



Federal Accounting Standards Advisory Board

December 5, 2017

Memorandum

To: Members of the Board

Ross Simms

From: Ross Simms, Assistant Director

Wendy M. Payne

Through: Wendy M. Payne, Executive Director

Subj: Federal Financial Reporting: Management's Discussion and Analysis and Required Supplementary Stewardship Information – **TAB B**¹

MEMBER ACTIONS REQUESTED:

- Review the materials regarding required supplementary stewardship information and management's discussion and analysis.
- Provide answers to the questions on page 26 by December 18, 2017.

OBJECTIVES

The objectives are to discuss guidance for improving the reporting of performance information in management's discussion and analysis (MD&A) and required supplementary stewardship information (RSSI).

BRIEFING MATERIALS

The briefing material includes this memorandum.

BACKGROUND

Upon completing the development of Statement of Federal Financial Accounting Concepts (SFFAC) 8, *Federal Financial Reporting*, the Board began discussing the need to improve the content of financial reports. In May 2017, Board members reviewed financial reports and FASAB staff conducted roundtable discussions and noted several areas for improvement, including management's discussion and analysis (MD&A),

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.

required supplementary stewardship information (RSSI), other information, the overall reporting model, and certain financial statements and note disclosures. The Board was particularly concerned about the voluminous content of financial reports and to address the concerns, the Board decided to use a two-phased approach. During the first phase, the Board will focus on areas that can be addressed in the near term and, in the second phase, consider areas to address over the long term.

The Board's near-term efforts involve MD&A and RSSI and, on July 20, 2017, staff engaged roundtable participants to discuss how the content of MD&A and RSSI might be improved. Although MD&A is intended to be concise, Board members and others noted MD&A is often broad and may overwhelm readers. In addition, with respect to RSSI, users can access the information from other sources, such as *Analytical Perspectives, Budget of the United States Government*, ("the Budget"). Related performance information may also be presented in agency performance reports.

In August 2017, staff prepared a draft exposure draft (ED) and suggested that the Board eliminate RSSI. The ED proposed rescinding Statement of Federal Financial Accounting Standards (SFFAS) 8, *Stewardship Reporting*, in its entirety and noted that users do not review the information provided in financial reports. Instead, they refer to the Budget. However, the Board discussed the history and complexities of RSSI and noted that the draft ED needed to include a comprehensive discussion of the rationale for rescinding RSSI.

In addition, staff suggested that the Board eliminate the reporting requirement that addresses the reporting entity's vital performance goals, objectives, and results in MD&A. As an alternative, the Board could require reporting entities to inform readers where to obtain the entity's annual performance report (APR).

Members noted that conditions have changed since FASAB developed the MD&A reporting standards. Component reporting entities currently issue separate financial and performance reports and issue the reports at different times. In addition, the Board's concepts acknowledge that information that users need may not reside in a single report. Consequently, the Board could develop an ED to amend the existing MD&A reporting standards, explain the rationale for the proposal, and obtain comments from users, preparers, and auditors.

During the October 2017 meeting, the Board continued discussions on improving RSSI and MD&A. Staff presented a proposal that would permit flexibility in reporting the remaining item of RSSI, stewardship investments, and eliminate the RSSI category. Staff also presented a proposal that would permit management to refer users to more detailed performance reports when preparing MD&A. The discretion in reporting RSSI and MD&A would be responsive to input from preparers and auditors regarding users' access to and preference for other sources of information.

However, given the discretion, Board members were concerned that financial reports would not present information needed to achieve the reporting objectives. Board

members noted that financial report users need information on expenses that provide long-term benefits, such as investments in human capital, research and development, and non-federal physical property. In addition, users need information about the reporting entity's performance.

The Board acknowledged that MD&A concepts provide additional guidance for performance reporting and Office of Management and Budget form and content guidance could help improve MD&As. In addition, Board members believed that stewardship investment information was important and sought additional information to help determine where the information should be presented.

NEXT STEPS

The next steps for the project will be determined during the meeting.

MEMBER FEEDBACK

If you have any questions or comments, please contact me by telephone at (202) 512-2512 or by email at simmsr@fasab.gov with a cc to paynew@fasab.gov .

Required Supplementary Stewardship Information

The Board is concerned about where information categorized as required supplementary stewardship information (RSSI) should be reported and how current reporting might be improved. The Board's concepts note that users need information to help assess whether government operations have contributed to the nation's current and future well-being. Presently, component reporting entities present trend information on stewardship investments—expenses for physical and human capital and research and development. However, the reporting community has expressed concern that the information is not used. Users instead access the Budget to review spending information regarding federal investments.

Users' Needs

Based on FASAB's concepts and a review of analysts' reports regarding federal investments, users generally need investment spending data to determine trends, assess needs, and determine financing options. Statement of Federal Financial Accounting Concepts (SFFAC) 1, *Objectives of Federal Financial Reporting*, notes that users need trends on investments versus spending on consumption. Also, Congress is a key user of investment spending data and seeks input from analysts such as the Congressional Budget Office (CBO), Congressional Research Service (CRS), and Government Accountability Office (GAO). These organizations seek investment spending data and prepare reports discussing background information regarding the various types of investments, the scope of investments being analyzed, investment spending trends, how investments were financed, and insights on the budgetary and economic effects of investments or how investments impact the nation. In addition, citizen intermediaries such as think tanks, seek investment spending data to identify and report on trends. With respect to physical capital or infrastructure investments, analysts report on areas where more investment spending may be needed and options for funding. Investments may be measured, classified, aggregated, and presented in different ways depending on the questions asked and access to data would facilitate the preparation of different reports to address a variety of questions.

