one objective that would result in the Board
40 excluding any aspect of the objective.

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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 agencies are required to consolidate their audited financial statements and other financial and performance reports into combined Performance and Accountability Reports.

Impact/Analysis: SFFAC 1 includes "Operating Performance" as one of the four 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 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 concepts and standards issued by FASAB, such SFFAC 3 *Management's Discussion and Analysis*, SFFAS 4 *Managerial Cost Accounting Concepts and Standards* and SFFAS 7 *Accounting for Revenue and Other Financing Sources*, SFFAS 15 *Management's Discussion and Analysis*, and SFFAS 30 *Inter-Entity Cost Implementation* adequately respond to these laws. Alternatively, other people may believe that 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 GPRA, the PMA represents an ongoing effort in the executive branch for improving management and performance in the Federal government. As stated above, the PMA, 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

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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.

Impact/Analysis: The PMA has resulted in additional oversight by OMB and other agency initiatives to address these important areas related to budget and performance integration and full costing. See discussion under GPRA above for additional discussion.

OMB’s Program Assessment Rating Tool (PART) Analysis--The Administration began (in the 2004 Budget) to assess Federal programs by a method known as the 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.

Impact/Analysis: The PART Analysis has resulted in additional oversight by OMB and other agency initiatives in the area of agency performance measurement and accountability. See discussion under GPRA above for additional discussion.

Conclusion on Performance Measurement Legislation and Linkage to Objectives

The legislation noted in this area focused on the production of complete and reliable information for use in management and evaluation of Federal programs. It appears that most of the items in this area have a direct relationship with the Operating Performance

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Objective. Some may consider that agency efforts to meet the above requirements and the resulting oversight by OMB significantly contribute to meeting many aspects of the Operating Performance Objective. Therefore the Board may wish to consider whether certain aspects of the objective (or sub-objective) could be excluded or lowered from its priorities or revised accordingly to reflect that it is being addressed through other means.

Internal Controls

Federal Managers' Financial Integrity Act of 1982¹³ (FMFIA)--Congress has long expressed concerns about controls in various laws, dating back to include the Budget and Accounting Procedures Act of 1950. The FMFIA required virtually all executive agencies to comprehensively report on internal control two decades before the Accountability for Tax Dollars Act of 2002 extended the requirement for audited financial statements to virtually all executive agencies. The requirement to report on internal controls under FMFIA and reporting on controls over financial reporting are not necessarily equivalent. 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 FMFIA 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.

FMFIA 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 FMFIA. If they do not fully comply, the report must identify the weaknesses and describe plans for correction. The report is to be signed by the head of the agency.

¹³ 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.

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Impact/Analysis: SFFAC 1 includes “Systems and Controls” as one of the four objectives of federal financial reporting. See discussion under OMB A-123 below for a discussion of the impact/analysis of recent legislation and regulations.

Federal Financial Management Improvement Act of 1996 (FFMIA)-- The FFMIA 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 CFO Act agency, FFMIA requires that the annual audit report state whether the agency’s financial management systems comply with the requirements.

Impact/Analysis: 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.

Sarbanes-Oxley Act of 2002 (SOX)--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.

Impact/Analysis: 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 FFMIA, Government Audit Standards and the recently revised OMB Circular A-123 (see

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next item for a further discussion of the impact/analysis) already accomplish a comparable result.

OMB Circular A-123 (REVISED December 2004) *Management's Responsibility for Internal Control*--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. Also, the CFO Council and the President's Council on Integrity and Efficiency (PCIE) prepared an implementation guide to assist agencies in addressing the requirements included in A-123 Appendix A, *Internal Control over Financial Reporting*. Appendix A directs management to become more proactive in overseeing internal controls related to financial reporting.

Impact/Analysis: As noted above, SFFAC 1 includes "Systems and Controls" as one of the four objectives of federal financial reporting. Based on a staff analysis of the standards issued, FASAB has not addressed this objective as much as the others in its standards. For example, it appears that SFFAS 15, *Management's Discussion & Analysis* may be the only standard that directly relates to the system and control objective by requiring the MD&A to address systems and controls.

Some may believe that this reference to systems and controls may be sufficient and that no change is needed as a result of the strengthening of the regulations related to internal controls, but others may believe that an amplification of these sections of SFFAC 1 would be in order. 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 systems and controls. Some may believe 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 appropriate.

Others have suggested that existing requirements of FMFIA, FFMIA, Government Audit Standards and the recently revised OMB Circular A-123 will accomplish a comparable result and has effectively ended any need for FASAB to act in this area.

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COMPARISON BETWEEN A-123 AND SOX

	A-123	SOX
Management Assessment	Requires management assessment as of June 30 ¹⁴ , 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 from 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.

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.

¹⁴ Unless an audit is done, at which time the report may be dated the same as the auditors report.

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Impact/Analysis: A Draft Report entitled *Estimating the Costs and Benefits of Opining on Agency's Internal Control over Financial Reporting* was issued for comments in May 2005. The Draft Report concluded that given the significant estimated partial costs for agencies to obtain an audit opinion on internal control, all CFO Act agencies should not be required to conduct such an audit at this time. Rather, agencies should be given the opportunity to continue to implement OMB Circular A-123 and obtain an internal control audit only where particular circumstances appropriately warrant such an audit.

President's Management Agenda (PMA)--Improved Financial Performance Initiative--As noted above, the President's Management Agenda is an aggressive strategy for improving the management of the Federal government. 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.

One of the core criteria for "getting to green" on the improving financial performance initiative is: Unqualified and timely audit opinions on the annual financial statements and no material internal control weaknesses.

Impact/Analysis: OMB monitors internal control weaknesses regularly. To receive green on the PMA scorecard, agencies must eliminate all internal control weaknesses. Quarterly, OMB monitors agency performance in meeting corrective action plan targets established under the PMA scorecard. Agencies are required to submit corrective action plans to OMB to resolve internal control weaknesses reported. Quarterly, agencies are graded on their progress in achieving the corrective action milestones contained in their plans.

Conclusion on Internal Control Legislation and Linkage to Objectives

The legislation noted in this area focused on the improvement of agency systems of accounting, financial management, and internal controls. It appears that most of the items in this area have a direct relationship with the Systems and Controls Objective. Some may consider that agency efforts to meet the above requirements and the resulting oversight by OMB significantly contribute to meeting many aspects of the Systems and Control Objective. Therefore the Board may wish to consider whether certain aspects of the objective (or sub-objective) could be excluded or lowered from its priorities or revised accordingly to reflect that it is being addressed through other means.

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Objectives Roundtable Meetings

Purpose of Roundtables

The Board believed that it would be beneficial to get feedback from the community on the reporting objectives given the changes in the environment over the past 10 years. During 2005, FASAB staff conducted separate roundtable discussions on each of the four reporting objectives. The primary purpose of the discussions was to determine how the objective might be improved to facilitate its use as a means for guiding the board in developing standards of financial accounting and reporting and in developing solutions to financial accounting and reporting issues. Experts involved in specific areas, as well as those external to the accounting community provided insights on the four objectives. The roundtable meetings focused on the following general topics:

- Participant's observations on the financial reporting objective;
- Evaluating the objective in the evolutionary environment; and
- Broad nature of the objective and determining the scope of FASAB's role.

Additionally each of the roundtable meetings focused on specific issues related to the objective being discussed.

Overall Conclusion from Roundtables

Overall, the participants agreed that the financial reporting objectives were very broad, but they did not expect FASAB or financial statement reporting to cover or meet all the objectives alone. This was consistent with the Board's view that information sources other than financial statements help to attain the objectives. The participants viewed the SFFAC 1 objectives as a broad statement of federal financial reporting objectives and not limited to objectives to be met by the development of accounting standards. The participants also expressed that FASAB should not limit itself by eliminating certain objectives in SFFAC 1. Although the participants did offer areas for improvement, there was no indication that any objective should be removed.

As for area of improvements, there were several common themes discussed in most of the Roundtable meetings that relate to enhancements of SFFAC 1 or other areas, rather than an enhancement to a particular objective. The issue areas include the following:

- Discussion of the inter-relationship of information to explain the relationship between the financial reporting objectives and the totality of reporting
- Proactively encourage better use of the Management's Discussion and Analysis
- Need for education and reiteration of decision usefulness as most requirements have become a compliance exercise
- Expansion of the discussion of Accountability
- Better understanding of user needs--as well as internal users versus external users

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Staff believes the above items do not warrant enhancing the reporting objectives, but instead relate to possible enhancements to SFFAC 1 or other areas. However, these are prevalent issues that came up in all or most of the roundtable meetings and should be considered if the Board decides to amend SFFAC 1.

