



August 12, 2011

Memorandum

To: Members of the Board

From: Ross Simms, Assistant Director

Through: Wendy M. Payne, Executive Director

Subj: Reporting Model Component Entity Project Plan – **Tab C**¹

OBJECTIVE

The objective of this session is to **approve the attached project plan** for the project on the Reporting Model – Component Entity, **so that staff may take action on the next agreed-upon step.**

BRIEFING MATERIAL

The proposed Project Plan is attached to this transmittal memorandum. In addition, there is a separate Appendix containing reference material that provides additional information should you desire more details. You may electronically access all of the briefing material at <http://www.fasab.gov/board-activities/meeting/briefing-materials/>.

MEMBER FEEDBACK

If you require additional information or wish to suggest another alternative not considered in the staff proposal, please contact staff as soon as possible. In most cases, staff would be able to respond to your request for information and prepare to discuss your suggestions with the Board, as needed, in advance of the meeting. If you have any questions or comments prior to the meeting, please contact me by telephone at 202-512-2512 or by e-mail at simmsr@fasab.gov with a cc to paynew@fasab.gov.

Attachments:

Project Plan
Appendix

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.

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REPORTING MODEL – COMPONENT ENTITY

PROJECT PLAN



AUGUST 2011



Why

Why is a project on the Reporting Model – Component Entity needed?

- Increased demand for information to facilitate decision-making and demonstrate accountability, e.g. cost of programs and spending data.
- Citizens expect financial information about agencies, but have difficulty understanding financial reports.
- The public relies on electronic media to obtain information.
- Agencies are experimenting with a statement of spending.



What

What questions / issues does the Reporting Model – Component Entity project plan to address?

- What financial information would be helpful for decision-making, demonstrating accountability, and achieving the reporting objectives?
- How should information be presented in a manner that is most responsive to users and the manner in which they obtain information?
- Should a statement of spending be added and how should it relate to other financial statements?

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REPORTING MODEL – COMPONENT ENTITY

PROJECT PLAN

Purpose: This project is being undertaken by the Federal Accounting Standards Advisory Board (FASAB or Board) because of increased demands for financial information to facilitate decision-making and demonstrate accountability, and the changes in how users expect financial information to be delivered. For example, our research has noted that:

- Decision-makers are seeking information on the full cost of programs and citizens are accessing detailed information on spending, such as who received federal funds and what was accomplished with those funds.²
- Citizens expect financial information about component entities but they have difficulty understanding current financial reports.³
- The public is relying increasingly on electronic media (digital devices, complex networks, and interactivity) to obtain information on demand.⁴

In addition, component entities are experimenting with a statement of spending and the Board may consider whether that statement should become a basic financial statement. If so, guidance may be needed to help ensure that users understand the information presented and how it relates to existing financial statements. For additional information, you may read the Background section of the Appendix to Tab C.

Applicability: This project applies to component entities that prepare and present general purpose financial reports in conformance with Statement of Federal Financial Accounting Standards (SFFAS) 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*.

Also, any conceptual guidance developed as a result of the project would guide the Board's development of accounting and reporting standards. Knowledge of the concepts that the Board considers should help users and others who are affected by or interested in federal financial accounting and reporting standards understand the purposes, content, and qualitative characteristics of information provided by federal financial accounting and reporting.

Objectives: The primary objectives of this project are to:

- a. Determine what financial information would be helpful for decision-making, demonstrating accountability, and achieving the reporting

² Preparers Focus Group Discussion, February 10, 2009.

³ FASAB, *User Needs Study: Citizens*, April 2010.

⁴ FASAB Reporting Model Task Force, *Report to the FASAB*, December 22, 2010.

objectives.

- b. Determine how financial information should be presented to be most responsive to users and the manner in which they obtain information.
- c. Consider how a statement of spending should relate to other financial statements and financial information presented in reports.

Assigned staff:

Ross Simms

Other resources:

Staff plans to engage a task force to help accomplish the project objectives. Also, staff plans to consider the statement of spending pilot efforts. Optional resources include access to Web-based meeting software like Webex to reduce meeting logistics issues and permit wide participation.

Timeline:

September – October 2011

- Conduct inquiry of Organization for Economic Co-operation and Development (OECD) countries, including analysis of accounting literature sometimes provided by individual OECD members.

October 2011 Meeting

- Discuss the results of the 20-year CFO Act Review with FASAB (part I).

November 2011

- Staff organizes and conducts an initial task force meeting.
- Staff meets with government-wide reporting model task force.

December 2011 Meeting

- FASAB reviews results of OECD inquiry.
- Discuss the results of the 20-year CFO Act Review with FASAB (part II).

January – March 2012

- Task force meetings
- Meetings with agency staff piloting statement of spending
- Task force recommendations completed

April 2012 Meeting

- FASAB discussion of task force recommendations

June 2012 Meeting

- FASAB discussion of task force recommendations (continued from April 2012)

August 2012 Meeting

- Staff presents issues and proposals.

October 2012 Meeting

- Staff presents issues and proposals (continued from August 2012).

December 2012 - February 2013

- Draft ED and field testing

April, June, August, October 2013 Meetings

- Discuss draft ED with FASAB

December 2013

- Issue ED for comment

April and June 2013 Meetings

- Discuss analysis of ED comments

August, October, December 2013 Meetings

- Discuss draft standard

February 2014

- Submit standard to sponsors

May 2014

- Issue standard

PROPOSED APPROACH

I. Consider Existing Concepts, Standards, Other Guidance, and Legislation:

Existing concepts

- Statement of Federal Financial Accounting Concepts (SFFAC) 1, *Objectives of Federal Financial Reporting*, objectives of federal financial reporting, paragraphs 112 -150.
- SFFAC 2, *Entity and Display*, displaying financial information, paragraphs 54 – 67, and 74, and Table 1: Factors to Consider in Distinguishing Basic Information from RSI.
- SFFAC 3, *Management’s Discussion and Analysis*, making financial statements understandable, paragraph 37.
- SFFAC 5, *Definitions of Elements and Basic Recognition Criteria for Accrual-Basis Financial Statements*, elements of financial statements and basic recognition criteria, paragraph. 5.

