

Project Plan: Fiscal Sustainability Reporting

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Objective:

The Issue

The FASAB is considering what information would be most likely to enable readers of Federal financial reports to determine whether future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due. Ultimately, this may enhance the public's understanding of long-term fiscal issues.

Many believe that Federal financial reports currently do not adequately address the Federal financial reporting objective, titled "stewardship," presented below.

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

- a) the government's financial position improved or deteriorated over the period,
- b) future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due, and
- c) government operations have contributed to the nation's current and future well-being. [Source: Statement of Federal Financial Accounting Concepts (SFFAC) 1, pars. 134-145, available at <http://www.fasab.gov/codifica.html>.]

SFFAC 1 indicates that "financial condition" is a broader and more forward-looking concept than that of "financial position" as reported via the balance sheet. Reporting on financial condition requires information about the national economy and society, as well as about the government itself. Indicators of financial position, measured on an accrual basis, are the starting point for reporting on financial condition but must be supplemented in a variety of ways. Many of the examples provided in SFFAC 1 suggest a projection of the economy as a whole to provide a context against which to assess budget projections. (SFFAC 1, par. 144-145)

Existing Reporting Requirements for the Financial Report of the U.S.

Government

Current reporting requirements for the U.S. Government's long-term fiscal outlook are contained in paragraphs 3 and 6 of Statement of Federal Financial Accounting Standards

(SFFAS) 15, *Management's Discussion and Analysis*, (MD&A) as follows:

[3] MD&A should include forward-looking information regarding the possible future effects of the most important existing, currently-known demands, risks, uncertainties, events, conditions and trends. MD&A may also include forward-looking information about the possible effects of anticipated future demands, events, conditions, and trends.³ Forward-looking information may comprise a separate section of MD&A or may be incorporated with the sections listed above.

[6] MD&A should deal with the "vital few" matters; i.e., the most important matters that will probably affect the judgments and decisions of people who rely on the general purpose Federal financial report (GPFFR) as a source of information. (The specific topics mentioned in *Concepts for Management's Discussion and Analysis* are examples of items that might be relevant for MD&A of a given entity.) Matters to be discussed and analyzed are those that management of the reporting entity believes it is reasonable to assume could:

- lead to significant actions or proposals by top management of the reporting unit;
- be significant to the managing, budgeting, and oversight functions of Congress and the Administration; or
- significantly affect the judgment of citizens about the efficiency and effectiveness of their Federal Government.

³The word "anticipated" is used in a broad, generic sense in this document. In this context the term may encompass both "probable" losses arising from events that have occurred, which should be recognized on the face of the basic or "principal" financial statements, as well as "reasonably possible" losses arising from events that have occurred, which should be disclosed in notes to those statements. "Anticipated" may include the effects of future events that are deemed probable, for which a financial forecast would be appropriate. The term may also encompass hypothetical future trends or events that are not necessarily deemed probable, for which financial projections may be appropriate. Such information about the possible effects of anticipated future demands, events, conditions and trends, if presented, should include the term or label "projected" or "projection," and the key hypothetical underlying assumptions should be explained. As with other information presented in MD&A, no examination of this information by the auditor is now routinely included within the scope of an audit of a federal entity's financial statements; however, preparers and auditors may find useful background information in the AICPA's Statements on Standards for Attestation Engagements Nos. 1 and 4, codified as section 200, "Financial Forecasts and Projections," of the AICPA's *Codification of Statements on Standards for Attestation Engagements*.

The FASAB elaborated on the above requirements in its companion concept statement, SFFAC 3, *Management's Discussion and Analysis*, which explains the Board's expectations regarding the description of future effects of both existing and anticipated events, conditions and trends.

[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*.)

[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”).

[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 interrelated 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.

¹³The term “commitments” is used here in the customary sense, not as it is used in budgetary accounting.

¹⁴Some 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.

Plan to Address the Issue

Fiscal Sustainability Task Force

The Board is requesting the recommendations of a task force whose members have technical knowledge relevant to the issues and/or communications expertise relevant to the challenge of how to effectively communicate information on fiscal sustainability.

A subsequent “financial statement users/communications experts” group will review the recommendations of the technical experts and discuss reporting options that would maximize the understandability of the information presented. This group will include members of Congress and academia, including the area of communications.

Research: International reporting

Staff will research existing reporting on government-wide fiscal sustainability by other developed, English-speaking countries such as the U.K., Australia, New Zealand and Canada.

Develop SFFAS

Based upon Task Force recommendations and research, staff will develop a draft SFFAS with the estimated timeline in the Milestones section.

Fiscal Sustainability Reporting

Milestones

April 5, 2007	Task Force Meeting: Technical Experts
May 24, 2007	Board meeting: Recap of results of April 2007 task force meeting
June 19, 2007	Task Force Meeting: Financial Statement Users/Communications Experts
July 25-26, 2007	Board meeting: Survey of international reporting; recap of results of June 2007 task force meeting
September 19-20, 2007	Board meeting: Present options and proposals for reporting
December 4-5, 2007 *	Board meeting: Present draft ED for discussion
February 13-14, 2008 *	Board meeting: Continue discussion of draft ED
April 16-17, 2008	Board meeting: Discuss preballot draft ED
April 30, 2008	Ballot draft ED
May 15, 2008	Issue ED: Comments due August 15, 2008
August 20-21, 2008	Board meeting: Public hearing
October 22-23, 2008	Board meeting: Discuss ED comments and staff proposal(s)
December 17-18, 2008	Board meeting: Continue discussion of comments/proposal(s)
Jan/Feb 2009 TBA	Board meeting: Continue discussion of comments/proposal(s)
Mar/Apr 2009 TBA	Board meeting: Discuss Preballot draft SFFAS
May/June 2009 TBA	Board meeting: Ballot draft SFFAS
June/July 2009	Transmittal to principals; Begin 90-day review period
October 2009	End 90-day review period and issue SFFAS

* If desired, Task Force members may be invited to meet with the Board.