A brief summary of each of the roundtable meetings is provided below.

Budgetary Integrity Roundtable

The participants' views were consistent with the Board's views and general satisfaction with the Budgetary Integrity objective. The participants agreed that financial reporting and the related audit have improved the reliability of accounting information. Certain participants explained that although financial reports may not be useful to agency management, the fact that the reports are subjected to audit has been beneficial to improving the accuracy of the agency's underlying accounting data. Auditing the financial statements has served to improve the accounting and underlying data that the agencies use in managing programs. The participants believed that budget data has improved since agency financial reports have been subjected to audit because the audit has resulted in the identification of errors that lead to correcting budgetary reports. Additionally, the participants believed that audits help bring about consistency in definitions and improvements in controls over assets. The participants agreed that the objective was broad but FASAB or financial statement reporting was not expected to cover or meet the objective alone.

The participants also discussed issues concerning how to better achieve the objective. The topics discussed included:

- *Statement of Budgetary Resources.* Participants discussed the following concerns regarding the Statement of Budgetary Resources.
 - *Materiality and Presentation Detail.* The Statement of Budgetary Resources is prepared and audited at a very high-level. The participants explained that the materiality level is high and that it does not provide assurance that each account is accurate. Participants most actively involved in budget oversight expressed greater interest in accuracy at the account level.
 - *Conveying Accountability.* The Statement of Budgetary Resources may not demonstrate whether an entity is publicly accountable. Most participants agreed that a budget to actual comparison would provide a better report in meeting the overall Budgetary Objective. Specifically, several participants expressed the view that a budget to actual comparison at some meaningful level of detail would meet the objective of having the government publicly accountable.

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- *Statement of Financing and Sub-objective 3.* Although the participants believed that the Statement of Financing was intended to achieve sub-objective 3,¹⁵ several thought that most users do not understand the Statement of Financing and therefore, may not understand the relationship between budget and cost that it is attempting to convey. Most of the participants believed the Statement of Financing may serve as an internal document rather than a published document.
- *Internal Versus External Users.* Certain participants commented that the Board should select whether financial reporting is intended for internal or external users. It was noted that information that is important for managing an organization may not be useful for demonstrating accountability to the public at large.
- *Other Report Formats and Other Guidance Vehicles.* Participants commented that some of the PARs are lengthy and overwhelming to read. The participants agreed that it is a struggle to clearly communicate the information effectively in the PARS, but noted that many agencies are moving towards a 'popular report' or a 'condensed report' and believed that the general public may find those much more useful and interesting.

The full Summary and Analysis of the Budgetary Integrity Roundtable Meeting can be found at <http://www.fasab.gov/projectsconobjectives.html>.

Operating Performance Roundtable

The participants' views regarding the Operating Performance objective were consistent with the Board's position that the objective appears broad, but there are other documents and requirements that assist in accomplishing the objective. The participants confirmed that performance reporting is an important initiative in the federal government and they did not expect FASAB or financial statement reporting to cover or meet the objective alone.

The participants also discussed the following challenges to achieving the Operating Performance objective.

- *Systems and Control Issues.* Difficulty meeting fundamental requirements such as those involved in preparing financial statements for the standard financial statement audits. This condition results from existing system issues and internal control weaknesses.

¹⁵ Sub-objective 3 states, "Federal financial reporting should provide information that helps the reader to determine how information on the use of budgetary resources relates to information on the costs of programs operations and whether information on the status of budgetary resources is consistent with other accounting information on assets and liabilities."

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- 1 ▪ *Determining Appropriate Information to Convey and Utility of Information.*
2 Difficulty determining the appropriate information to convey through performance
3 measures. Additionally, the participants described that agencies are having
4 difficulty determining unit cost information, linking that information to outcome,
5 and developing performance measures for some services.
6
- 7 ▪ *Integrating Budget, Performance and Financial Information and Consequences.*
8 There is a need for integration of accounting data, internal controls, financial
9 management, and performance reporting with the capital management and
10 performance management systems.
11
- 12 ▪ *Other Report Formats and Guidance Vehicles.* Too many requirements already
13 exist, and agencies are still trying to meet those. Any guidance issued should be
14 less prescriptive and more open so it may be applied as needed to particular
15 agencies. FASAB could have a role in education and providing non-authoritative
16 guidance.
17

18 The participants discussed methods for better achieving the Operating Performance
19 objective as follows.
20

- 21 ▪ *Cost Accounting Issues and SFFAS 4, Managerial Cost Accounting Concepts*
22 *and Standards.* Participants discussed the belief that the least has been
23 completed to achieve sub-objective 1.¹⁶ Although some agency financial
24 statements show the total costs of strategic goals, the notion of costs of specific
25 programs and activities is not specifically included in the statements. FASAB
26 could ascertain and address the conditions that are impeding the
27 implementation of SFFAS 4.
28
- 29 ▪ *Sub-objective 3.* Certain participants believed that additional reporting could be
30 done with respect to sub-objective 3.¹⁷ Particularly, participants expressed the
31 concern that physical assets may be underutilized in the federal government.
32

33 The complete Summary and Analysis of the Operating Performance Roundtable
34 Meeting can be found at <http://www.fasab.gov/projectsconobjectives.html>.
35
36

37 **Stewardship Roundtable**

38
39 The participants discussed the importance of the Stewardship objective in federal
40 financial reporting as well as their perceptions about the Stewardship objective and

¹⁶ Sub-objective 1 states, "Federal financial reporting should provide information that helps the reader to determine the costs of providing specific programs and activities and the composition of, and changes in, these costs."

¹⁷ Sub-objective 3 states, "Federal financial reporting should provide information that helps the reader to the efficiency and effectiveness of the government's management of its assets and liabilities."

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FASAB's role in meeting the objective. The participants remarked that the stewardship objective was intended to be broad and it is currently the focus of discussions in the federal environment. The participants expressed that the stewardship objective is very different as it speaks to the government as a whole and the nation, and therefore is a much broader objective compared to other traditional accounting standards body objectives. Although most participants did believe that FASAB has an advantage in developing a reporting framework that fairly presents the financial condition of the Federal government, the participants noted that much of the information needed to fulfill the stewardship objective is developed outside of FASAB's domain. FASAB may make a contribution by providing reporting concepts that fairly present financial condition and sustainability, accounting standards that have a complementary role in analyzing financial condition, and support for the transparency and validity of data. FASAB could say that this information is important and fits the framework that should be filled out, but the specifics of the information may be left up to others. For this and other objectives, the participants commented that a combination of accounting and other data are essential for a full assessment of whether the objective is met.

The participants also discussed various approaches for better achieving the stewardship objective. The discussions included the following topics.

- *Address Two Tiers of Stewardship Reporting.* Participants discussed two-tiers of financial reporting - the government broadly versus a specific program. A macro view is needed for the forward-looking long-term projections because such information could be misleading and may not make sense piecemeal. One set of criteria may be needed for reporting at the government-wide level, which would involve forward looking projections, and perhaps another set for the component level which could discuss operating stewardship information.
- *Understanding and Reporting Financial Condition of the Nation.* The participants discussed that the stewardship objective concerns the government as a whole and the nation, and therefore is a much broader objective compared to other traditional accounting standards body objectives. Citizens care about information on the government and nation as a whole.
- *Projections.* Participants discussed that, given that the objective concerns how the government's and the nation's financial condition could change in the future, certain projections would be needed. However, they expressed concern that projections involve uncertainties.
- *Key National Indicators.* The participants discussed the need for economic indicators and it was noted that there appears to be a tremendous amount of interest in national indicators. The participants noted that the government has continued working on developing appropriate indicators and the information will get better with time. However, some participants were concerned because inputs are important but there may not be a cause and effect relationship.