Existing standards

- Statement of Federal Financial Accounting Standards (SFFAS) 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*, sources of financing for component entities, paragraph 23; presentation of budgetary information, paragraph 77; and explaining the relationship between budgetary resources obligated by the entity during the period and the net cost of operations, paragraph 80.
- SFFAS 17, *Accounting for Social Insurance*, as amended by SFFAS 26, *Presentation of Significant Assumptions for the Statement of Social Insurance: Amending SFFAS 25*, requirement for a statement of social insurance
- SFFAS 37, *Social Insurance: Additional Requirements for Management’s Discussion and Analysis and Basic Financial Statements*, requirements for presentations in the Management Discussion and Analysis (MD&A) and a statement of changes in social insurance amounts, paragraph 2.

Existing Guidance

- Office of Management and Budget (OMB) Circular A-136, *Financial Reporting Requirements*, the financial section of financial reports, section II.4.

Legislation

- Federal Managers Financial Integrity Act of 1982
- Chief Financial Officer's (CFO) Act of 1990
- Government Performance and Results Act of 1993
- Government Management Reform Act of 1994
- Federal Financial Management Improvement Act of 1996
- Reports Consolidation Act of 2000
- Accountability of Tax Dollars Act of 2002
- Improper Payments Information Act of 2002
- Sarbanes-Oxley Act of 2002
- Department of Homeland Security Financial Accountability Act
- Improper Payments Elimination and Recovery Act (IPERA) of 2010

II. Resources

Staff plans to engage a task force to help achieve the project objectives. The task force will consist of volunteers from various component level entities and experts in disciplines such as actuarial science, federal budgeting, federal performance management, federal financial auditing, information technology, and communications. The task force will consist of about 12 members and will be divided into teams to accomplish some tasks concurrently.

III. Research Steps

- a. Determine the component level financial reporting requirements of other countries.
 - i. Inquire of OECD countries to determine:
 1. whether national government departments/ministries (components entities) are required to prepare financial statements and why;
 2. whether the component entity financial statements are prepared in conformity to generally accepted accounting principles;
 3. what types of financial statements they prepare and the reporting period (monthly, quarterly, annually)

4. in general, how are the statements used, e.g. for strategic planning, evaluating performance, demonstrate accountability, etc.; and
 5. what are some key metrics, comparisons, and trends that the financial statements are intended to provide at the component level.
 - ii. Research International Public Sector Accounting Standards Board (IPSASB) literature regarding component entity reporting, if any.
 - iii. Summarize and report inquiry results.
- b. Organize a task force to determine what financial information would be helpful for decision-making, demonstrating accountability, and achieving the reporting objectives.
 - i. Seek task force members from agencies and non-federal sources such as academia and experts in actuarial science and information technology.
 - ii. Provide task force members with previous research (User needs, task force recommendations, CFO Council and CIGIE recommendations, statement of spending information, OECD inquiry results).
- c. Conduct steps to determine what financial information would be helpful for decision-making, demonstrating accountability, and achieving the reporting objectives.
 - i. Divide the task force into two teams.
 1. Team 1 will determine what financial information would be helpful for decision-making and demonstrating accountability.
 2. Team 2 will determine what financial reporting objectives could be better achieved.
 3. The full task force will meet periodically to discuss the progress of the individual teams.
 - ii. Determine what financial information would be useful for decision-making and demonstrating accountability (Team 1).
 1. Identify a program or design a case study and ask task force members to review the case and determine:
 - a. What are some of the key financial decisions that a report user would need to make annually with respect to the program?
 - b. What financial metrics and other information would help the user address the decisions identified in the previous step?

- i. What comparisons would help provide useful information?
 - ii. What trends would help provide useful information?
 - iii. What future oriented information would be needed?
 - c. Are those metrics available from the existing model? If not, determine what enhancements may be needed, e.g. a new statement or revision of an existing statement.
 2. Review legislation and determine what financial metrics are required to be monitored or required to be summarized and considered in actions, e.g. the Dodd-Frank Act discusses requirements for the Deposit Insurance Fund *reserve ratio*?
 - a. Are the metrics currently available from the existing model?
 - b. If not, determine why and whether enhancements are needed.
 3. Consider the data elements that may be needed to develop the metrics and the impact on systems.
 4. Summarize results.
- iii. Concurrent with step ii. above, determine what reporting objectives could be better achieved (Team 2).
 1. Assess how well each reporting objective is being achieved by the existing financial statements
 2. Specific steps are presented in the Reporting Model Analysis Guide. See the Appendix section entitled, Reporting Model Analysis Guide.
 3. Summarize results
 - iv. Considering the results of the previous steps, determine enhancements to the financial statements.
 1. Is the content of the existing and proposed statements structured in a manner that is most responsive to the needs of users and the manner in which they obtain information?
 - a. Refer to user needs results and other research.
 - b. Ensure to obtain input from analysts.
 - c. Consider the following:

- i. Should only tabular formats with text and numbers be used, considering that many users obtain information from “tweets,” “texting,” and graphics?
 - ii. How can technology be maximized to present information in the least costly manner?
 - d. Determine enhancements, if any, needed to accommodate spending information and the results of the previous steps.
 - i. Review the progress in preparing a statement of spending
 - ii. Determine what enhancements may be needed to help users understand how the spending information relates to other information that may be presented such as program costs, outlays, obligations, social insurance projections, etc.
 - e. Report task force results to the Board.
 - f. Develop ED.
 - g. Issue ED for comment.
 - h. Analyze comments.
 - i. Issue standard.

POTENTIAL PROJECT MANAGEMENT CONCERNS

Timeline

Currently, some agencies are pilot testing a statement of spending. Adherence to the proposed timeline will depend on the progress made in conducting the pilot.

