Federal Accounting Standards Advisory Board

June 12, 2018

Memorandum

MEMBER ACTIONS REQUESTED:

- Provide answers to the questions on page 9 by June 22, 2018.

To: Members of the Board

Ross Simms

From: Ross Simms, Assistant Director

Wendy M. Payne

Through: Wendy M. Payne, Executive Director

Subj: Required Supplementary Stewardship Information – **TAB E**[1]

OBJECTIVES

The objective is to select an alternative for improving stewardship investment information currently presented as required supplementary stewardship information (RSSI).

BRIEFING MATERIALS

The briefing material includes this memorandum.

BACKGROUND

During the April 2018 meeting, the Board agreed to eliminate the RSSI category and present stewardship investments in management's discussion and analysis (MD&A). Staff noted that the RSSI "category" is not understood by the financial reporting community; however, the only component of the category, stewardship investments, provides information about the government's long-term investments. Various analysts seek information on the government's long-term investments. However, to do so, they

[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.

consult the data provided in the Budget of the U.S. Government ("the Budget") rather than the aggregated RSSI. The Board believed that stewardship investments reporting provides important information which should be presented in MD&A. In developing guidance, staff could consider the approach used for presenting tax expenditures.

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 .

Improving RSSI – Stewardship Investments

Why the Board Undertook this Project?

Users and the financial reporting community did not completely understand the Board's intent for the RSSI category. The Board established the RSSI category in the mid-90s based on the notion that a unique category was needed to highlight information regarding the government's stewardship, such as investments that provide long-term benefits. Stewardship information required non-financial data, projections, and other elements the Board believed did not articulate with the basic financial statements. However, audit guidance for RSSI was not developed and the financial reporting community was not clear whether RSSI was essential to fair presentation.

After completing the reporting model concepts, staff conducted outreach to preparers, auditors, and users to identify improvement opportunities. Outreach revealed that the cost of providing stewardship investment information in RSSI may not be justified by the benefits of doing so.

Development of a Proposal

The Board decided to eliminate the RSSI category and present the RSSI element, stewardship investments, in MD&A. To develop a proposal for eliminating the RSSI category and addressing stewardship investments, staff considered the Board's conceptual framework. The conceptual framework guides the Board in developing standards and discusses:

- user's needs and the objectives of Federal financial reporting,
- how to communicate information in financial reports,
- the need for the Board to make judgments about the costs and benefits of requiring information,
- the qualitative characteristics of information in financial reports,
- the Board's approach to developing standards, and
- the government-wide versus component reporting entities.

<u>Users' Needs and the Objectives of Federal Financial Reporting</u>

Information on stewardship investments would be useful to users of the financial statements. Statement of Federal Financial Accounting Concepts (SFFAC) 1, *The Objectives of Federal Financial Reporting*, discusses users' needs which define the objectives of Federal financial reporting. SFFAC 1 notes that users need information on the government's contribution to the nation's future well-being.[2] While reporting on an entity's stewardship investments in non-federal physical property, human capital, and

[2] SFFAC 1, par. 143.

research and development address expenditures that provide long-term benefits for the nation, the reporting may not be viewed as comprehensive given the various definitions of “investment” used in the Budget and by public policy analysts. Further, the reporting does not include information about the degree to which stewardship investments increase economic growth and provide benefits to the nation over an extended period. Discussing stewardship investments in general purpose federal financial reports (GPFFR) could help users determine the provisions that the government is making for the future. However, important contextual information is lacking and a comprehensive definition of “investment” has yet to be developed.

<u>How to Communicate Information in Financial Reports</u>

Once the Board reclassifies or eliminates stewardship investments, the RSSI category will be eliminated. SFFAC 6, *Distinguishing Basic Information, Required Supplementary Information, and Other Accompanying Information*, provides guidance on the categories for presenting information in GPFFRs and eliminated references to the RSSI category. SFFAC 6 notes that the Board plans to eliminate the RSSI category once it reclassifies all the RSSI components.[3] Currently, stewardship investments is the sole component of RSSI. All the other components have been reclassified or eliminated through a series of standards amending SFFAS 8, *Supplementary Stewardship Reporting*.

<u>Cost of Presenting Information versus Its Benefits</u>

Presenting the RSSI category is an exercise that consumes resources but does not provide intended benefits. Users seek disaggregated budgetary-basis information presented in the Budget. The Board recognizes that developing financial reporting standards is not a simple progression from determining users’ needs to requiring the information. The Board also considers the cost of implementing standards versus the benefits of providing the information.[4] Reporting entities incur costs to present stewardship investment information in two separate sections of the GPFFR—basic financial statements and RSSI. If management determines that stewardship investments are an important part of the entity’s mission, stewardship information is already included in the statement of net cost (SNC) and in its agency performance report (APR).

<u>Qualitative Characteristics of Investments</u>

Staff is concerned about the reliability and relevance of stewardship investments. For instance, there may not be a direct cause and effect relationship between a Federal government expense and an improvement in the economy. Users would need information on factors that are beyond the Federal government’s control, such as actions of state governments. In addition, the stewardship objective concerns the nation as a whole and focusing entirely on the Federal government could mislead users. Stewardship objective roundtable participants noted that assessing stewardship

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[3] SFFAS 8, par. A15.
[4] SFFAC 1, par. 151.

involves all sectors and, in addition to information on investments, data is needed from the National Income and Product Accounts and Flow of Funds Balance Sheets.[5] Regarding the reliability of information, SFFAC 1, paragraph 160 states

> Nothing material should be omitted from the information necessary to represent faithfully the underlying events and conditions, nor should anything be included that would likely cause the information to be misleading to the intended report user.