What FASAB's Concepts Say about Users' Needs Regarding Investments

SFFAC 1 is a key source of insights on the users of financial reports and their information needs. The concepts state that users include citizens, Congress, federal executives, and federal managers. They need information about the government's financial condition, necessitating financial and non-financial information about the government and the national economy. Financial reporting should provide information to help users determine whether government operations have contributed to the nation's

current and future well-being.² Examples of information that would be helpful to these users include trends on investments in physical capital and human capital versus spending on consumption³ and information about investments or expenditures in research and development.⁴

In addition, SFFAC 1 notes that reports intended to achieve the reporting objectives might disclose the government 's contribution to "national wealth" by financing assets that are "not" federally owned, such as research and development, education and training, and state-owned infrastructure.⁵ In this discussion, the concepts distinguish three types of investment: non-federal physical capital, human capital, and research and development. However, the concepts do not explicitly define investments in general and each specific type.

The Office of Management and Budget (OMB) notes that distinguishing investment spending from current outlays is a matter of judgment.⁶ The Budget of the U.S. ("the Budget") has historically employed a relatively broad classification of investment, encompassing physical investment, research, development, education, and training. However, the definition of investments used in particular circumstances varies based on the following considerations:

- Taking the approach of a traditional balance sheet would limit investment to only those physical assets owned by the Federal Government, excluding capital financed through grants and intangible assets such as research and education.
- Focusing on the role of investment in improving national productivity and enhancing economic growth would exclude items such as national defense assets, the direct benefits of which enhance national security rather than economic growth.
- Examining the efficiency of Federal operations would confine the coverage to investments that reduce costs or improve the effectiveness of internal Federal agency operations, such as computer systems.
- Considering a "social investment" perspective would broaden the coverage of investment beyond what is included in this chapter to include programs such as maternal health, certain nutrition programs, and substance abuse treatment, which are designed in part to prevent more costly health problems in future years.⁷

²² SFFAC 1, par. 143.

³ SFFAC 1, par. 102.

⁴ SFFAC 1, par. 144.

⁵ SFFAC 1, par. 145.

⁶ Fiscal Year 2018, Budget of the U.S., Analytical Perspectives, p.197

⁷ Fiscal Year 2018, Budget of the U.S., Analytical Perspectives, p.197.

Given the stewardship objective, FASAB concepts appear to focus on the role of investments in improving national productivity and enhancing economic growth and exclude federally owned physical capital and national defense assets. On the other hand, the OMB includes both investments in federally owned and state owned physical capital as well as defense and non-defense investments in its reporting.

SFFAC 1 does imply the use of cash basis accounting to determine the amount of investments. The concepts use terms such as “spending” and “expenditures” when referring to investments. Given that the government-wide reporting entity primarily uses cash-based accounting to recognize budget receipts and outlays, the concepts appear to indicate that the government-wide reporting entity would be the level that provides information on investments. Also, users such as Congress would be able to determine the amount of investment spending relative to expenditures for consumption and the effects of investments on budget deficits or surpluses and the economy.

In addition, the stewardship reporting objective concerns the government-wide reporting entity. The concepts state the following regarding the stewardship reporting objective

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...⁸

During the December 2013 FASAB meeting, the Board acknowledged that the objective mainly concerns the government-wide reporting entity and involves financial reporting rather than financial statements. Many sources other than financial statements contribute to the objective.⁹

SFFAC 1 presents examples on how the objective might be achieved and the examples inform high-level questions such as the following:

- How much is the government spending on non-federal physical property, education and training, and research and development?
- How much has the government spent on non-federal physical capital, education and training, research and development over the past several years?
- How much is the government spending for investments versus spending on consumption?¹⁰

⁸ SFFAC 1, par. 135.

⁹ FASAB Minutes December 18, 2013.

¹⁰ Note that the concepts discuss investment and consumption expenditures but do not provide definitions of these terms. The term “stewardship investments” is limited to the three types of investments identified in SFFAS 8. The Board did not attempt to distinguish between federal expenditures qualifying broadly as investment. Therefore, readers should not assume that expenditures other than “stewardship investments” would be consumption expenditures.

Also, although the concepts do not explicitly discuss users' need for context, users may benefit from information intended to help them understand the information provided. For instance, users may need information to help them understand the nature of the investments selected for reporting and what a change in investment spending relative to consumption spending might mean. Does it indicate that the financial condition of the government is improving or deteriorating or does it indicate that the government has chosen a near-term approach for improving the economy versus a long-term approach?

Implications of Users' Needs Based on Citizen Intermediary Reporting

Anecdotal evidence of users' needs regarding investments may be obtained from reports by citizen intermediaries. Congress seeks information on investment trends and their budgetary and economic effects. This information assists Congress in analyzing policy options. For instance, the CBO, CRS, and GAO provide historical information and analysis on investments and infrastructure spending has received significant attention recently.

During the recent presidential election, the need for infrastructure spending was discussed and the Budget proposals for FY 2018 included an infrastructure investment plan.¹¹ Various analysts discussed the economic and budgetary effects of infrastructure investments and the following are examples of the types of information analysts discussed:

¹¹ Budget of the U. S. FY 2018, p.19.

- CBO prepared several reports on investments including legislation that affects investment spending, the benefits of spending and, with respect to infrastructure, recently provided a report showing historical trends and presenting the amount of investment spending relative to gross domestic product (GDP), and showing how federal infrastructure spending affects private sector productivity.¹²
- GAO prepares reports on the various types of investments, challenges associated with infrastructure, and infrastructure funding options, and recently reported on how entities determine drinking water and wastewater infrastructure needs and the extent that federal and state agencies have coordinated in funding projects.¹³
- USAFACTS Summary 2017 presents investment expenditures for transportation, education, and research and development for a seven year period.¹⁴
- McKinsey and Company prepared a report discussing worldwide infrastructure needs and projected shortfalls.¹⁵
- The American Society of Civil Engineers prepared a report discussing the economic impact of failing to improve the condition of U.S. infrastructure.¹⁶
- CRS prepared several reports showing historical trends and a report explaining that estimating infrastructure needs is challenging. Key assumptions can result in significant differences in estimates and consumer demand can be met and managed in different ways. In addition, there is no optimal percentage of GDP that should be invested in infrastructure.¹⁷

The reports indicate that, in addition to historical data and trends, users may be concerned about whether the government is investing enough, how investments are financed, and the role of the federal government in relation to the private sector.