OECD Inquiry

An inquiry of OECD countries may be beneficial. The Board can learn about the reporting practices that other countries have developed for government departments and the types of metrics that they found helpful. Such an inquiry did not require substantial staff resources in the past and countries were delighted to participate and share their experiences.

The objective of this session is to approve this project plan for the project on the Reporting Model – Component Entity, so that staff may take action on the next agreed-upon step.

If you require additional information or wish to suggest another alternative not considered in the staff proposal, please contact staff as soon as possible. In most cases, staff would be able to respond to your request for information and prepare to discuss your suggestions with the Board, as needed, in advance of the meeting. If you have any questions or comments prior to the meeting, please contact me by telephone at 202-512-2512 or by e-mail at simmsr@fasab.gov with a cc to paynew@fasab.gov.

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Tab C – Appendix
Reporting Model – Component Entity
Reference Material
(For More Information)

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BACKGROUND

FASAB initiated the overall reporting model project to determine necessary improvements to the existing federal reporting model. To determine how best to improve the model while balancing the cost and benefit of its decisions, the Board sought input from users and the financial reporting community and organized a task force to consider enhancements to the model. The task force focused on the government-wide level because this was the level that users would likely begin their search for financial information about the federal government. Upon completion of reviewing this level, the task force prepared a report with recommendations for FASAB and its sponsors and the Board discussed the report and recommendations during the December 2010 meeting. Also, during the February 2011 meeting, the Board discussed an analysis of the recommendations that could likely be addressed by FASAB. Subsequently, the Board noted that many of the task force proposals could be implemented voluntarily by preparers and experimentation would be needed before the Board could consider addressing other proposals.

In April 2011, the FASAB discussed a staff proposal to develop a new basic financial statement that would articulate (link) information in the existing financial statements. The Board had initiated work to develop this statement as part of its Social Insurance project and staff suggested continuing this work while concurrently enhancing the conceptual framework. The conceptual framework segment would address voids and concerns that Board members raised during their deliberations on social insurance and other topics. Upon discussing the staff proposal, the Board determined that adding a new basic financial statement to articulate existing information would not be beneficial to readers. Instead, the focus should be on better presenting or communicating the existing information. Also, the Board believed that it would be premature to revisit the conceptual framework at that time. The Board acknowledged that the financial reporting community had a number of initiatives ongoing that may inform an analysis of the conceptual guidance.

Consequently, the Board has reviewed the government-wide level model and staff is preparing to proceed to the next phase – a review of the component entity level model.

EXISTING RESEARCH

As part of the reporting model project, staff conducted an inquiry of OECD countries. In January and February 2010, staff inquired of OECD countries to determine their overall financial reporting practices. Staff received inquiry responses from 10 OECD member countries (Australia, Austria, Canada, France, Italy, New Zealand, Norway, Portugal, Sweden, and United Kingdom) and the following summarizes the results:

- All of the respondents indicated that they make their government-wide financial report available on the internet.
- Most of the respondents indicated that departmental financial statements are prepared and audited.
- Many of the countries indicated similar financial statement users as the U.S. For example, all the respondents noted that legislative bodies (parliament) and citizens or the public were considered users. In addition to parliament, some countries noted other internal users such as those within ministries or departments.
- Financial statements were used for various purposes, including budget decisions, demonstrating stewardship over assets or asset management, monitoring efficiency, and accountability and decision-making in general.
- Most of the survey respondents use accrual accounting and some countries consider private sector accounting standards in preparing their financial reports.
- Respondents generally used the same basis for budgeting and accounting and some countries indicated that they currently use or are moving to accrual budgeting and accounting.¹

In addition, staff conducted a series of user studies involving citizens, executives and managers, and the Congress. Upon completion of the studies, staff developed a user needs inventory for use in determining improvements in existing federal financial reports. The financial reporting objectives are broad enough to encompass the user needs identified and the following are some of the highlights of the user needs studies:

- Citizens and some executives and managers noted difficulty in understanding information in financial reports. They believed that the documents are intended for accountants or economists rather than citizens and managers. In some instances, executives and managers develop their own data and reports.
- Congress seeks timely, easy to understand information to address particular issues.
- Citizens were not aware that the federal government and agencies prepared audited financial statements and some executives and managers had not seen their agency's financial statements.

¹ Staff Issue Paper for February 2010, available at <http://www.fasab.gov/projects/active-projects/concepts-the-financial-report/>.

- Some executives and managers noted that they need training in financial management.
- Congress seeks financial information about specific issues of the day and uses many sources to obtain the information it needs such as obtaining the information directly from agencies and utilizing legislative support organizations, i.e., the Government Accountability Office, Congressional Budget Office, and Congressional Research Service.
- Congress also routinely seeks information about the budgetary effect of legislative proposals on the budget and the cumulative effects of legislation.
- Executives and managers use multiple systems, cuff systems, or systems other than financial systems to get financial information, including basic budgetary information.
- Both cash and accrual basis accounting appears to be needed to provide the information users need.
- Executives and managers need information at least monthly, but timelier, if possible. However, some did not believe that timelier information was possible.²

Subsequently, staff organized a task force to consider the user needs work and FASAB member concerns and determine enhancements to the government-wide model. The task force believed that to best meet FASAB's objectives and the public's needs for transparency and accountability, the federal government should adopt an electronic, Web-based method of communicating information about the financial condition and performance of the federal government. They noted that this method would enable the federal government to meet more user needs more quickly and at a lower cost than the paper-based method currently used. The task force envisioned that the electronic, Web-based method would involve a central Web site for financial and performance information with multimedia presentations to help educate users about the significance of the information. In addition, the site should include: the ability for users to "drill-down" to the appropriate level of detailed material; machine-readable data to enable users to conduct searches and download data for analysis; and the ability to report cost and accomplishments in a variety of ways based on user preferences. The task force also recommended reporting additional financial and non-financial measures and changes in the presentation of information in existing financial reports to assist users in understanding the financial condition and performance of the federal government.³

In addition, the task force believed that the success of the electronic, Web-based method of reporting and its other recommendations requires adequate public awareness of federal financial reporting. Thus, the task force recommended

² Staff Issue Paper for April 2010, available at <http://www.fasab.gov/projects/active-projects/concepts-the-financial-report/>.