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- 1 ▪ *Intergenerational Responsibilities.* The participants discussed that stewardship is
2 a term with long-term implications and this should include addressing
3 intergenerational responsibilities.
4
- 5 ▪ *Other Reporting Vehicles.* Some participants commented that an approach other
6 than traditional financial statements should be considered. A participant noted
7 that perhaps there is a way of combining what is reported in the financial
8 statements with what is reported in the stewardship report. The participants
9 believed this would satisfy a need for a more comprehensive view of the financial
10 condition of the nation.
11
- 12 ▪ *Comments on the sub-objectives.* The participants believed that the objective
13 could be worded to require more of a measure of a level rather than in the form
14 of a yes/no question. It was noted that although the government is never
15 expected to default on its obligations and not be able to borrow funds in the
16 future, the government could borrow too much and impact the nation's economy.
17 Also, the participants believed that the Concepts Statement should include more
18 narrative about why the information is needed and why it is important as this
19 would be much more helpful than having specific examples listed in the
20 concepts. Additional comments related to specific sub-objectives are as follows:
21
 - 22 ○ *Second sub-objective.*¹⁸ Certain participants commented that the wording
23 needs to be clarified to explain whether "sustain public services" means at
24 a current level or future level.
25
 - 26 ○ *Third sub-objective.*¹⁹ The participants expressed concern that there may
27 not be a direct cause and effect relationship between the government
28 operations and the nation's well-being or, if there is, it would be difficult to
29 measure how the government is contributing.
30
- 31 ▪ *Enhancing explanations throughout SFFAC 1 and Other Areas.* The participants
32 expressed that SFFAC 1 could also be enhanced by discussing some of the
33 knowledge that has been gained in the past 12 years. Other enhancements
34 included the following.
35
 - 36 ○ *Better Use of Management's Discussion and Analysis.* Participants
37 believed that the thrust of better achieving the stewardship objective could
38 be to better analyze existing information rather than prescribing more
39 information. Some participants noted that perhaps the MD&A could be
40 better utilized for communicating such information. The MD&A offers a

¹⁸ The second sub-objective states, "Federal financial reporting should provide information that helps the reader to determine whether future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due."

¹⁹ Federal financial reporting should provide information that helps the reader to determine whether government operations have contributed to the nation's current and future well-being.

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place in the performance and accountability report to describe the interrelationship of all the information presented.

- *Determining User Needs and Decision Usefulness.* The participants noted that a differentiator between FASAB objectives and other board's objectives is meeting internal and external needs. The participants believed the notion of internal needs versus external needs could be further developed in the concepts by expanding more fully and explaining how one differentiates the two.
- *Audit Issues and Concerns.* Certain participants believed that FASAB should focus on what information needs to be presented because the issue of auditing may cloud and sometimes confuse decisions. Given that there are various levels of audit work, such as a review or agreed-upon-procedures, FASAB could first determine what information needs to be reported and next consider where it should be presented which would in turn dictate the level of audit involvement necessary.

The full Summary and Analysis of the Stewardship Roundtable Meeting can be found at <http://www.fasab.gov/projectsconobjectives.html>.

Systems and Control Roundtable

The participants believed that the Systems and Control objective remains valid in today's environment and agreed with FASAB's indirect role in achieving the objective. Most of the participants expressed support for FASAB to continue the indirect approach and did not believe that FASAB should issue a specific standard on systems and control. In addition, the participants explained that an indirect approach rather than prescriptive guidelines enables the Board to be encompassing for everyone to accomplish their mission. Some of the other comments on the objective and the role of FASAB were as follows.

- SFFAC 1 was structured to have an accountability mechanism and, given the financial challenges the nation faces, the information in the concept statement is even more important today than it was when originally crafted.
- Commercial type audited financial statements were not viewed as the driver for affecting policy decisions at the federal level. Instead, the statements were seen as a catalyst to move individuals toward improving their accounting.
- FASAB with its limited resources should focus its efforts on addressing the direct technical accounting issues that remain and those other items on the technical agenda.

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The participants also discussed ideas that could lead to better achievement of the objective. Discussions included the following.

- *Enhancing Explanations throughout SFFAC 1.* SFFAC 1 could be enhanced by discussing some of the knowledge gained since its issuance and updated to emphasize that it is not just the financial statements that enable the objectives to be met. Additional comments for enhancing SFFAC 1 are as follows.
 - *Interrelationships.* The participants indicated that there is a need to explain the relationship between the financial reporting objectives and the totality of reporting that is taking place in the federal government. It was expressed that some preparers and auditors are possibly engaging in compliance exercises or simply “checking the boxes” for many requirements, including those related to systems and control.
 - *Accountability Notion.* The participants commented that Concepts 1 was structured to have an accountability mechanism and that is why the concept statement is even more important today. They noted that Concepts 1 should be more about overall “accountability” versus “accounting.”
 - *Educational Platform.* SFFAC 1 could be used as a way to convey the relationships of various reporting requirements. This may assist preparers and auditors in understanding the importance of meaningful information versus viewing it as a compliance exercise. Also, some examples of how the objectives are currently being met could be included in the discussions on each objective to help non-accountants understand the role of accountability and financial reports and the information that is used to demonstrate accountability.
 - *Other Possible Enhancements.* The participants commented on other possible enhancements to SFFAC 1 such as the statement possibly including an explanation of a financial management system; an explanation of why performance information is important; and the concept statement could be updated and fine-tuned to reflect the COSO changes and perhaps the changes that COSO is now considering.

The full Summary and Analysis of the Systems and Control Roundtable Meeting can be found at <http://www.fasab.gov/projectsconobjectives.html>.

Board Consideration of Roundtable Meetings

From the Roundtable meetings, staff learned that participants at all roundtables believe that the financial reporting objectives, although broad, are still valid today. The participants viewed the SFFAC 1 objectives as a broad statement of federal financial reporting objectives and not limited to objectives to be met by the development of accounting standards. The participants also expressed that FASAB should not limit itself by eliminating certain objectives in SFFAC 1. Although the participants did offer areas for improvement, there was no indication that any objective should be removed. The participants believed that the federal financial reporting objectives should remain broad and that if FASAB wishes to document its focus, it should be done in a manner that would not limit itself in the future.

Staff presented the results of the Roundtable meetings to the Board at the March 2006 Board meeting. Based on the results from the roundtables, staff requested the Board's input on maintaining the broad objectives. The Board members discussed whether the federal financial reporting objectives should remain broad and the Board noted that FASAB does appear to have a comparative advantage in stating the objectives of federal financial reporting. The Board acknowledged the original Board did a lot of good thinking when developing the objectives and forums such as the roundtables are a good way to determine whether the objectives are still valid. After discussing concerns regarding the Systems and Control objective, the Board agreed to maintain the current broad objectives of federal financial reporting and that FASAB should not eliminate objectives in SFFAC 1.

Given that the Board decided to retain the broad objectives of federal financial reporting, the Board discussed how to best articulate FASAB's role in relation to the broad objectives. The Board believes that the broad objectives may result in a lack of focus for FASAB and there would be benefit to articulating FASAB's objectives or role in relation to the overall broad objectives. The Board discussed that amending SFFAC 1 could take up considerable resources. Additionally, Board members discussed that it could define its priorities through a strategic plan but agreed that the scope of the strategic plan would need to be defined. The Board also believed it would be plausible to continue developing this Draft White Paper on Objectives with an emphasis on describing FASAB's role in relation to the broad objectives. The Board discussed the possibility that the White Paper on Objectives could be used more as a guiding, internal document for Board members. The Board could later determine if it should be included in a formal Board document, such as a Concepts statement or if it could be part of the strategic plan. Accordingly, the different options for articulating FASAB's role in relation to those objectives required further Board assessment and will be addressed in future meetings.

Defining FASAB's Role in Relation to the Broad Objectives of Financial Reporting

Consideration of the Mission of FASAB

When defining FASAB's role in relation to the broad objectives of federal financial reporting, FASAB's mission should be considered. SFFAC 1 provides FASAB's mission as follows:

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.

When evaluating FASAB's mission, one could point out that the mission does in essence provide some narrowing by identifying FASAB's role in relation to 'accounting standards'. SFFAC 1 further states in par. 26 that: "The FASAB was created to advise OMB and Treasury (agents of the President) and the GAO (an agent of the Congress) on accounting standards for federal agencies and programs in order to improve financial reporting practices."

Further support of FASAB's focus on accounting is explained in SFFAC 1, Chapter 7 *How Accounting Supports Federal Financial Reporting*. Par. 165 states "This chapter explains the focus of the FASAB's concern by showing how accounting supports financial reporting and thus how accounting standards recommended by the FASAB can influence federal financial reporting. This chapter shows how the FASAB's recommendations can influence a wide variety of financial reports...."