In addition, upon obtaining answers to the high-level questions noted earlier, the analysts' reports indicate that users may look to drill down and answer additional questions including questions about the effects of investments on the economy. For

¹² For example, see CBO, *Approaches for Increasing the Productivity of Federal Infrastructure Spending*, September 25, 2017.

¹³ GAO, *Drinking Water and Wastewater Infrastructure: Information on Identified Needs, Planning for Future Conditions, and Coordination of Project Funding*, GAO-17-559 (Washington, D.C.: September 20, 2017).

¹⁴ <https://usafacts.org/report-summary-slides> accessed November 27, 2017.

¹⁵ McKinsey Global Institute, *Bridging Global Infrastructure Gaps*, June 2016.

¹⁶ American Society of Civil Engineers, *Failure to Act: Closing the Infrastructure Investment Gap For America's Economic Future*, 2016.

¹⁷ Congressional Research Service, *Infrastructure Investment and the Federal Government*, February 16, 2017.

instance, to help better understand the government's investments and their impact on the nation, users may ask:

- What is the target amount, if any, that the government should be investing in non-federal physical capital, education and training, and research and development?
- What are the purposes of government investments (for what functions or programs)?
- Understanding that spending on physical capital, education and training, and research and development benefit the nation over a long-term period, which of each type of investment may start to impact the nation earlier than the others (rate of impact)?
- Do all the physical capital, education and training, and research and development investments have the same impact on the economy (strength of impact)? If not, on which of each type has the government focused spending and why?
- What are the funding options and how has the government financed these investments (method of financing)?
- Does the method of financing impact investment outcomes?
- Does the federal government directly make each investment or does the government rely on others (method of allocation)?
- Why has investment spending changed over time?
- What have been the results of the investments?

Providing information to answer such questions in a printed document may appear overwhelming to the reader and may require developing an approach for disaggregating each type of investment. The following factors may be considered in developing an approach:

- Overall Impact. Some investments focus on national security (defense) while others are intended to improve productivity (nondefense).
- Rate of Impact. Some investments start improving productivity sooner than others. For instance, constructing a bridge may start to impact the economy sooner than early childhood education.
- Strength of Impact. Some investments have stronger effects on productivity than others.
- Method of Financing. Some investments are financed by debt while others are financed by reducing spending in other areas, or other methods.
- Method of Allocation. The government makes some investments directly, such as by constructing infrastructure, or indirectly through grants, loans, or tax preferences, such as tax-preferred bonds issued by state and local governments.¹⁸

¹⁸ Based on Congressional Budget Office, *The Macroeconomic and Budgetary Effects of Federal Investment*, June 2016.

As an alternative, a concise presentation could provide links to data and, with illustrations, users could prepare additional presentations.

Current Practices

Currently, reporting entities provide stewardship investment expense trends. FASAB standards define the types of investments that should be reported and require descriptions of the investment programs in general purpose federal financial reports (GPFFR). In addition, the Budget defines investments more broadly and provides investment spending trends and historical data that analysts access. Both GPFFRs and the Budget provide information that helps achieve the stewardship objective.

GPFFRs

GPFFRs report trends in stewardship investments as RSSI. Stewardship investments include expenses incurred for non-federal physical property—investments in highways and bridges; expenses incurred to increase or maintain national economic productive capacity—investments in human capital; and expenses incurred for research and development that are intended to provide future benefits or returns. The definition of each type of investment is as follows:

Non-federal physical property. “Investment in nonfederal physical property” refers to those expenses incurred by the Federal Government for the purchase, the construction, or the major renovation of physical property owned by state and local governments, including major additions, alterations, and replacements; the purchase of major equipment; and the purchase or improvement of other physical assets. Grants for maintenance and operations are not considered investments.¹⁹

Human capital. “Investment in human capital” refers to those expenses incurred for programs for education and training of the public that are intended to maintain or increase national productive capacity and that produce outputs and outcomes that provide evidence of maintaining or increasing national productive capacity. The definition excludes education and training expenses for Federal civilian and military personnel. It also excludes education and training expenses whose purpose is not maintaining or enhancing national productive capacity.²⁰

Research and Development. “Investment in research and development” refers to those expenses incurred to support the search for new or refined knowledge and ideas and for the application or use of such knowledge and ideas for the development of new or improved products and processes with the expectation of maintaining or increasing national economic productive capacity or yielding other future benefits. Research and development is composed of

¹⁹ SFFAS 8, par. 93.

²⁰ SFFAS 8, pars. 89-90.

- Basic research: systematic study to gain knowledge or understanding of the fundamental aspects of phenomena and of observable facts without specific applications toward processes or products in mind;
- Applied research: systematic study to gain knowledge or understanding necessary for determining the means by which a recognized and specific need may be met; and
- Development: systematic use of the knowledge and understanding gained from research for the production of useful materials, devices, systems, or methods, including the design and development of prototypes and processes.[footnote omitted]²¹

However, the definition of investments could be broader, depending on the considerations listed earlier.

Component reporting entities include the expenses incurred for stewardship investments in their statement of net cost and have flexibility in determining whether to distinguish the expenses on the face of the statement. The minimum RSSI for each stewardship investment component is as follows:

- a. Non-federal physical property. Annual investment²² including a description of federally-owned physical property transferred to state and local governments provided for the year ended on the balance sheet date as well as for each of the preceding four years. Reporting should be at a meaningful category or level. Reporting at the entity level should be more specific than at the government-wide level. Description of major programs involving federal investments in nonfederal physical property including a description of programs or policies under which non-cash assets are transferred to state and local governments.
- b. Human Capital. Annual investment provided for the year ended on the balance sheet date and for each of the preceding four years. Reporting should be at a meaningful category or level and reporting at the entity level should be more specific than at the government-wide level. Narrative description of major education and training programs.
- c. Research and Development. Annual investment provided for the year ended on the balance sheet date and for each of the preceding four years. Reporting should be at a meaningful category or level. Reporting at the entity level should be more specific than at the government-wide level. Narrative description of major research and development programs.