³ FASAB Reporting Model Task Force, *Report to the FASAB*, December 22, 2010.

establishing a federal financial information Web site and taking steps to raise public awareness of its availability.⁴

Also, the project will consider the results of the CFO Council initiative to develop a statement of spending and some agencies have started to pilot the statement. For example, the General Services Administration has prepared a Schedule of Spending. See Figure 1: Example Schedule of Spending.

⁴ Ibid.

Figure 1: Example Schedule of Spending

SCHEDULE OF SPENDING

(UNAUDITED)

The Schedule of Spending presented below is not a required report, but was developed in an attempt to present GSA's spending in a reader friendly format. To achieve this goal, standard accounting terms were modified to improve understanding of common federal accounting terms for the general public. For example the line item labeled Available to Spend matches the Total Budgetary Resources line in GSA's Combining Statements of Budgetary Resources (CSBR). The Committed to Spend section equals Obligations Incurred, Amounts Remaining after Agreements equals the Unobligated Balances, and the Payments Made section equals Gross Outlays all from the CSBR.

For the Fiscal Years Ended September 30, 2010 and 2009
(Dollars in Millions)

	2010				2009			
	Federal Buildings Fund	Acquisition Services Fund	Other Funds	GSA Combined Totals	Federal Buildings Fund	Acquisition Services Fund	Other Funds	GSA Combined Totals
Available to Spend	20,822	12,641	1,074	34,537	20,925	12,038	1,280	34,243
Committed to Spend								
Employee Salaries, Benefits and Travel	818	441	307	1,566	730	408	310	1,448
Building Leases	5,280	52	35	5,367	4,916	51	34	5,001
Utilities, Communications	463	1,176	29	1,668	466	1,184	33	1,683
Other Services	2,861	5,217	374	8,452	2,859	4,834	336	8,029
Supplies and Materials	34	3,131	47	3,212	39	3,392	303	3,734
Equipment	286	813	44	1,143	46	815	27	888
Land and Structures	4,966	8	0	4,974	2,395	4	0	2,399
Other	178	53	3	234	184	52	4	240
Total Agreements	14,886	10,891	839	26,616	11,635	10,740	1,047	23,422
Amounts Remaining after Commitments	5,936	1,750	235	7,921	9,290	1,298	233	10,821

	2010				2009			
	Federal Buildings Fund	Acquisition Services Fund	Other Funds	GSA Combined Totals	Federal Buildings Fund	Acquisition Services Fund	Other Funds	GSA Combined Totals
Payments Made								
Employee Salaries, Benefits and Travel	804	437	307	1,548	726	404	307	1,437
Space Rental	5,212	51	33	5,296	4,822	51	35	4,908
Communications, Utilities	449	1,188	25	1,662	446	1,139	32	1,617
Other Services	2,796	4,496	333	7,625	3,138	4,404	315	7,857
Supplies and Materials	36	3,071	95	3,202	39	3,145	253	3,437
Equipment	86	753	39	878	43	812	30	888
Land and Structures	1,675	2	0	1,677	776	3	0	779
Other	174	51	5	230	193	50	5	248
Total Payments	11,232	10,049	837	22,118	10,183	10,008	977	21,168

EXCERPTS FROM EXISTING CONCEPTS, STANDARDS, OTHER GUIDANCE, AND LEGISLATION

The project will consider existing concepts, standards, and legislation regarding financial statements of component entities. The concepts and standards consider legislation and help address the financial information needs of users. Accordingly, the resulting broad set of financial statements may require information from various systems in addition to accounting systems.

Also, while the concepts and standards call for an array of financial statements, the particular set of financial statements may not be the same for all component entities. For example, only component entities that collect nonexchange revenue for the government as a whole will have a statement of custodial activities among its set of financial statements; and only entities with social insurance programs will have a statement of social insurance and statement of changes in social insurance amounts included in its set of statements.

Given the possible range of financial statements that an entity may need to prepare, Management's Discussion and Analysis (MD&A) becomes a key component of a financial report. In this section, management can link the financial statements and assist users in understanding the various measures presented. Thus, the FASAB considers the various needs of users and the unique characteristics of individual component entities when determining what information should be required and how that information should be presented.

Concepts

Existing concepts that will be considered include Statement of Federal Financial Accounting Concepts (SFFAC) 1, *Objectives of Federal Financial Reporting*, and SFFAC 2, *Entity and Display*. The project will consider each of the reporting objectives (budgetary integrity, operating performance, stewardship, and systems and control) discussed in SFFAC 1. The concepts statement states that the reporting objectives "reflect many of the needs expressed by current and potential users of federal financial information."⁵ However, in deciding whether to address these needs only through financial statements, the concepts state,

The FASAB notes that many information sources other than financial statements help to attain these objectives. The objectives relate to the management and financial reporting systems in the federal government in their entirety.⁶

SFFAC 1 also discusses systems and internal controls. The different users of financial reports require data at different levels of aggregation, involving different

⁵ SFFAC 1, par. 4.

⁶ SFFAC 1, par. 5.

time periods, and requiring different formats. Consequently, some level of assurance is needed regarding the data that may need to be accessed. SFFAC 1 states that “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.”⁷

Meeting the requirements of a set of accounting standards requires systems with common data definitions, classification structures, and on-going internal controls to ensure data reliability. Fundamentally, the accounting standards provide a “common language” that can be used across entities, facilitate collaboration, streamline processes, and plan information technology investments. Also, systems and control activities synchronized throughout the organization may be used to provide executives and managers with daily or real-time data for other decision-making. As a result, the systems and control activities used in preparing information in conformity with generally accepted accounting principles can contribute to ensuring the reliability of data used for other purposes, including communications to executives and managers and data presented to Congress.