Consideration of the Definition of Financial Reporting

Additionally, the definition of 'financial reporting' should be considered in defining FASAB's role in relation to the broad objectives of financial reporting. Although SFFAC 1 recognizes "different people are likely to talk about very different things when asked to describe federal financial reporting or federal accounting."²⁰ SFFAC 1 par. 21- 22 describes financial reporting as follows:

21. Financial reporting by the federal government provides information for formulating policy, planning actions, evaluating performance, and other purposes. In addition, the processes of preparing and auditing financial reports can enhance the government's overall accountability structure by providing greater assurance that transactions are recorded and reported accurately, that consistent definitions are used to describe the transactions, etc. Thus, federal financial reporting helps to fulfill the government's duty to manage programs economically, efficiently, and effectively and to be publicly accountable.

²⁰ SFFAC 1, par. 38

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22. Financial reporting is supported and made possible by accounting and accounting systems. "Financial reporting" may be defined as the process of recording, reporting, and interpreting, in terms of money, an entity's financial transactions and events with economic consequences for the entity. Reporting in the federal government also deals with nonfinancial information about service efforts and accomplishments of the government, i.e., the inputs of resources used by the government, the outputs of goods and services provided by the government, the outcomes and impacts of governmental programs, and the relationships among these elements.

Consideration of the Limitations of Financial Reporting

SFFAC 1 also recognizes that financial reporting is not the only source of information in par. 106 by stating "Financial reporting is not the only source of information to support decision-making and accountability. Neither can financial reporting, by itself, ensure that the government operates as it should. Financial reporting can, however, make a useful contribution toward those objectives."

SFFAC 1 also describes the reporting methods and the need for general purpose financial reports, special reports and other reports in meeting the objectives and needs of users. It also addresses FASAB's ability to consider the issues involved in the reports. SFFAC par. 31 – 34 states:

31. While certain information is provided by general purpose financial reports, other information is better provided by, or can be provided only by, financial reporting outside such reports. Still other information is provided by nonfinancial reports or by financial reports about segments of the national society other than the federal government and its component entities (e.g., economic reporting).
32. Often, to satisfy the information needs of various individuals, it is necessary to combine and report financial and nonfinancial information. Often, combining information about the government with information about aspects of the national society is necessary to assess past or planned governmental actions. For example, information about the number of people gainfully employed after participating in a vocational education program would be important both in assessing past governmental expenditures for training and in evaluating plans for similar new expenditures.
33. Some questions arise with special force regarding the nature of general purpose reports because, by definition, no user or potential user is able unilaterally to define the requirements for these reports. The FASAB is, by design, well constituted to consider the issues involved with such reports.
34. Federal accounting also must support special purpose reporting to the Congress, executives, and others that the FASAB represents. Indeed, most federal financial reporting is special purpose reporting. Also, the Board notes that traditional "general

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purpose" financial reports may serve a larger and more useful purpose for a variety of audiences if traditional designs for such reports are expanded to include a variety of reports addressing budgetary integrity, operating performance, stewardship, and control of federal activities.

SFFAC 1 describes the objectives as a broad statement of federal financial reporting objectives and not limited to objectives to be met by the development of accounting standards. Specifically FASAB recognized its own limitations and other sources of information are important to achieving the objectives in SFFAC 1 par. 35-37 as follows:

35. The FASAB recognizes that developing and implementing standards that will contribute to achieving certain objectives may take considerable time. Time will be needed to establish information-gathering systems and to gain experience by experimenting with alternative approaches.

36. The FASAB expects that some of these objectives may best be accomplished through means of reporting outside general purpose financial reports. Indeed the FASAB recognizes that information sources other than financial reporting, sources over which the FASAB may have little or no influence, also are important to achieving the goals implied by these objectives.

37. In developing specific standards, the FASAB will consider the needs of financial information users, the usefulness of the information in relation to the cost of developing and providing it, and the ability of accounting standards to address those needs compared with other information sources.

SFFAC 1 and SFFAC 2, *Entity and Display*, do not envision a narrowly defined "general purpose financial report." References to combining financial and non-financial information are common. For example, SFFAC 2 recognizes the need for a statement of program performance and refers to such a statement as "not only an appropriate financial statement, but likely to be the most important financial statement for those persons interested in how a Federal entity is using its resources."²¹

Consideration of Other Factors

While FASAB acknowledges the broad, non-traditional vision, embodied in SFFACs 1 and 2, the board considered the following factors in defining its role in relation to the broad objectives and in establishing priorities for the near term:

1. the ability of accounting standards to address information needs compared with other information sources,
2. the interrelated nature of the reporting objectives and whether there are foundational issues that, when resolved, facilitate meeting other objectives, and
3. the contribution of current standards to meeting reporting objectives.

²¹ SFFAC 2, par. 66

Assessment of FASAB's Role in Achieving Each Objective

In assessing the objectives against the factors identified above, the Board considered language from SFFAC 1, discussions at roundtables held during 2005, and current reporting – including current GAAP reports and other reports - that contributes to meeting the objective. One of the main purposes of this project was to define the Board's role in achieving the broad objectives, as the nature of the Board's involvement may vary for each objective.

It should be noted that this is an assessment of FASAB's role in meeting each objective and should not be considered a ranking of the broad objectives.

Accordingly, FASAB assessed which objectives there would be more opportunity to play a direct role in developing standards to achieve the objectives in the upcoming years. FASAB's assessment of the objectives provides that there are two levels of focus for FASAB in the near-term²² as follows:

Primary Focus Objectives—Primary Focus Objectives are those objectives where there is the greatest opportunity for FASAB to play a direct role in developing standards to achieve the stated objectives, based on its comparative advantage and other factors noted above. Therefore, projects that support achieving primary focus objectives would be considered higher priorities in the near-term.

Secondary Focus Objectives—Secondary Focus Objectives are those objectives where there is not the greatest opportunity for FASAB to play a direct role in developing standards to achieve the stated objectives, based on its comparative advantage and other factors noted above. In contrast to primary focus objectives, FASAB believes that it will play an indirect role in developing standards that would meet these objectives in the near-term.

However, the Board believes that objectives not currently placed in a priority position may be re-prioritized as fundamental issues are resolved in the long-term. In the near-term, the Board believes that many of its active projects will address multiple objectives so that designation of a "primary focus" or "direct role" objective does not mean that no progress would be made towards meeting lower priority objectives. Further, it is possible that resources would remain available to contribute to meeting an objective even if it is not a primary focus in the near-term. The reason for this classification and prioritization is discussed below for each objective.

²² Near-term is defined as approximately five years for the purposes of this document. In conjunction with strategic planning, FASAB may re-evaluate this assessment at earlier intervals in future years.

FASAB's Primary Focus Objectives in the Near-Term

Based on the assessment and consideration of the factors noted above, FASAB determined its Primary Focus Objectives in the near-term are the Operating Performance Objective and the Stewardship Objective. Among the two primary focus objectives, FASAB believes the Operating Performance Objective to be its top priority. FASAB believes that making it the top priority allows for progress on all of the objectives because of the interrelated nature of the reporting objectives. A summary of the factors supporting placing these two objectives as primary focus objectives is below.

Operating Performance

The Operating Performance objective of federal financial reporting states that:

Federal financial reporting should assist report users in evaluating the service efforts, costs, and accomplishments of the reporting entity; the manner in which these efforts and accomplishments have been financed; and the management of the entity's assets and liabilities. Federal financial reporting should provide information that helps the reader to determine:

- the costs of providing specific programs and activities and the composition of, and changes in, these costs;
- the efforts and accomplishments associated with federal programs and the changes over time and in relation to costs; and
- the efficiency and effectiveness of the government's management of its assets and liabilities.

The Operating Performance Objective could be considered FASAB's top priority at the present time and the one where there is greatest opportunity to play a direct role in developing standards that would achieve the objective. Most would agree that the Operating Performance Objective relates to integrating cost information derived from accrual accounting with performance reporting. In addition, it addresses the financing of efforts; creating a link to budgetary resources, changes in assets and liabilities over time, and financial sustainability reporting. Information about the assets and liabilities of the government also provides a foundation for meeting the Stewardship Objective which calls first for information about the financial position of the government. Placing the Operating Performance Objective as a top priority allows for progress on all of the objectives because of the interrelated nature of the reporting objectives.