²¹ SFFAS 8, par. 96.

²² The term annual investment refers to the full cost of the investment measured and accounted for in accordance with SFFAS 4, *Managerial Cost Accounting Standards and Concepts*.

To support categorizing human capital and research and development expenses as investments, reporting entities needed to provide performance information on the programs reported. Reporting entities would consider the performance information in measuring human capital and research and development investments, but the performance information was not considered a reporting requirement.

The government-wide reporting entity presents stewardship investment trends and notes the component reporting entities that make investments.

The Budget

The Budget presents investment information that addresses users' needs discussed in SFFAC 1. The Board has noted that the Budget is "the most widely recognized and used financial report of the federal government."²³ The Budget presents the government's investments in physical capital, education and training, and research and development to help users assess the government's impact on the economy. The presentation does not consider education and training as human capital and distinguishes between investments for defense and nondefense purposes to inform users on investments for national security and investments to impact productivity. In addition, the Budget classifies investments into grants to states and local governments and all other investments—spending for assets the federal government owns and grants to private organizations and individuals.

For each type of investment, the Budget provides several periods of aggregated and disaggregated data to help users identify changes in the government's investments, the percentage of investment spending relative to total spending, and the government's investments share of GDP. In particular, the historical tables of the Budget FY 2018 provide data showing the following:

- Total Investment Outlays for Physical Capital, Research and Development, and Education and Training: 1962— 2018
- Major Public Physical Capital Investment Outlays in Current and Constant (FY 2009) Dollars: 1940—2018
- Major Public Physical Capital Investment Outlays in Percentage Terms: 1940—2018
- National Defense Outlays for Major Public Direct Physical Capital Investment: 1940—2018
- Nondefense Outlays for Major Public Direct Physical Capital Investment: 1940—2018
- Composition of Outlays for Grants for Major Public Physical Capital Investment: 1941—2018

²³ SFFAC 1, par. 67.

- Summary of Outlays for the Conduct of Research and Development: 1949–2018 (In Current Dollars, as Percentages of Total Outlays, as Percentages of GDP, and in Constant (FY 2009) Dollars)
- Composition of Outlays for the Conduct of Research and Development: 1949–2018
- Composition of Outlays for the Conduct of Education and Training: 1962–2018

Providing access to data is a key feature of the Budget, addressing the challenges posed by a general purpose presentation. Economists, the media, special interest groups, think tanks, and others can access the data to probe deeper and gain a better understanding of the government’s actions. For example, Figure 1: Investment Spending as a Percent of GDP provides an example of the trend information a user can prepare using the data in the Budget. The figure shows total investment spending as a share of GDP has been declining since 1962, largely due to declines in investments for national security.

In addition, the Analytical Perspectives section of the Budget provides a chapter on federal investments. The chapter provides a discussion on federal investments and their share of the economy. For instance, the Budget FY 2018 notes that federal investments (defense and nondefense) will comprise 12 percent of outlays and 2.5 percent of GDP.²⁴

²⁴ Budget of the U.S. FY 2018, Analytical Perspectives, p.198.