In addition, SFFAC 2 discusses the role of financial statements, identifies the types of financial statements for communicating financial information about component level entities, and suggests the types of information each statement should convey. Regarding the role of financial statements, the conceptual guidance states,

Financial statements represent the principal means of communicating accounting information about an entity’s resources, obligations, revenues, costs, etc. to those outside the entity. However, financial statements, and particularly those prepared for governmental and other not-for-profit organizations, may also contain information from sources other than accounting records.⁸

While it is clear that FASAB intends for financial statements to be the principal method of communicating financial information, two additional notions about financial statements can be derived. First, it appears that financial statements are not limited to presenting information traditionally captured in accounting systems. Thus, financial statements may present information on service efforts and accomplishments, sustainability of programs, and other issues.

Second, the concept implies that financial statements do not necessarily need to link or articulate. Accounting systems are governed by double-entry which means that a single event has an equal and opposite effect in at least two accounts. This convention facilitates the preparation of financial statements that can show different aspects of the same event. Given that the Board envisions financial statements derived from sources other than such systems, the conceptual guidance does not appear to preclude considering a broad set of financial statements that do not articulate.

⁷ SFFAC 1, par. 21.

⁸ SFFAC 2, par. 54.

The flexibility implied in the guidance seems to distinguish federal accounting concepts from commercial accounting concepts which state that, “the financial statements of an entity are a fundamentally related set that articulate with each other and derive from the same underlying data.”⁹ However, current Board members have expressed concern that nonarticulation can hinder a reader’s understanding.

SFFAC 2 suggests that financial reports of component entities include the following financial statements:

- statement of financial position (commonly referred to as balance sheet);
- statement of net costs;
- statement of changes in net position;
- statement of custodial activities (appropriate for those entities whose primary mission is collecting taxes or other revenues intended to finance the federal government as a whole);
- statement of budgetary resources;
- statement of financing (currently presented as a schedule in the disclosures);
- statement of program performance measures (currently not a basic financial statement).¹⁰

The conceptual guidance also provides illustrations of the different types of financial statements suggested.¹¹ However, not all the financial statements listed in SFFAC 2 are basic statements and component entities are currently presenting basic statements that are not identified in SFFAC 2, but are required by standards. See Table 1: Basic Financial Statements for Component Entities on page 9 for a listing of the current set of component entity financial statements.

Acknowledging the need to ensure that users understand the array of component entity financial statements, SFFAC 3, *Management’s Discussion and Analysis*, states,

MD&A should make federal financial statements understandable to a wide audience, not just to users who are specialized analysts or members of the entity’s management. There may be many potential sources of misunderstanding. Management should try to identify those sources of misunderstanding that may be important and deal with them in MD&A. Some of these are general and pervasive, such as those that may arise in the minds of new users of federal financial statements. New users may have been budget-oriented rather than accrual-accounting oriented, or may be accustomed to seeing financial statements prepared on the basis of private sector accounting standards. A general discussion and reference to the Statement of Financing and

⁹ Financial Accounting Standards Board (FASAB) Statement of Financial Accounting Concepts 5, *Recognition and Measurement in Financial Statements of Business Enterprises*, par. 6.

¹⁰ SFFAC 2, par. 74.

¹¹ See SFFAC 2, Appendix 1.

the basis of accounting footnote may be sufficient for such users, although more specific treatment may be appropriate where the resulting differences in the reported amounts may be important to the understanding of users.¹²

Thus, the conceptual guidance notes that a basic financial statement can provide the link between financial statements prepared from different bases. SFFAC 3 refers to a Statement of Financing¹³ which served that purpose and the MD&A could discuss and refer to that statement.

Additional concepts that may be considered during the project include SFFAC 5, *Definitions of Elements and Basic Recognition Criteria for Accrual-Basis Financial Statements*. SFFAC 5 defines the five elements of accrual basis financial statements (asset, liability, net position, revenue, and expense) and the two basic criteria for recognizing an item in the body of a financial statement:

- (1) the item meets the definition of an element; and
- (2) the item must be measurable.¹⁴

Also, SFFAC 2 discusses factors that the Board may consider in determining whether an item of information should be considered basic information or required supplementary information (RSI). The following provides an example:

For example, members may consider the relevance of the information to fair presentation. If the information has a high relevance to fair presentation, it may be a candidate for basic information communicated by financial statements and notes to the financial statements. The financial statements and notes could not be considered fairly presented if the information is missing or materially misstated.¹⁵

Table 1: Basic Financial Statements for Component Entities

Financial Statement	According to concepts or standards, this statement ...	Directly helps to achieve the _____ reporting objective(s)	Basis used in preparing the statement	Linkage to other financial statements
Statement of Financial Position (Balance Sheet)	presents “the total balances of assets, liabilities, and net position of an organization as of a specific time.” (SFFAC 2, par. 57)	operating performance and stewardship	Accrual	Linked to the Statement of Net Cost via the Statement of Changes in Net Position

¹² SFFAC 3, par. 37.

¹³ The Statement of Financing is currently presented as a schedule in the disclosures. SFFAC 2, footnote 12a states that “The Statement of Financing may be presented as a financial statement or as a schedule in the notes to the financial statements. The OMB will provide guidance regarding details of how the information will be displayed.

¹⁴ SFFAC 5, par. 5.

¹⁵ SFFAC 3, par. 73E.