With respect to the Stewardship Objective, SFFAC 1, par. 137 states that "analysis of *why* financial position improved or deteriorated helps explain whether financial burdens were passed on by current-year taxpayers to future-year taxpayers without related benefits." In addition, while Stewardship sub-objective 3B (...whether future budgetary resources will likely be sufficient to sustain public services and to meet obligations as

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they come due.) appears to call for projections, the narrative related to the sub-objective explains that “information about the results of past government operations is useful in assessing the stewardship exercised by the government.” Examples of information relevant to the sub-objective are (1) financial risks from government-sponsored enterprises, deposit insurance, and disaster relief programs, (2) the long-term financial implications of the budgetary process, (3) the status of trust funds, and (4) backlogs of deferred maintenance. Many – if not all - of the above examples relate to reporting on financial position. Thus, a thorough assessment of financial position is essential to meeting (but not sufficient to meet) Operating Performance and Stewardship objectives.

Developing standards for achieving the Operating Performance Objective should be considered a top priority based on the factors discussed below--language found in SFFAC 1, FASAB's comparative advantage in this area, results from the Roundtable meetings, and changes in the environment due to new laws and regulations.

- Language from SFFAC 1

SFFAC 1 describes that most accountants, auditors and accounting students typically think about proprietary accounts and reports prepared from them when considering financial reporting. SFFAC1 describes that FASAB is most directly concerned with these accounts in par. 47 “These accounts are used to record assets and liabilities that are not accounted for in the budgetary accounts. These reports are said to present “financial position” and “results of operations” in accordance with some set of accounting standards. The FASAB is most directly concerned with these accounts and with the reports that are prepared, in large part, with information from them.”

In addition, par. 191 describes the Board's focus as follows “The Board's own focus is on developing generally accepted accounting standards for reporting on the financial operations, financial position, and financial condition of the federal government and its component entities and other useful financial information...” As such, most would also see this as meaning that perhaps FASAB is most directly concerned with the Operating Performance objective because it relates most closely with these types of items—assets, liabilities, and results.

SFFAC 2, *Entity and Display*, recognized that each reporting objective could be achieved through different reporting. Par. 56 of SFFAC 2 states “The objective of operating performance can be best met with financial statements from organizations / sub-organizations and programs...” The Statement of Net Cost was designed with that in mind and calls for presentation of net cost by responsibility segment and program. SFFAC 2, par. 66, further suggests that a statement of program performance is “an appropriate financial statement.” On balance, SFFAC 1 envisions a financial report that includes non-financial performance information. SFFAC 1 and 2 seem to suggest a role for FASAB in ensuring that financial information about costs, assets and liabilities is integrated with performance information. With respect to non-financial information, FASAB has provided for summary performance information in the MD&A but has not addressed a statement of program performance.

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- FASAB's Comparative Advantage

During its deliberations, the Board has acknowledged the comparative advantages of federal accounting in general and of GAAP reporting in particular. One advantage in particular is that users can gain a level of assurance that the information they utilize is reliable and comprehensive. Also, the discipline of preparing financial statements for audit can lead to improved government systems and processes. The section "Advantages of a GAAP Standards Setter" above in this white paper discusses FASAB's comparative advantage in more detail.

In addition, the Board has noted that financial statements are the principal means of communicating accounting information about an entity's resources, obligations, revenues, costs, etc. to those outside the entity. Considering that a primary objective of the Federal government is to provide services, a financial statement would help communicate to citizens how much of the services were financed by taxpayers. A Statement of Net Cost communicates this information and supports achievement of the Operating Performance objective. Other financial statements, such as a Statement of Changes in Net Position help citizens understand the manner in which net costs were financed and the effect on the government entity's net position. The Statement of Changes in Net Position also contributes to achieving the Operating Performance objective.²³ An open issue is whether FASAB has an advantage over others involved in requiring that performance measures be reported.

- Roundtable Meetings

The participants at the Operating Performance Roundtable Meeting described that the Operating Performance Objective is very important and it is vitally important that agencies continue to make progress in all areas at achieving this objective. The participants noted that while there is a need to maintain high standards, agencies are still having difficulty meeting basic financial reporting requirements as well as the objective. Additionally, the participants noted that agencies continue to struggle with determining what information should be conveyed and that there is still a need for improvement in understanding how the information relates and utilizing it in decision making. The participants also believed that integrating financial and performance systems and consequences for not controlling costs may help change behavior and begin to address some of the challenges. Further, the participants discussed that FASAB could have a role in education and providing non-authoritative guidance.

In addition, participants at the roundtable meetings for the other objectives, echoed concerns that there are still very basic accounting issues that need to be addressed by the Board and there is much progress to be made by agencies in some of the more basic accounting type areas that could be viewed to relate to or be addressed in the Operating Performance Objective. Specifically, certain participants offered that FASAB,

²³ SFFAC 2 paragraphs 59 and 60.

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with its limited resources, should focus its efforts on addressing the direct technical accounting issues that remain and those other items on the technical agenda.

Overall, the operating performance roundtable discussion suggests that FASAB may wish to offer leadership regarding the integration of financial and non-financial information while developing additional standards that support determination of full cost and financial position.

- Changes in the Environment due to New Laws and Regulations

Considering that the Operating Performance Objective addresses several sub-objectives that are related²⁴ but suggest different reporting outcomes, one could rank the sub-objectives since this objective is considered FASAB's top priority. This ranking could potentially be in the following order:

1. The efficiency and effectiveness of the government's management of its assets and liabilities.
2. The costs of providing specific programs and activities and the composition of, and changes in, these costs.
3. The efforts and accomplishments associated with federal programs and the changes over time and in relation to costs.

This ranking of sub-objectives would be appropriate after consideration of the evolution of federal financial reporting laws and regulations and the changes in the environment resulting. As mentioned earlier in this white paper, since the CFO Act, Congress has enacted a series of laws to reform and improve financial management in the federal government. It was noted that there were several new laws that contributed to effective financial management practices, such as extending the requirements of the CFO Act, streamlining reporting requirements, and requiring timely reporting.

It was also noted that there were several new laws and regulations related to performance information (such as GPRA, PMA, and PART) that focused on the production of complete and reliable information for use in management and evaluation of Federal programs. It appears that most of the items in this area have a direct relationship with the Operating Performance Objective, and in particular the sub-objective 'The efforts and accomplishments associated with federal programs and the changes over time and in relation to costs'. Some may consider that agency efforts to meet the requirements and the resulting oversight by OMB significantly contribute to meeting many aspects of the sub-objective. Also, considering that many of the new requirements, such as the PART, are very new and the ultimate benefit and effect on performance reporting is not known. Therefore, it would be appropriate to lower this sub-objective in priorities (when compared to the other Operating Performance sub-objectives) as this area continues to evolve.

²⁴ For example, costs can not be determined absent recognition of assets and liabilities. In addition, efficiency of managing assets suggests an assessment of the cost associated with holding, using or preserving assets.

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Stewardship

The Stewardship Objective is based on the government's responsibility for the general welfare of the nation. The Stewardship objective of federal financial reporting states that:

Federal financial reporting should assist report users in assessing the impact on the country of the government's operations and investments for the period and how, as a result, the government's and the nation's financial condition has changed and may change in the future. Federal financial reporting should provide information that helps the reader to determine whether

- the government's financial position improved or deteriorated over the period,
- future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due, and
- government operations have contributed to the nation's current and future well-being.

The Stewardship Objective is the broadest of all the objectives and although many aspects of this objective are important to citizens and FASAB does consider it a primary focus objective, the objective would not be considered FASAB's 'top priority' (when compared to the Operating Performance Objective) for the reasons discussed below—language from SFFAC 1, results from the roundtable meetings, current FASAB standards and concepts statements, and other reports fulfilling this objective.

Considering that the Stewardship Objective addresses several sub-objectives that differ, one could rank the sub-objectives. This ranking would actually fall in line with the order presented above, (which is consistent with how it was presented in SFFAC 1.) One could argue that the first sub-objective "the government's financial position improved or deteriorated over the period" could in essence be ranked as a higher priority among the other sub-objectives within the Stewardship Objective. The first sub-objective involves assessing the government's financial position from one period to another which is very important in analyzing operations and many aspects that could be considered similar to those of the Operating Performance Objective. Therefore, this sub-objective would be considered the highest of importance among the Stewardship sub-objectives.

However, the remaining two sub-objectives seem to relate more to sustainability and financial condition, which rely more on long-term considerations, forecasting, and forward-looking information. In addition, financial condition is a much broader concept than financial position as it involves financial and non-financial information about the national economy and society and therefore would include areas outside of the government.

- Language from SFFAC 1

SFFAC 1 provides a brief discussion on economical financial reporting and notes that most reports of this type would address the national society as a whole and national income and product accounts (NIPAs). It further describes that NIPAs provide vital

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information to policymakers and are an essential part of economic reporting by national governments.