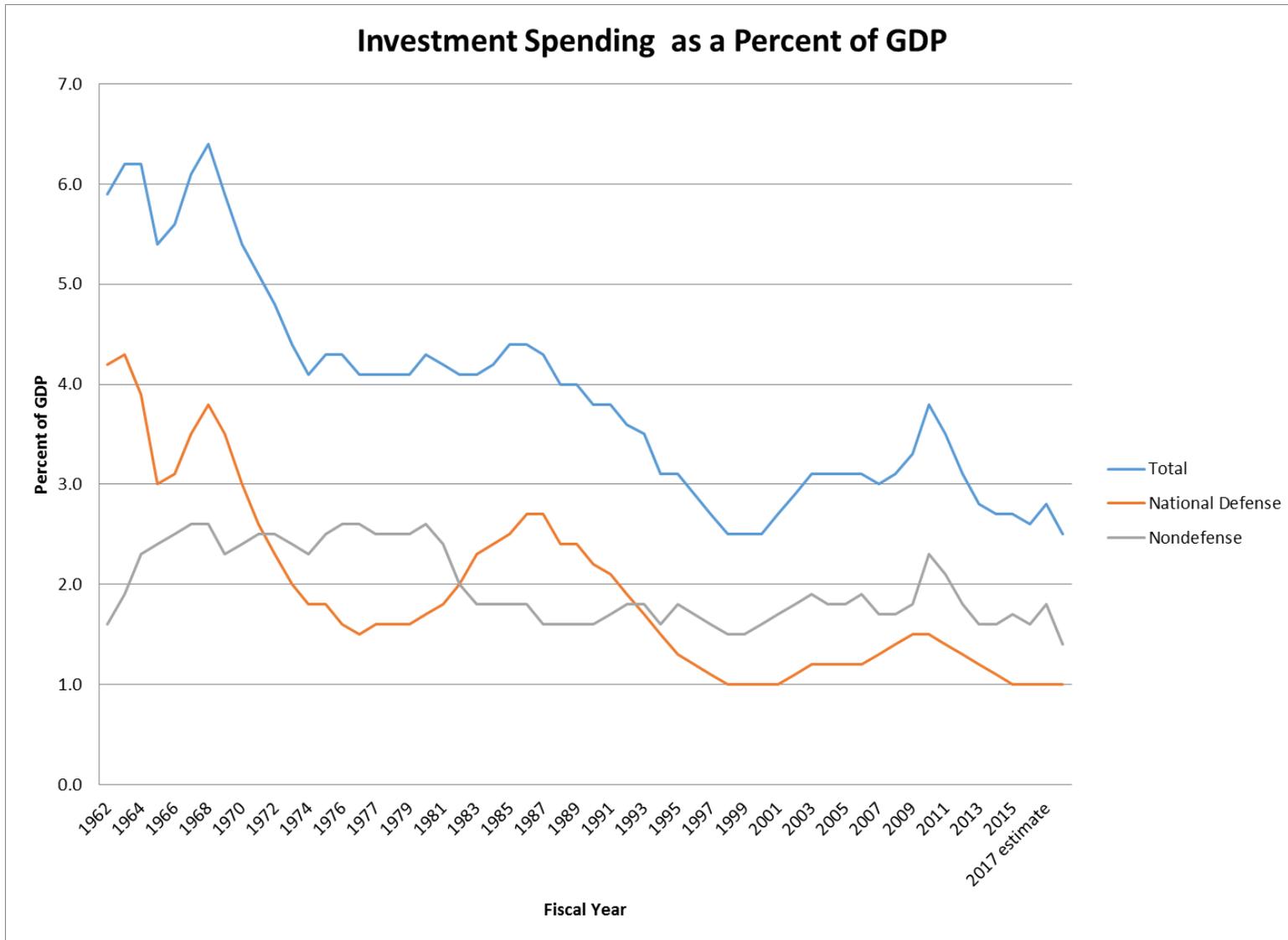


Figure 1: Investment Spending as a Percent of GDP

Comparison of Users' Needs and Current Practices

Both GPFFRs and the Budget provide information to address high-level questions noted in SFFAC 1. Table 1: GPFFR and the Budget Comparison summarize the user information needs GPFFRs and the Budget addresses. While the information presented in GPFFRs is accrual based and subject to some audit procedures, the Budget presents cash-based information. Also, although the Budget is not audited, the presentation permits users to access data that could be used to address more specific questions.

Users' Needs	GPFFRs	the Budget
Scope of investment	Non-federal physical property, human capital (excluding federal education and training), and research and development ²⁵	Federal physical property (defense and non-defense), education and training (excluding federal education and training), and research and development
Data to observe trends in investments	Provides 5 years of expense data	Provides over 50 years of actual spending data and estimates of future spending
Spending on consumption relative to investments	Users can compare investment expenses to net cost of operations	Provides spending on investments relative to total spending
Spending on defense versus non-defense investments	Reports expenses for non-defense investments not federally owned	Provides spending on defense versus non-defense investments
Spending on investments by budget function	Reporting entities have discretion in how to disaggregate investments	Provides spending on investments by function
Information on how physical and human capital investments were allocated (direct spending versus grants)	Provides a description of investment programs	Provides information on direct versus indirect spending
Information on budgetary and economic effects or outcomes	Not required	Provides spending data and relationship to GDP
Access to data	Not required	Provides access to historical data

Table 1: GPFFR and the Budget Comparison

²⁵ Note that programs for which no outcome or output data is available would be excluded from human capital and R&D categories.

Recommendations

Focus on the Government-wide Reporting Entity

Regarding next steps, staff suggests that the Board focus on the government-wide reporting entity and enhance its stewardship investment reporting. SFFAC 1 primarily discusses users need for stewardship information about the government-wide reporting entity and SFFAC 8, *Federal Financial Reporting*, states that the government-wide reporting entity's financial statements and required supplementary information assist users in understanding the government's investments in productivity and economic growth.²⁶ In addition, the government-wide reporting entity may be the starting point for users interested in the government's investments and the government-wide reporting entity presents the budget deficit.

Analysts seek information to assist them in determining the impact of investment spending on the budget deficit and the effect. Such analysts may be interested in a broader notion of investment than currently provided in stewardship investments.

Moreover, a government-wide focus would assist Congress in obtaining an overall view of investment spending while considering the effect of the budget deficit on the economy. The Board has also acknowledged that the government-wide reporting entity is the focus of the stewardship reporting objective.

Upon completion of the government-wide reporting entity enhancements, the Board could determine what reporting, if any, would be needed at the component reporting entity level.

Question for the Board

1. Does the Board agree or disagree that, regarding next steps, the Board should focus on the government-wide reporting entity and enhance its stewardship investment reporting?

Considerations for Enhancing Government-wide Reporting Entity Investment Reporting: Reporting on the Same Basis as the Budget Deficit

To enhance the government-wide reporting entity's investment reporting, the Board could require the government-wide reporting entity to report investment trends using the same basis as the budget deficit. The Board's conceptual guidance indicates that investment reporting should be measured using the same basis as the budget deficit. Also, reporting on the same basis as the budget deficit would enable users to determine the amount of investment spending relative to the budget deficit and the economy.

²⁶ SFFAC 8, par. 39.h.

Question for the Board

2. Does the Board agree or disagree that investments should be reported on the same basis of accounting as the budget deficit?
3. The stewardship objective concerns financial reporting rather than financial statements. If the Board agrees that investments should be reported on the same basis as the budget deficit, should the government-wide reporting entity have the option of reporting investments in the financial report of the U.S. or referring users to the Budget?

Depending on the Board's response to Question 3, the following are additional questions to consider.

Considerations for Enhancing Government-wide Reporting Entity Investment Reporting: Assisting Users in Understanding the Information Presented

To enhance the government-wide reporting entity's investment reporting, the Board could develop guidance to help users better understand the nature of the investments being reported and what the information could indicate. Investment reporting often includes spending trends, but different analysts define investments differently depending on the reporting objective. In addition, additional information may provide context and help users understand the data. For instance, the guidance could require information regarding

- how the government defined the investments
- how the government measured the investments
- how the government finances the investments
- assumptions used
- factors influencing trends

Question for the Board

4. Does the Board agree or disagree that, as part of enhancing government-wide reporting entity investment reporting, guidance should be developed to help users better understand the nature of the investments being reported and what the information could indicate?

Considerations for Enhancing Government-wide Reporting Entity Investment Reporting: Facilitating Access to Data

A key feature of the Budget is that it provides summary information and access to data. Consequently, the government-wide reporting entity investment reporting could provide a summary presentation and links to sources of data. Users could access the sources and address additional questions. Sources of data may include the Budget and the Bureau of Economic Analysis Interactive Data.