Excerpts from Existing Concepts, Standards, Other Guidance, and Legislation

Financial Statement	According to concepts or standards, this statement ...	Directly helps to achieve the _____ reporting objective(s)	Basis used in preparing the statement	Linkage to other financial statements
Statement of Net Cost	presents "how much of the services provided by the entity was financed by the taxpayers." (SFFAC 2, par. 59)	operating performance	Accrual	Linked to the Balance Sheet via the Statement of Changes in Net Position and linked to the Statement of Budgetary Resources via a schedule in the disclosures
Statement of Budgetary Resources	subjects budget execution information to audit and helps address concerns that had been expressed about "whether the budget is being properly executed in all cases." (SFFAS 7, par. 9)	budgetary integrity	Budgetary (obligation and cash)	Not linked via a basic statement (linked to the Statement of Net Cost via a schedule in the disclosures)
Statement of Changes in Net Position	presents "the manner in which the entity's net costs were financed and the resulting effect on the entity's net position." (SFFAC 2, par. 60)	budgetary integrity	Budgetary (obligation and cash)	Links the Balance Sheet and Statement of Net Cost
Statement of Custodial Activities	"...provides an understanding of from whom the taxes or other monies were collected and to whom they were distributed." (SFFAC 2, par. 61).	stewardship	Cash	Not linked
Statement of Social Insurance	"...information for an assessment of sustainability of specific programs	stewardship	Long-term projections	Links to the Statement of Changes in Social Insurance

Excerpts from Existing Concepts, Standards, Other Guidance, and Legislation

Financial Statement	According to concepts or standards, this statement ...	Directly helps to achieve the _____ reporting objective(s)	Basis used in preparing the statement	Linkage to other financial statements
	in governmentwide financial reports and in the financial reports of component entities that administer social insurance programs.” SFFAS 37, par. 8.			Amounts, but not linked to accrual or budgetary basis statements
Statement of Changes in Social Insurance Amounts	is intended to “reconcile beginning and ending open group measures and present the components of the changes in the open group measure from the end of the previous reporting period.” (SFFAS 37, par. 31)	stewardship	Long-term projections	Links to the Statement of Social Insurance, but not linked to accrual or budgetary basis statements

Standards (Including those Standards that Discuss Concepts)

In addition to financial statements suggested by conceptual guidance, existing standards discuss principles important to understanding component entity financial statements and require financial statements. Statement of Federal Financial Accounting Standards (SFFAS) 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting* discusses that multiple bases of accounting are needed to provide readers with a comprehensive perspective of a component entity. One reason for different bases is that many component entities finance their operations through the budget process, which is distinct from the government as a whole. SFFAS 7 states,

The main sources of financing for the Government as a whole are exchange and nonexchange revenues and borrowing from the public. For component reporting entities, however, the sources of financing are provided through the budget and are largely financing sources other than revenue. Appropriations and other budget authority provide an agency with the authority to incur obligations to acquire goods and services or to provide benefits and grants. These other financing sources are not earned by an entity's operations. Therefore, as with nonexchange revenue, they should be accounted for in a way that does not obscure the entity's net cost.¹⁶

Given that component entities are financed through the budget process rather than earning revenue, SFFAS 7 requires a presentation of the following budgetary information:

- total budgetary resources available to the reporting entity during the period;
- the status of those resources (including "obligations incurred"); and
- outlays.¹⁷

The budgetary information is required for those entities whose financing comes wholly or partially from the budget.¹⁸ Thus, the standard allows a level of flexibility and the budgetary information requirements may not apply to self-financing component entities.

Also, while obligations and cash are the bases of accounting that are helpful for reporting on budgetary execution, SFFAS 7 notes that accrual accounting provides better information for evaluating operating performance. It states,

Those who prepare financial statements have recognized that accrual accounting and the budget are complementary. Accrual-basis accounting often provides better information than cash-basis accounting for evaluating performance. It can provide more information for planning and control of operations. Accrual accounting provides an understanding of a reporting entity's net position and cost of operations.¹⁹

Table 2: Summary of Accounting Bases Used in Federal Financial Reporting provides a brief description of when the obligation, cash, and accrual bases recognize different economic events. The summary shows that each has a particular purpose but, for the purposes of determining the cost of programs, the accrual basis recognizes events that the others do not, such as the use of assets or depreciation.

The term depreciation and possibly others used in accrual basis statements may be misunderstood in the federal financial reporting environment. For example, during staff user needs discussions, some participants referred to depreciation in terms of an economic event for remeasuring the *value* of assets. However, FASAB literature

¹⁶ SFFAS 7, par. 23.

¹⁷ SFFAS 7, par. 77.

¹⁸ Ibid.

¹⁹ SFFAS 7, par. 26.

refers to depreciation in terms of recognizing the *use* of assets and in determining the *costs* incurred during the reporting period. This would facilitate comparing program costs with program outcomes. FASAB exposure draft, *Measurement of the Elements of Accrual-Basis Financial Statements in Periods After Initial Recording*, explains the difference between economic events that reflect changes in an asset's value versus adjustments that do not reflect such a change. It states,

Remeasured amounts of assets and liabilities are determined using one of several possible measurement attributes that reflect economic conditions at the financial statement date, including, for example, fair value or settlement amount. Remeasurement updates a previously determined carrying amount to reflect a change in the economic value of an asset or liability that has occurred since the previous financial statement date. A remeasured amount thus differs from an adjustment to an initial amount that does not reflect a change in value. For example, an increase in the accumulated depreciation balance on a building does not change the economic value of the building and does not constitute remeasurement of its carrying amount. Unless the value of the building itself is remeasured at, for example, its fair value, the reported amount will continue to be considered the initial amount. In contrast, an adjustment to an allowance for uncollectible accounts receivable due to an increased risk of noncollection constitutes remeasurement of the carrying amount, even when the gross amount of receivables is not remeasured, because the adjustment reflects a change in the economic value of the receivables—the anticipated net settlement amount.²⁰

Table 2: Summary of Accounting Bases Used in Federal Financial Reporting

Type of Event	Obligation – useful for controlling expenditures. Under this basis, the event is recorded when...	Cash – useful for managing cashflow. Under this basis, the event is recorded when...	Accrual – useful for managing costs. Under this basis, the event is recorded when...
Revenue	not recognized	received	the entity performs the services
Purchase of property, plant, and equipment	the contract is awarded	vendor is paid and is recorded as an outlay	the item of property, plant, and equipment is received and is

²⁰ FASAB exposure draft, *Measurement of the Elements of Accrual-Basis Financial Statements in Periods After Initial Recording*, September 13, 2010, par. 20.