Also, instead of explicitly focusing on targets for investments, Congress focuses on targets for spending and receipts, the deficit or surplus, and the amount of debt. In addition, analysts refer to the Budget for investment information. SFFAC 1, paragraph 161 states that information is relevant if it is capable of making a difference in a user's assessment of a problem, condition, or event.

In addition, staff is concerned about definitional issues regarding investments. Distinguishing investments from other expenses is a matter of judgment. The Office of Management and Budget (OMB) notes that the definition of investments used in particular circumstances can vary 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 [Analytical Perspectives, Federal Investments 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.[6]

[5] FASAB Staff Memo, Conceptual Project--Objectives Phase TAB A, March 10, 2006.
[6] Fiscal Year 2019, Budget of the U.S., Analytical Perspectives, p. 227.

The Board's Approach to Developing Standards

The Budget presents investment information that addresses users' needs and the Board's concepts note that the Budget is "the most widely recognized and used financial report of the federal government."[7] 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. OMB Circular A-11, *Preparation, Submission and Execution of the Budget*, provides guidance for investments.

Also, users need performance information to assess whether investments are accomplishing their objectives and reporting entities prepare detailed annual performance reports (APR). OMB Circular A-11 provides guidance for reporting the information.

The Board acknowledged that sources other than financial reports may provide information to achieve the reporting objectives. SFFAC 1, paragraphs 36 and 37 state

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

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

The Board does provide standards to facilitate the reliability of budgetary data. With respect to budgetary data, SFFAC 2, paragraph 64 notes

> The assurance as to reliability of the information could be accomplished by including a **statement of budgetary resources** in the reporting entity's financial statements, recognizing that the statement will likely be subject to audit…

The Government-wide versus Component Reporting Entities

The government-wide reporting entity may best communicate stewardship information. The Board noted that the government as a whole is responsible for the nation's defense and general welfare and financial statements and RSI should collectively assist users in understanding the government's investments in productivity and economic growth during the period.[8] However, component reporting entities assist users in understanding the investments consistent with their mission.[9]

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[7] SFFAC 1, par. 67.
[8] SFFAC 8, *Federal Financial Reporting*, par. 39.h.
[9] SFFAC 8, par. 42.f.

Users would likely review the government-wide GPFFR for stewardship investment information. SFFAC 1, par. 134 states

> 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.

As noted earlier, stewardship concerns the government as a whole and the nation, a broader perspective than the operating performance objective. The operating performance objective concerns component reporting entities and their programs.[10]

What Changes in Stewardship Investment Reporting?

Staff suggests rescinding SFFAS 8, *Stewardship Reporting*, in its entirety. SFFAS 8 established the RSSI category and discusses the nature of stewardship information. However, the Board has reclassified or eliminated all the RSSI elements except stewardship investments. SFFAS 8 currently requires reporting trends in stewardship investment expenses. Staff's proposal would remove this requirement and the definitions of the stewardship investment components— non-federal physical property, human capital, and research and development—from the standards.

Because analysts do seek investment information, a new standard could state that MD&A of the Financial Report of the U.S. Government (CFR) should include:

1. a discussion on the definition of the term 'investments' as used in the Budget,

2. factors to help users place investment information in an appropriate context, such as considering expenditures to improve national productivity and enhancing economic growth and the limitations of the information,

3. examples of the types of investments, such as physical capital, research and development, and education and training, and

4. a statement regarding the availability of published information on investments, such as the Budget, and how that information can be obtained.

Also, in the basis for conclusions section of the standard, the Board could encourage practices to help users better access and analyze the data and present results. For instance, the Board could encourage using hyperlinked text and the presentation of investment data in machine-readable format. Users could access the data, prepare trends, and present visualizations.

[10] For example, SFFAC 1, paragraph 126 states that financial reporting should provide information that helps the reader determine the costs of providing specific programs and activities and the composition of, and changes in, these costs.

In addition, existing standards, such as SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*, provides guidance to facilitate the reliability of budgetary data used to report investments. Thus, the Board could have an indirect role in investment reporting.

Questions for the Board

1. Which of the following alternatives does the Board support?

    a. Staff's Response to the Board's April 2018 Conclusion - MD&A of the CFR presents a discussion on investments and refer users to the Budget. SFFAS 8 would be rescinded in its entirety, including the term 'stewardship investments.' Also, component reporting entities would not be required to discuss stewardship investments. The basis for conclusions of the proposed standard could encourage using hyperlinked text and the presentation of investment data in machine-readable format to help users access and analyze the data and present the results.

    b. Management has discretion in determining whether MD&A of the CFR and component reporting entities would include a discussion on stewardship investments. Reporting entities would discuss stewardship investments if management determines it to be a major program presented in the Statement of Net Cost (SNC). Management would also discuss its approach for determining the major programs presented in the SNC. SFFAS 8 would be rescinded in its entirety; however the term and definition of 'stewardship investments' would be presented in a new standard.

    c. MD&A of the CFR and component reporting entities should include a discussion and trend information regarding stewardship investments. SFFAS 8 would be rescinded in its entirety; however the term and definition of 'stewardship investments' and the reporting guidance would be presented in a new standard.

    d. Staff Recommendation - Management has the discretion to discuss stewardship investments in the APR. If investments are important to the entity's mission, management could report investments in the APR along with results. SFFAS 8 would be rescinded in its entirety; however the term and definition of 'stewardship investments' would be retained in a new standard. The basis for conclusions could explain that definitions could be used in discussing the entity's performance. Also, to help users access the information, the basis for conclusions could encourage reporting entities to provide stewardship investment data in machine-readable format in presentations such as the APR.

2. What other suggestions do members have regarding guidance for presenting investments in MD&A?