Question for the Board

5. Does the Board agree or disagree that the government-wide reporting entity should provide links to data that users could access for additional analyses?

Performance Reporting in Management's Discussion and Analysis

Over the past several years, FASAB members have been concerned that management's discussion and analysis (MD&A) in general purpose federal financial reports (GPFFR) do not meet expectations established in the concepts and standards. Primarily, the reports provide extensive discussion of performance and may overwhelm readers. Also, although the Accounting and Auditing Policy Committee (AAPC) prepared MD&A best practice guidance in 2011, the Board's concerns continue.

In addition, component reporting entities have expressed that annual performance reports (APR) are prepared and issued after component reporting entities issue GPFFRs. Component reporting entities issue APRs at a time to inform budget decisions. Thus, performance information may not be available at the time component reporting entities prepare GPFFRs. Component reporting entities suggest that MD&A readers be directed to the separately issued APR. This approach would be consistent with the evolution toward individual reports that focus on different topics rather than a single document that addresses several reporting requirements.

Existing Concepts

Statement of Federal Financial Accounting Concepts (SFFAC) 3, *Management's Discussion and Analysis*, provides detailed conceptual guidance for the content of MD&A, including the performance section. The Board developed the concepts in the 1990s when component reporting entities were experimenting with meeting several reporting requirements in a single report and performance reporting was in its early stages. At that time, component reporting entities presented detailed performance information with their financials statements.

The basic concept noted in SFFAC 3 is that MD&A should address the reporting entity's program and financial performance measures, financial statements, systems and controls, compliance with laws and regulations, and actions taken or planned to address problems, and significant events, conditions, trends and contingencies that may affect future operations. The discussion and analyses may be based partly on information contained in reports other than the GPFFR.²⁷

Although each of the areas that should be addressed in MD&A involve numerous issues, the concepts note that MD&A should be a concise presentation overall.²⁸ Regarding component reporting entity performance, the concepts discuss that MD&A should concisely address several items including:

1. an explanation of what key performance indicators say about program performance,

²⁷ SFFAC 3, par.1.

²⁸ SFFAC 3, par. 5.

2. a discussion on the strategies and resources the agency uses to achieve its performance goals,
3. a clear picture of actual and planned performance across the agency,
4. an explanation of the procedures that management has designed and followed to provide reasonable assurance that the reported performance information is relevant and reliable,
5. both positive and negative results,
6. a presentation of historical and future trends, if relevant,
7. an explanation of the significance of the trends,
8. a comparison of actual results to goals or benchmarks,
9. an explanation of variations from goals and plans,
10. other explanatory information that management believes readers will need to understand the significance of the indicators, the results, and any variations from goals and plans,
11. an explanation of what needs to be done and what the reporting entity plans to do to improve program performance,
12. limitations and difficulties associated with performance measurement and reporting, such as
 - a. performance usually cannot be fully described by a single indicator,
 - b. indicators of performance do not, by themselves, say why performance is at the level reported, and
 - c. focusing exclusively on quantifiable indicators can sometimes have unintended consequences.
13. explanatory information to help report users understand reported indicators, assess the reporting entity's performance, and evaluate the significance of underlying factors that may have affected the reported performance including, for example,
 - a. information about factors substantially outside the entity's control, and
 - b. information about factors over which the entity has significant control.²⁹

Because component reporting entities have wide-ranging responsibilities including numerous, distinct programs, it may be challenging for component reporting entities to address the above items in a concise presentation.

In addition, the concepts indicate that cost data is highly relevant to both performance reporting and financial reporting and cost data could link the two topics. For instance,

²⁹ SFFAC 3, pars. 45-49.

although component reporting entities prepare separate APRs, the concepts indicate that this information could be presented in the context of audited financial statements. The concepts state

...Combining information on these topics adds value by putting the information about performance, internal controls, and systems in the context of audited financial statements. For example, the quality of information on the cost of outputs and outcomes of programs is enhanced by linking these indicators to the audited Statement of Net Cost. This is true even though the Statement of Net Cost may be too highly aggregated to identify separately all the programs reported on for the Results Act.³⁰

Integrating performance information with the financial statements would be facilitated if the requirements for preparing APRs utilized parallel concepts and terminology, expressing similar views regarding the qualitative characteristics of cost data.

Requirements for Preparing APRs

Since the development of SFFAC 3, component reporting entities began issuing APRs and digitizing the data, making performance information available on a centralized website. FASAB concepts note that while MD&A should discuss the most important aspects of performance information, reporting entities should present performance information in conformance with OMB guidelines.³¹ OMB Circular A-11, *Preparation, Submission and Execution of the Budget*, provides the guideline for preparing APRs and publishing information through a centralized website. The guidance uses terms and concepts that differ from the terms and concepts in SFFAC 3. For instance, a component reporting entity's APR uses the following terms and sections:

1. Agency and Mission Information
2. Cross-Agency Priority (CAP) Goals³²
3. Strategic Goals³³
4. Strategic Objectives³⁴
5. Agency Priority Goals (APG)³⁵

³⁰ SFFAC 3, par. 22.

³¹ SFFAC 3, par. 19.

³² A statement of the long-term level of desired performance improvement for Government-wide goals set or revised at least every four years.

³³ A statement of aim or purpose that is included in a Strategic Plan. Strategic goals articulate clear statements of what the agency wants to achieve to advance its mission and address relevant national problems, needs, challenges and opportunities.

³⁴ Reflects the outcome or management impact the agency is trying to achieve and generally include the agency's role. Each objective is tracked through a suite of performance goals and other indicators.

³⁵ Advances progress toward longer-term, outcome-focused goals in the agency's Strategic Plan, near-term outcomes, improvements in customer responsiveness, or efficiencies. An APG is a near-term result or achievement that leadership wants to accomplish within approximately 24 months that relies predominantly on agency implementation (as opposed to budget or legislative accomplishments). APGs reflect the top near-term performance improvement priorities of agency leadership, not the full scope of the agency mission.