SFFAC 1 par. 42 clarifies FASAB's role and the objectives in relation to the economical reports as follows:

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.

Consequently, 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," and "federal financial reporting cannot by itself accomplish the objectives of evaluating or assuring stewardship; it can only contribute to those goals."²⁵

The Board recognized that the focus of the stewardship objective was broader than the other objectives as par. 135 of SFFAC 1 states: "This objective is based on the federal government's responsibility for the general welfare of the nation in perpetuity. It focuses not on the provision of specific services but on the requirement that the government report the broad outcomes of its actions..." In addition, the Basis for Conclusion provides additional reasoning for the broad focus and recognition of two levels of stewardship:

236. The Board notes that the federal government has two levels of stewardship. One is for its own assets and liabilities and its ongoing ability to operate. The other is its constitutional responsibility for the nation's wealth and well-being. It is unique in this respect. If the nation's wealth and well-being are deteriorating, the government's financial condition is, or soon will be, deteriorating also and vice versa. The financial condition of a sovereign national government and that of the nation itself are inextricably intertwined. Some information about the overall context must be provided, therefore, when reporting on the government as a whole, and perhaps when reporting on selected programs. As explained in chapter 1 the FASAB does not recommend standards for economic reporting, but it may consider whether such information should be included in certain financial reports.

²⁵ SFFAC 1, par. 235

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• Roundtable Meetings

Although most participants at the Stewardship Objective Roundtable Meeting believed that FASAB has an advantage in developing a reporting framework that fairly presents the financial condition of the Federal government, the participants noted that much of the information needed to fulfill the stewardship objective is developed outside of FASAB's domain. The participants discussed that FASAB could say that certain information is important and fits the framework that should be filled out, but the specifics of the information may be left up to others. For this and other objectives, the participants commented that a combination of accounting and other data are essential for a full assessment of whether the objective is met.

The participants also discussed that the stewardship objective relates to the nation as a whole. The participants explained that when looking at the nation as a whole, wealth includes all sectors, and draws on the National Income and Product Accounts, Flow of Funds Balance Sheets, and data on total investment in education and R&D. The participants discussed that the wealth of the nation is more than the Federal government and the participants believed that developing standards for these measures is not the role of FASAB.

A participant stated, "I think some of this discussion is interesting, but I think for purposes of what is FASAB's mission and where its standard-setting resources should be targeted, it is kind of out in somebody else's domain." The participants noted that many of the issues relative to the stewardship objective are subject to political debate and that is where they should be. The participants noted that this is an important area, but may not be a role for an accounting standards board. However, the participants believed that FASAB could make a contribution by providing reporting concepts that fairly present financial condition and sustainability, accounting standards that have a complementary role in analyzing financial condition, and support for the transparency and validity of data.

Based on the discussions of the roundtable participants, it does not appear that the Stewardship Objective would be considered FASAB's top priority among its primary focus objectives. Nonetheless, as explained under the Operating Performance Objective, substantial progress can be made toward meeting the Stewardship Objective through enhanced information about financial position. In addition, resources would remain available to contribute to meeting this objective.

• Other Reports Fulfilling this Objective

There are several other current reports that provide information to fulfill the Stewardship Objective. SFFAC 1, Appendix C: Selected Federal Reports Prepared on a Recurring Basis, lists the Budget of the U.S. Government as one of several reports that contributes to meeting the financial reporting objectives. The Analytical Perspectives section of the Budget of the U. S. Government provides a chapter on Stewardship,

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which focuses on reviewing the condition of the Federal government. The chapter is intended to meet the interests of economists and others in evaluating past and future trends. It notes that no single statistic encompasses all the factors that affect the financial condition of the Federal government. Instead, the Federal government's fiscal status should be evaluated using a broad range of data and complementary perspectives. The Stewardship chapter provides information on how the government affects national economic and social conditions, and it provides data to indicate the scope of the government's future responsibilities and the resources it will have available to discharge them under current law and policy. The chapter presents some economic and social indicators such as median income, civilian unemployment, poverty rate, air quality, violent crime rate, and life expectancy. Other reports that contribute to the objective include the Analysis of the President's Budget (CBO) which discusses the budgetary impact of the proposals in the President's budget and the Budget and Economic Outlook Report (CBO) which discusses the state of the budget and the economy.

- Consideration of FASAB's Current Standards and Other Concepts Statements

In addition to other reports, SFFAC 3 and SFFAS 15 require a Management's Discussion and Analysis that is forward looking. The SFFAC 3 description of the information relevant to meeting the Stewardship Objective is shown below:

32. Future Effects of Current Demands, Risks, Uncertainties, Events, Conditions and Trends—The discussion of these current factors should go beyond a mere description of existing conditions, such as demographic characteristics, claims, deferred maintenance, commitments¹³ undertaken, and major unfunded liabilities, to include a discussion of the possible future effect of those factors. (This discussion of possible future effect of existing, currently-known factors is required pursuant to the standards in *Standards for Management's Discussion and Analysis*.) (footnote 13 - The term "commitments" is used here in the customary sense, not as it is used in budgetary accounting.)

33. Future Effects of Anticipated Future Events, Conditions, and Trends—To the extent feasible and appropriate, the discussion should also encompass the possible future effects of anticipated future events, conditions, and trends, although this additional information is not required by the standards for MD&A.¹⁴ For example, MD&A might discuss the possible future effect of anticipated trends in the cost of inputs that may significantly affect future output costs. Other examples include the future effect of anticipated demographic trends, such as declining mortality rates, and the future effects of potential changes in behavior that may be caused by changes in Government programs. Such behavioral changes can greatly affect the future cost of some Governmental programs. For example, such effects can arise if subsidized insurance encourages the people or entities most at risk to participate in insurance programs ("adverse selection") or encourages risky behavior ("moral hazard"). [footnote 14 - Some projections that could involve consideration of anticipated factors would be presented as required supplementary stewardship information pursuant to the standards exposed for comment in FASAB's exposure draft Accounting for Social Insurance, February, 1998.]

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34. An anticipated condition such as a prospective demographic trend or potential behavioral change may not, in itself, constitute a contingency or assumed risk that must be recognized, disclosed, or reported pursuant to SFFAS 5. Likewise, it may not be something that must be discussed in MD&A pursuant to the *Standards for Management's Discussion and Analysis*. Even so, if there is a reasonable prospect of a major effect on the reporting entity due to the anticipated condition, then MD&A should include this information to the extent feasible.

35. Where appropriate, the description of possible future effects of both existing and anticipated factors should include quantitative forecasts* or projections*. Such forecasts or projections can show the implications of existing policies and conditions in light of anticipated or reasonably possible future conditions. For example, for MD&A of the Government-wide financial statements, long-term projections of the deficit or surplus may be important indicators of financial condition and sustainability. For insurance programs, this kind of projection—which actuaries sometimes call “dynamic analysis”—would consider possible interactions among current assets, reserves, policies in force, expected future business or populations covered by the insurance, and potential behavioral changes such as adverse selection and moral hazard, if appropriate. Some programs are inter-related among themselves and/or with conditions in the private sector. For example, flood insurance programs and disaster assistance programs may be related to such an extent that analysis of programs individually would not provide a good idea of their potential impact on the Government. To the extent feasible, projections should consider the potential implications of such relationships.

36. The future implications of current or anticipated factors often can better be expressed as a range of possible outcomes and associated probabilities than as a single point estimate. Sometimes the implications may best be discussed in nonfinancial as well as financial terms. Forward-looking information can be highly useful, but management should avoid turning this part of MD&A into mere “lobbying” for more budgetary authority.

Therefore it would be appropriate for the Board to assess the Stewardship Objective as a lower priority (when compared to the Operating Performance Objective) because it has been addressed somewhat through existing FASAB requirements, is being addressed through other means and will be addressed as an integral part of meeting the Operating Performance Objective.

FASAB's Secondary Focus Objectives in the Near-Term

Based on the assessment and consideration of the factors noted above, FASAB determined its Secondary Focus Objectives in the near-term are the Budgetary Integrity Objective and the Systems and Control Objective. A summary of the factors supporting placing these two objectives as secondary focus objectives is below.

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Budgetary Integrity

The Budgetary Integrity objective states that:

Federal financial reporting should assist in fulfilling the government's duty to be publicly accountable for monies raised through taxes and other means and for their expenditure in accordance with the appropriations laws that establish the government's budget for a particular fiscal year and related laws and regulations. Federal financial reporting should provide information that helps the reader to determine:

- how budgetary resources have been obtained and used and whether their acquisition and use were in accordance with the legal authorization,
- the status of budgetary resources, and
- how information on the use of budgetary resources relates to information on the costs of programs operations and whether information on the status of budgetary resources is consistent with other accounting information on assets and liabilities.