Type of Event	Obligation – useful for controlling expenditures. Under this basis, the event is recorded when...	Cash – useful for managing cashflow. Under this basis, the event is recorded when...	Accrual – useful for managing costs. Under this basis, the event is recorded when...
			recorded as an asset
Acquisition of goods and services	the contract is awarded	vendor is paid and is recorded as an outlay	the services are performed and are recorded as an expense or cost
Use of property, plant, and equipment (depreciation)	not recognized	not recognized	the equipment is used and is recorded as an expense or cost

SFFAS 7 also requires a reconciliation to explain “the relationship between budgetary resources obligated by the entity during the period and the net cost of operations.”²¹ Thus, FASAB recognizes that basic information is needed to “reconcile the use of budgetary resources to acquire or provide goods and services with the net cost of using those goods and services.”²²

In addition to obligation, cash, and accrual bases financial statements, SFFAS 17, *Accounting for Social Insurance*, as amended by SFFAS 26, *Presentation of Significant Assumptions for the Statement of Social Insurance: Amending SFFAS 25* introduced a financial statement that focuses on another perspective, long-term projections of future costs. The standard requires a statement of social insurance (SOSI) which presents the actuarial present values of future benefits and contributions and tax income for social insurance programs. While the standard primarily affects component entities with social insurance programs, it helps achieve the stewardship objective.

Understanding the need to explain the relationship among the different financial statements and help ensure that readers comprehend them, FASAB appeared to focus on additional RSI rather than basic as in the case of SFFAS 7. FASAB issued SFFAS 37, *Social Insurance: Additional Requirements for Management’s Discussion and Analysis and Basic Financial Statements* which required additional information in the MD&A (a component of RSI), changes to the SOSI, and a new basic statement. In particular, the standard

...amends sections of SFFAS 17, *Accounting for Social Insurance*. In addition to the current requirements in SFFAS 17, the standard requires the

²¹ SFFAS 7, par. 80.

²² SFFAS 7, par. 89.

government-wide entity as well as entities that present a statement of social insurance (SOSI) to:

- a. include in one section of management's discussion and analysis (MD&A) information [footnote omitted] about costs, assets and liabilities, social insurance commitments, budget flows, and long-term fiscal projections; [footnote omitted]
- b. include in MD&A a table or other singular presentation of key measures drawn from the basic financial statements;
- c. add a section within the SOSI that summarizes the net present values of cash flows and presents certain subtotals and totals (see Appendix C: Illustrative Statement of Social Insurance, Part I, Government-wide SOSI); and
- d. present a statement of changes in social insurance amounts (SCSIA) that indicates the reasons for changes in the open group measure from the end of the previous reporting period (see Appendix D: Illustrative Statement of Changes in Social Insurance Amounts).²³

In addition to some accrual basis terms, the long-term projections provide another opportunity to improve community understanding. During our analysis of the government-wide level reporting, staff noted that analysts combine the long-term projections with liabilities reported on the balance sheet. This may result from an effort to determine the significant risks that the government assumes; however, the measures were not intended to be combined.

Consequently, FASAB standards require a range of measures to provide a comprehensive view of a component entity's activities during the period and its prospects for the future. Standards require basic information to help explain the relationship between budgetary and accrual bases statements, but call for RSI to help relate the long-term projections statements to the other statements. Table 1: Basic Financial Statements provides an overview of the basic financial statements currently presented by component entities.

Existing Guidance

The project will consider the financial section (section II.4) of OMB A-136, *Financial Reporting Requirements*. The complete section can be accessed at http://www.whitehouse.gov/omb/circulars_default.

²³ SFFAS 37, par. 2.

Legislation

Legislation that will be considered during the project includes those described in [FASAB's Strategic Directions, Appendix IV](#). The document, accessible at <http://www.fasab.gov/about/mission-objectives/>, provides a discussion and analysis of the following legislation:

- Federal Managers Financial Integrity Act of 1982
- Chief Financial Officer's (CFO) Act of 1990
- Government Performance and Results Act of 1993
- Government Management Reform Act of 1994
- Federal Financial Management Improvement Act of 1996
- Reports Consolidation Act of 2000
- Accountability of Tax Dollars Act of 2002
- Improper Payments Information Act of 2002
- Sarbanes-Oxley Act of 2002
- Department of Homeland Security Financial Accountability Act

Generally, the laws require components of the federal government to provide audited financial statements and other information such as strategic plans and information on operating performance and systems and control. Accordingly, each component is responsible for managing its resources and program performance and developing discrete financial and performance information. Also, components may need to develop systems and internal controls to help them accomplish these responsibilities. However, while developing discrete financial and performance information, components must rely on centralized processes conducted for the benefit of the government as a whole. Those processes include taxation, borrowing from the public, acquisition services, and employee retirement, health benefits, and life insurance programs.

In addition, the project will consider the results of particular Improper Payments Elimination and Recovery Act (IPERA) of 2010 requirements. IPERA requires the CFO Council and the Council of the Inspectors General on Integrity and Efficiency (CIGIE) to

- A. jointly examine the lessons learned during the first, 20 years of implementing the Chief Financial Officers Act of 1990 (31 U.S.C. 901) and identify reforms or improvements, if any, to the legislative and regulatory compliance framework for Federal financial management that will optimize Federal agency efforts to
 - publish relevant, timely, and reliable reports on Government finances; and

- implement internal controls that mitigate the risk for fraud, waste, and error in Government programs; and
- B. jointly submit a report on the results of the examination...²⁴

²⁴ IPERA of 2010, Section 3(e).