6. Performance Goals³⁶
7. Other indicators
8. Other information (such as evaluations and data quality)³⁷

While the concepts generically use the term “goal,” APRs discuss different types of goals. Figure 2: Illustration of Goal Relationships from OMB Circular A-11 provides an example of the relationship among the different types of goals in the component reporting entity performance framework. APRs may include CAP goals for government-wide initiatives, such as cybersecurity and infrastructure permitting, and CAP goals may not have budget accounts aligned to them.³⁸ The concepts do not explicitly discuss cross-agency performance and the CAP goal model.

Also, the phrase “performance goals” used in the concepts has a distinct meaning and set of requirements for APRs. The following is an explicit example of a performance goal:

Performance Goal: Reduce the number of homeless veterans on any given night to 35,000 by June 2012.

- Performance Indicator: Number of homeless veterans on any given night
- Target: 35,000
- Time period: June 2012³⁹

Note that the term target is used rather than “goal” or “plan” and the performance indicator is non-financial. In addition, the component reporting entity presents actual performance indicator results for at least the five preceding fiscal years, if available and, where useful, presents trend data from its earliest point available even if the agency is publishing the performance indicator for the first time. Component reporting entities do not need to present historic targets in the APR.⁴⁰

With respect to the relevance of cost data, the concepts note that efficiency and effectiveness measures are important elements of performance measurement and measuring cost is “integral” to assessing efficiency and effectiveness. Also, the concepts describe inputs as cost incurred to provide the services.⁴¹ In contrast, APR requirements allow flexibility in determining efficiency, noting that inputs may not always be derived using financial measures such as cost. Instead, inputs can be derived using non-financial measures such as time.

³⁶ A statement of the level of performance to be accomplished within a timeframe, expressed as a tangible, measurable objective or as a quantitative standard, value, or rate. a performance goal includes a performance indicator, a target, and a time period.

³⁷ See OMB Circular A-11, *Preparation, Submission and Execution of the Budget*, August 1, 2017 for an overview of the performance framework and definition of each term.

³⁸ FASAB Minutes, Performance Reporting Educational Session, August 25, 2016.

³⁹ OMB Circular A-11, *Preparation, Submission and Execution of the Budget*, August 1, 2017, Section 200-16.

⁴⁰ OMB Circular A-11, Section 210-11.

⁴¹ SFFAC 3, par. 43.

Reporting entities prioritize and determine what information may be relevant to each goal. Although cost information may be relevant to operational areas, program evaluations or expert advisory boards may be necessary in others.⁴² The APR requirements state, "...measuring the cost per unit of outcome or output tends to be most useful for similar, repeated practices. In other circumstances, it tends to be more useful to find effective practices and then look for lower cost ways of delivering them."⁴³

Regarding the characteristics of information needed by federal managers and executives, federal managers and executives provided comments such as the following:

In our system, we strive very hard for timeliness and accuracy, and I would say that timeliness is the most important issue in project development, and that is the function of electronic databases that are, of course, accurate and that they're on schedule.

Internet definitely would be helpful because that will allow us access to it anytime and anywhere,... timely access to information is important.⁴⁴

In addition, recent research cautions against the assumption that cost accounting and performance measurement may be easily integrated,⁴⁵ and the National Academy of Public Administration's (NAPA) study, *Financial and Related Information for Decision-Making: Enhancing Management Information to Support Operational Effectiveness and Priority Goals*, noted that appropriations-based revenue and/or regulatory, policy, and grant-making agencies perceived less value and more difficulty in conducting cost analysis.⁴⁶ In addition, reporting entities are considering forward-looking information. As part of their performance reviews, reporting entities use enterprise risk management techniques and consider different risks to accomplishing their goals.⁴⁷

In general, APRs discuss how the work of the agency benefits the public, enable the public to understand the actions agencies have taken to make progress, explain what the agency is doing to improve performance, and focus on comparing and reporting results achieved against performance goals and associated measures and indicators established in the agency's Annual Performance Plan.⁴⁸

Also, new Priority Goals are being established and component reporting entities working on the prior administration's Priority Goals should "...focus their efforts on furthering the work and activities of current goal strategies only where they are aligned with the policy

⁴² FASAB Minutes, Performance Reporting Educational Session, August 25, 2016.

⁴³ OMB Circular A-11, Section 200-17.

⁴⁴ FASAB, *User Needs Study: Interviews with Executives and Managers*, April 14, 2010.

⁴⁵ Mohr, Zachary T. 2016. "Performance Measurement and Cost Accounting: Are They Complementary or Competing Systems of Control?" *Public Administration Review* 76 (4):616-625.

⁴⁶ NAPA, *Financial and Related Information for Decision-Making: Enhancing Management Information to Support Operational Effectiveness and Priority Goals*, April 2014.

⁴⁷ FASAB Minutes, Performance Reporting Educational Session, August 25, 2016.

⁴⁸ OMB Circular A-11, Section 260-3.

priorities of the current Administration, and report the results of progress on these shared goals.”⁴⁹