Although the information that meets this objective is considered very important, the Budgetary Integrity objective is not assessed as a primary focus objective for developing standards to achieve because the Board's authority does not extend to budgetary standards and therefore the Board would not have a comparative advantage in this area. The objective would not be considered one of FASAB's primary focus objectives for the reasons discussed below—language from SFFAC 1, results from the roundtable meetings, current FASAB standards and concepts statements, and other reports fulfilling this objective.

- Language from SFFAC 1 Regarding FASAB's Authority

The Board's authority does not extend to recommending budgetary standards or concepts. Specifically, par. 46 of SFFAC 1 states "Although the FASAB does not recommend standards for the budget or budget concepts, part of its mission is to recommend accounting principles that will help provide relevant and reliable financial information to support the budgetary process. Furthermore, information about budget execution is essential to assessing budgetary integrity."

Rather, the Board has recognized that assurance regarding the reliability of budget information could be accomplished through financial reporting and subjecting the statements to audit. Specifically, SFFAC 1 paragraphs 190-191 states:

190. The Board's authority does not extend to recommending budgetary standards or budgetary concepts, but the Board is committed to providing reliable accounting information that supports budget planning and formulation. The Board also supports efforts to ensure the accuracy and reliability of reporting on the budget.

191. The Board's own focus is on developing generally accepted accounting standards for reporting on the financial operations, financial position, and financial condition of the federal government and its component entities and other useful financial information. This implies a variety of measures of costs and other information that complements the

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information available in the budget. Together with budgetary reports, these reports will provide a more comprehensive and insightful understanding of the government's financial position, results of operations, and financial condition than either set of reports alone.

- Other Language from SFFAC 1

SFFAC 1 recognizes that accrual based financial statements may not be the primary means of achieving the Budgetary objective, and that the Budget is the main focus. However, most would agree that the budget is the most widely recognized and used financial report of the federal government. The budget provides a system for controlling expenditures. SFFAC 1 par. 113 states “This objective arises generally from the responsibility of representative governments to be accountable for the monies that are raised and spent and for compliance with law.... Its focus is the Budget of the United States Government, the President's annual budget submission to the Congress, which is the government's principal financial report, and the laws enacting budget authority for a given fiscal year. The Budget of the United States Government is the initial frame of reference within which Congress and the President enact the laws that require the payment of taxes and provide the authority to obligate and spend money.”

SFFAC 1 par. 121 further reiterates that budgetary measurements are used to address the Budgetary Objective by stating “Reports primarily intended to address objective 1 and its first two subobjectives would use budgetary measurement. Subobjective 1C would use both budgetary and accrual measures because reconciliation of the two is implied...”

In addition, SFFAC 2, Entity and Display, recognized that each reporting objective could be achieved through different reporting. Par. 56 of SFFAC 2 states “For example, the objective of budgetary integrity can be best met with the program and financing schedules prepared for individual budget accounts.”

- Roundtable Meetings

The participants at the Budgetary Integrity roundtable meeting agreed that financial reporting and the related audit have improved the reliability of budgetary data and information. The participants noted that there were some ways that the Budgetary information could be enhanced but recognized the fact that FASAB does not prescribe budgetary standards and determining how to select accounts and sub-accounts to programs may not be within FASAB's authority. The participants noted that there are other ways of meeting the needs of internal users and achieving the Budgetary Integrity Objective without FASAB involvement.

Based on the discussions of the roundtable participants, it does not appear that the Budgetary Integrity Objective would be considered a primary focus objective for FASAB.

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• Other Reports Fulfilling this Objective

There are several other current reports that provide information to fulfill the Budgetary Integrity Objective. For example, as discussed above, the Budget of the United States Government is considered the government's principal financial report and provides much of the information necessary to meet the Budgetary Integrity objective because it provides detailed budget information such as:

- The amount by account that each agency may obligate the Government to pay (budget authority) and estimates of payments (outlays) by agency and account;
- The amount of receipts each agency collects from various sources;
- Budget authority, outlays, and receipts by major function of Government, such as national defense;
- Total budget authority, outlays, and receipts for the Government; and
- The actual or estimated surplus (when receipts exceed outlays) or deficit (when outlays exceed receipts).²⁶

Also, budget execution information is reported in the Report on Budget Execution and Budgetary Resources (SF 133). The SF 133 presents information that facilitates monitoring the status of budgetary resources and provides a consistent presentation of information across programs within each agency, and across agencies. Consistent presentation helps program, budget, and accounting staffs communicate. The report also provides a historical reference that can be used to help prepare the President's Budget and program operating plans. Other reports that contribute to the Budgetary Integrity Objective include the Analysis of the President's Budget (CBO) and the Budget and Economic Outlook Report (CBO).

• Consideration of FASAB's Current Standards and Other Concepts Statements

In addition to other reports, FASAB concepts and standards have helped achieve the objective. SFFAC 2, SFFAS 7, and the Implementation Guide to SFFAS 7 provide guidance related to reporting information to assist users of budgetary information. For instance, SFFAC 2 paragraphs 63 and 64 state:

63. Meeting the first objective of SFFAC No. 1, "Objectives of Federal Financial Reporting," namely the budgetary integrity objective, necessitates that the reader receive assurance that

- the amounts obligated or spent did not exceed the available budget authority,
- obligations and outlays were for the purposes intended in the appropriations and authorizing legislation,

²⁶ OMB Circular A-11, para. 10.3.

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- other legal requirements pertaining to the account have been met, and
- the amounts are properly classified and accurately reported.

64. This information is provided in other reports, but there needs to be auditor involvement to provide assurance as to the reliability of the information. The assurance as to reliability of the information could be accomplished by including a **statement of budgetary resources** in the reporting entity's financial statements, recognizing that the statement will likely be subject to audit. The presentation of data could be for the reporting entity as a whole, for the major suborganization units (assuming there is congruity among the major suborganization units and the budget accounts), or for the aggregations of the major budget accounts, rather than for the individual budget accounts of the entity or other types of entities. Violations of budgetary integrity at the account level occurring during the current year could be disclosed on an exception basis. (Many violations of budgetary integrity would also be violations of the Anti-Deficiency Act. Disclosure in the financial statements notwithstanding, these violations would also have to be reported as required by the Act.)

With the issuance of SFFAS 7, FASAB acknowledged that financial statements had not previously presented budget execution information needed by the users of budget execution reports.²⁷ SFFAS 7 presented standards to require the presentation and, consequently, the audit of information about budgetary resources, the status of those resources, and outlays. Also, SFFAS 7 required that the Statement of Financing explain how budgetary resources obligated during the period relate to the net cost of operations for that reporting entity. This information should be presented in a way that clarifies the relationship between the obligation basis of budgetary accounting and the accrual basis of financial (i.e., proprietary) accounting. The SFFAS 7 Implementation Guide provides detailed information about the Statement of Financing and explains its underlying concepts.

Therefore it would be appropriate for the Board to assess the Budgetary Integrity Objective as a secondary focus objective because it has been addressed somewhat through existing FASAB requirements, is being addressed through other means, and because the Board's authority does not extend to recommending budgetary standards or concepts. Nonetheless, as explained earlier, the Board believes that objectives not currently placed in a priority position may be re-prioritized as fundamental issues are resolved in the long-term. Further, the Board believes that many of its active projects will address multiple objectives so that designation of a "primary focus" objective does not mean that no progress would be made towards meeting lower priority objectives. Further, it is possible that resources would remain available to contribute to meeting this objective even if it is not a primary focus in the near-term.

²⁷ SFFAS 7, Summary.

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Systems and Control

The Systems and Control objective of federal financial reporting states that:

Federal financial reporting should assist report users in understanding whether financial management systems and internal accounting and administrative controls are adequate to ensure that:

- transactions are executed in accordance with budgetary and financial laws and other requirements, consistent with the purposes authorized, and are recorded in accordance with federal accounting standards;
- assets are properly safeguarded to deter fraud, waste, and abuse; and
- performance measurement information is adequately supported.

Although the Systems and Control Objective remains a significant objective of federal financial reporting, it is not considered a primary focus area for FASAB in the near-term. Its significance is evident in the many reforms and initiatives that have occurred in the past few years. The Systems and Control Objective is assessed lowest among FASAB's priorities because the Board will continue with an indirect approach toward achieving this objective.