FEDERAL FINANCIAL REPORTING SUPPLY CHAIN

Federal financial reporting involves processes for:

- considering the financial information needs of users and developing accounting standards;
- developing additional reporting requirements to address particular concerns such as the adequacy of systems and internal controls;
- preparing financial reports in conformity with accounting standards and additional reporting requirements;
- auditing financial statements and reporting on the fair presentation of financial statements, internal controls, and compliance with laws and regulations (audits are conducted in accordance with generally accepted government auditing standards (GAGAS)); and
- analyzing financial reports and/or the data underlying those reports and making economic decisions (includes users such as citizen intermediaries who help deliver financial information to other users).

These processes may be considered the financial reporting supply chain and are illustrated in Figure 2: Federal Financial Reporting Supply Chain. While each process is important to ultimately delivering financial information to users, the scope of the project will focus on considering the financial information needs of users and developing accounting standards rather than each component of the supply chain.

Figure 2: Federal Financial Reporting Supply Chain



* Auditors report on the fair presentation of financial statements, internal control, and compliance with laws and regulations

Source: FASAB staff.

REPORTING MODEL ANALYSIS GUIDE

As discussed in the proposed research steps, the task force will use the following guide in determining the reporting objectives that could be better achieved.

	STEPS	Completion Date
I.	<p>Objective:</p> <p>The objective of this step is to identify reporting objectives that are not being achieved so that the FASAB can ensure that users have the information they expect.</p>	
I.A.	<p>Direct task force team to review the staff roundtable discussions on the reporting objectives. In 2005, staff conducted roundtable discussions to determine how the reporting objectives could be improved for guiding the Board in developing financial accounting and reporting standards. During the discussions, the participants provided suggestions on how the objectives could be better achieved. These suggestions may be beneficial to the task force members and can be accessed at http://www.fasab.gov/projects/archived-projects/concepts-objectives/ Issue Paper for March 2006.</p>	
I.B.	<p>Complete the Reporting Objectives Analysis provided in Table 3: Reporting Objective Analysis.</p>	
I.C.	<p>Summarize the results of the analysis.</p>	
I.C.1.	<p>Identify the objective(s) that could be better achieved.</p>	
I.C.2.	<p>Discuss considerations for the type of financial statement and elements that may be needed to help better achieve the reporting objective.</p>	

Table 3: Reporting Objective Analysis

Financial Reporting Objective Category	Financial Reporting Objective	Component Level Financial Statement(s) that Helps Achieve the Objective	Analysis – How well has objective been achieved?	Enhancements – What improvements are needed?
Budgetary Integrity	<p><u>Overall</u></p> <p>Federal financial reporting should assist in fulfilling the government's duty to be</p>			

Financial Reporting Objective Category	Financial Reporting Objective	Component Level Financial Statement(s) that Helps Achieve the Objective	Analysis – How well has objective been achieved?	Enhancements – What improvements are needed?
	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.			
	<u>Sub-objective 1</u> 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.			
	<u>Sub-objective 2</u> Federal financial reporting should provide information that helps the reader to determine the status of budgetary resources.			
	<u>Sub-objective 3</u> 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.			
Operating Performance	<u>Overall</u> 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			

Financial Reporting Objective Category	Financial Reporting Objective	Component Level Financial Statement(s) that Helps Achieve the Objective	Analysis – How well has objective been achieved?	Enhancements – What improvements are needed?
	accomplishments have been financed; and the management of the entity's assets and liabilities.			
	<p><u>Sub-objective 1</u></p> <p>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.</p>			
	<p><u>Sub-objective 2</u></p> <p>Federal financial reporting should provide information that helps the reader to determine the efforts and accomplishments associated with federal programs and the changes over time and in relation to costs.</p>			
	<p><u>Sub-objective 3</u></p> <p>Federal financial reporting should provide information that helps the reader to determine the efficiency and effectiveness of the government's management of its assets and liabilities.</p>			
Stewardship	<p><u>Overall</u></p> <p>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.</p>			
	<p><u>Sub-objective 1</u></p> <p>Federal financial reporting should provide information that helps the reader to determine whether the government's financial position improved or</p>			

Financial Reporting Objective Category	Financial Reporting Objective	Component Level Financial Statement(s) that Helps Achieve the Objective	Analysis – How well has objective been achieved?	Enhancements – What improvements are needed?
	deteriorated over the period.			
	<p><u>Sub-objective 2</u></p> <p>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.</p>			
	<p><u>Sub-objective 3</u></p> <p>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.</p>			
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 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.			
	<p><u>Sub-objective 1</u></p> <p>Federal financial reporting should assist report users in understanding whether financial management systems and internal accounting and administrative controls are adequate to ensure that assets are properly safeguarded to deter fraud, waste, and abuse.</p>			

Financial Reporting Objective Category	Financial Reporting Objective	Component Level Financial Statement(s) that Helps Achieve the Objective	Analysis – How well has objective been achieved?	Enhancements – What improvements are needed?
	<p><u>Sub-objective 2</u></p> <p>Federal financial reporting should assist report users in understanding whether financial management systems and internal accounting and administrative controls are adequate to ensure that performance measurement information is adequately supported.</p>			

ABBREVIATIONS

CFO	Chief Financial Officer
CIGIE	Council of the Inspectors General on Integrity and Efficiency
FASAB	Federal Accounting Standards Advisory Board or Board
GAGAS	Generally Accepted Government Auditing Standards
OECD	Organization for Economic Co-operation and Development
IPERA	Improper Payments Elimination and Recovery Act
IPSASB	International Public Sector Accounting Standards Board
MD&A	Management's Discussion and Analysis
RSI	Required Supplementary Information
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards

KEY TERMS

Federal Financial Reporting Supply Chain refers to the processes used in delivering financial information.

Reporting model refers to the financial statements, terminology, and methods used to communicate basic federal financial information