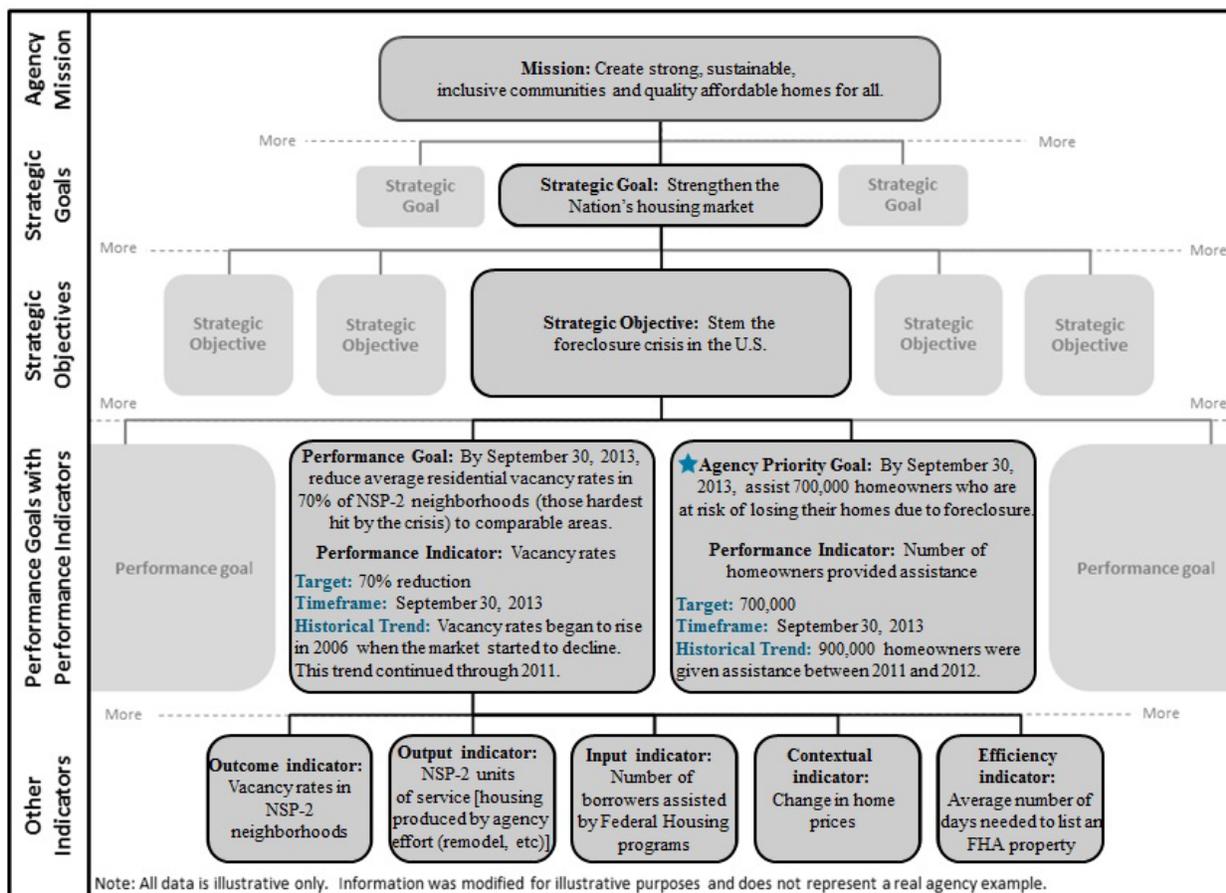


Figure 2: Illustration of Goal Relationships from OMB Circular A-11

In addition, federal performance reporting is progressing toward more dynamic presentations with digitized data. Regarding the use of performance information, component reporting entities use quarterly data-driven reviews to determine short-term progress and annual strategic reviews to assess progress toward longer-term objectives. Also, disaggregated data provides a source for determining next steps and increasing productivity. Annual performance reports inform external stakeholders on the component reporting entity’s progress and the development of the next strategic plan or annual performance plan.⁵⁰

Component reporting entities also present progress on APGs and CAPs on a centralized website.⁵¹ For instance, component reporting entities presented quarterly updates with a focus on work completed in the prior quarter, work planned for the

⁴⁹ Ibid.

⁵⁰ OMB Circular A-11, Executive Summary-2-4.

⁵¹ Ibid, Section 210-2.

remainder of the goal period, and the addition of most recent data where available. Component reporting entities also, on an annual basis, reported progress on strategic objectives in the agency Strategic Plan. Component reporting entities provide a description of achievements during the last fiscal year, any challenges encountered, and next steps planned to address identified challenges to performance improvements.⁵²

Recommendation

Staff suggests that the Board consider updating the MD&A concepts, overall, before determining MD&A performance reporting standards. Federal financial reporting in general and performance reporting in particular have evolved significantly since the Board developed the MD&A concepts. There have been legislative changes to drive data on cross-agency areas, performance information in a machine-readable format, and the presentation of performance information on a centralized website.⁵³ Also, administrative directive changes have led to component reporting entities preparing a summary of performance and financial information, distinct from MD&A. The changes have contributed to concepts and terms used for performance reporting that differ from those used to guide MD&A reporting.

Users are reviewing performance information about government-wide initiatives in addition to component reporting entity initiatives. Also, users are reviewing the highlights of budget, performance, and financial information in a brief, user-friendly format and, in addition to standardized documents, users are accessing digitized data to assist them in identifying ways of improving performance.

As part of updating the MD&A concepts, the Board could consider the role of MD&A in an environment involving dynamic reporting and more timely data access, and the performance community's perspectives on the qualitative characteristics of cost information. One step toward enhancing the concepts could be to focus on principles rather than prescriptive guidance.

Question for the Board

6. Does the Board agree or disagree with the suggestion to update the MD&A concepts?

⁵² <https://obamaadministration.archives.performance.gov/faq.html> accessed November 30, 2017.

⁵³ Pub. L. No. 111-352, 124 Stat. 3866 (2011). GPRAMA amended the Government Performance and Results Act of 1993, Pub. L. No. 103-62, 107 Stat. 285 (1993).

Questions for the Board

1. Does the Board agree or disagree that, regarding next steps, the Board should focus on the government-wide reporting entity and enhance its stewardship investment reporting?
2. Does the Board agree or disagree that investments should be reported on the same basis of accounting as the budget deficit?
3. The stewardship objective concerns financial reporting rather than financial statements. If the Board agrees that investments should be reported on the same basis as the budget deficit, should the government-wide reporting entity have the option of reporting investments in the financial report of the U.S. or referring users to the Budget?
4. Does the Board agree or disagree that, as part of enhancing government-wide reporting entity investment reporting, guidance should be developed to help users better understand the nature of the investments being reported and what the information could indicate?
5. Does the Board agree or disagree that the government-wide reporting entity should provide links to data that users could access for additional analyses?
6. Does the Board agree or disagree with the suggestion to update the MD&A concepts?