The objective's broad nature permits accounting standards and other sources to act and provide guidance. This flexibility appears to be working as intended. The OMB recently issued more rigorous internal control requirements through the revised OMB Circular A-123. Considering that the requirements have yet to be fully implemented and the actual impact is not certain at this time, the Board's focus on this objective should be considered low while monitoring the agencies' progress.

Assessing the Systems and Control Objective as a secondary focus for FASAB and perhaps its lowest priority in relation to the objectives is based on the fact that the Board will continue to utilize an indirect approach to addressing the objective and for the reasons discussed below—language from SFFAC 1, results from the roundtable meetings, current FASAB standards and concepts statements, and other reports fulfilling this objective.

- Indirect Approach and Language from SFFAC 1

Most would agree that FASAB standards have had an "indirect" impact on achieving the systems and control objective. Improved systems and control is a by-product of the federal accounting standards. Further support for this indirect approach to achieving the systems and control objective can be found in the SFFAC 1 discussion relating to the objective. Specifically, par. 147-149 of SFFAC 1 describes the systems and control objective as follows:

147. This objective arises from the three preceding objectives, in conjunction with the fact that accounting supports both effective management and control of organizations and the

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process of reporting useful information. Indeed, accounting processes are an integral part of the management control system.

148. The ability to prepare financial reports that report all transactions, classified in appropriate ways that faithfully represent the underlying events, is itself an indication that certain essential controls are in place and operating effectively. The preparation of reliable financial reports also helps to ensure that reporting entities have early warning systems to indicate potential problems and take actions to correct material weaknesses or problems.

149. Sound controls over internal processes are essential both to safeguard assets and to ensure economy, efficiency, and effectiveness in many governmental programs.

There is discussion in the Basis for Conclusions that demonstrates respondents (to the SFFAC 1 exposure draft) also believed that the systems and control object is accomplished through the other objectives, as par. 237 of SFFAC 1 includes the following: "Others suggested that a separate objective on this topic was not necessary because it could be inferred from the other objectives." However, the Board explained the following view in response to the above in par. 238 of SFFAC 1: "With regard to the fundamental point, however, the Board continues to believe that systems and controls are topics of sufficient importance and relevance to warrant addressing in their own right."

- Changes in the Environment due to New Laws and Regulations

Further support for a low ranking of the Systems and Control Objective is provided when one considers the evolution of federal financial reporting laws and regulations. As mentioned earlier in this white paper, since the CFO Act, Congress has enacted a series of laws to reform and improve financial management in the federal government. It was noted that there were several new laws and regulations related to internal control legislation (such as FFMIA, SOX, and OMB A-123) that focused on the improvement of agency systems of accounting, financial management, and internal controls. In particular, the revised OMB Circular A-123 requires management assurance statements on internal control. It appears that most of the items in this area have a direct relationship with the Systems and Controls Objective. Some may consider that agency efforts to meet the requirements and the resulting oversight by OMB significantly contribute to meeting many aspects of the Systems and Control Objective. Considering that the requirements have yet to be fully implemented and the actual impact is not certain at this time the Board's focus on this objective should be considered low while monitoring the agencies' progress.

- Roundtable Meetings

The participants at the Systems and Control roundtable meeting believed that the systems and control objective remains valid in today's environment and agreed with the indirect role of standards in achieving the objective. The participants did not convey a need for changes to the systems and control objective. Instead, they discussed the

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1 importance of the objective in federal financial reporting, and they discussed methods
2 that could enhance achievement of the objective.

3
4 The participants did not believe that FASAB should issue a specific standard on
5 systems and control. Most of the participants expressed support for FASAB to continue
6 the indirect approach as it related to systems and control. In addition, the participants
7 explained that an indirect approach rather than prescriptive guidelines enables the
8 Board to be encompassing for everyone to accomplish their mission.

9
10 The participants did not identify a need for FASAB to engage in setting standards
11 concerning internal control. Some saw this as GAO's role and it was noted that on
12 December 21, 2004, the Office of Management and Budget (OMB) issued a revised
13 Circular A-123, *Management's Responsibility for Internal Control*. Circular A-123
14 requires a management assurance statement on the effectiveness of internal control
15 over financial reporting. Rather than issuing a standard, it was expressed that perhaps
16 FASAB could refer to Circular A-123 and state that the Board endorses the notion of
17 management's reporting on controls over financial reporting.

18
19 Certain participants offered that FASAB, with its limited resources, should focus its
20 efforts on addressing the direct technical accounting issues that remain and those other
21 items on the technical agenda. The participants believed the projects on FASAB's
22 technical agenda as well as those that are often the subject of inquiries are important to
23 do when compared to areas related to systems and control.

24
25 Based on the discussions of the roundtable participants, it does not appear that the
26 Systems and Control Objective would be considered a primary focus objective for
27 FASAB.

- 28
29
30
 - Consideration of FASAB's Current Standards and Other Concepts
31 Statements

32
33 Within the stated objective, FASAB concepts and standards have contributed to
34 ensuring that federal entities maintain a focus on sound internal control. In addition to
35 the many accounting standards that indirectly contributed to the objective, the concepts
36 and standards for management's discussion and analysis (MD&A) of the financial
37 statements have had a direct impact.

38
39 SFFAC 3, *Management Discussion and Analysis* discusses the significance of the
40 systems and control objective and the relationship between a federal entity's internal
41 controls and its financial statements. The Board noted that reporting information that
42 helps people understand the condition of the entity's internal control is an important
43 objective of federal financial reporting. The Board also noted that financial statements
44 alone do not provide adequate information about the status of the entity's internal
45 control that support reporting on financial and operating performance and reporting on
46 compliance with applicable laws. Consequently, SFFAC 3 provided that in addition to

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its basic financial statements, a federal entity should include information about internal control and legal compliance.

The Board then developed standards for MD&A that would include requirements for internal control. In Statement of Federal Financial Accounting Standards No. 15, *Management's Discussion and Analysis*, the Board stated that each general purpose federal financial report should include a MD&A section. SFFAS 15 provides that the MD&A is regarded as required supplemental information and it should include information on the federal entity's internal control. The Board allowed for OMB to provide more prescriptive guidance by stating, "More specific requirements regarding the content of MD&A may be added later by OMB acting on its own authority or pursuant to future FASAB recommendations."

With the MD&A being an integral part of the entity's financial report and providing the link between information on internal control and the financial statements, the OMB acted and provided more prescriptive guidance. The revised OMB Circular A-123 requires management assurance statements on internal control.

- Other Reports Fulfilling this Objective

There are several other current reports that provide information to fulfill the Systems and Control Objective. The FMFIA requires GAO to prescribe standards of internal accounting and administrative control and agencies to comply with them. It also requires OMB to establish guidelines for agency evaluation of internal control to determine compliance with the internal control standards and agency heads are required 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.

In addition, to the FMFIA, the FFMIA 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. The FFMIA also requires that the agency annual audit report state whether the agency's financial management systems comply with the requirements.

Agencies include information on internal control in their PARs. OMB A-123 requires management assurance statements on internal control, including the effectiveness of internal control over financial reporting, and OMB Circular A-136 requires agencies to include the assurance statements in the MD&A section of the PAR. Also, generally accepted government auditing standards require auditors to report on the scope of their testing of internal control over financial reporting and of compliance with laws and regulations. Agencies include the auditor's reports in the PAR.

In addition, the internal control weaknesses identified through the assessment and audit processes are monitored regularly. As part of the PMA, OMB monitors internal control weaknesses and agencies must eliminate all internal control weaknesses to receive

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1 green on the PMA scorecard. Agencies submit corrective action plans to OMB to
2 resolve internal control weaknesses reported and OMB grades the agencies on their
3 progress in achieving the corrective action milestones contained in their plans.
4

5
6 Therefore it would be appropriate for the Board to assess the Systems and Control
7 Objective as a secondary focus objective because it has been addressed somewhat
8 through existing FASAB requirements, is being addressed through other means, and
9 because the Board plans to continue with an indirect approach in achieving this
10 objective. Improved systems and control is a by-product of the federal accounting
11 standards and therefore, most active projects would naturally result in achievement of
12 this objective. In addition, as explained earlier, the Board believes that objectives not
13 currently placed in a priority position may be re-prioritized as fundamental issues are
14 resolved in the long-term. Further, it is possible that resources would remain available
15 to contribute to meeting this objective even if it is not a primary focus in the near-term.