



April 3, 2008

Memorandum

To: Members of the Board

From: Ross Simms, Assistant Director

Through: Wendy M. Payne, Executive Director

Subj: **The Financial Reporting Model – TAB E¹**

MEETING OBJECTIVES

The purpose of the discussion will be to review and approve a draft project plan. As a result of the discussion, staff expects to begin conducting research to develop conceptual guidance.

BRIEFING MATERIALS

The Attachment provides the draft project plan. Topics covered in the plan are as follows:

- Project objective
- How this Project would Improve Federal Financial Reporting
- Scope
- Milestone I: Review Current Accrual Basis Financial Statements
- Milestone II: Review Other Current Statements
- Milestone III: Assess the Need for Additional Statements
- Milestone IV: Develop Enhancements to Concepts

Also, each milestone includes a discussion of the milestone objective and the proposed approach for accomplishing the objective.

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.

BACKGROUND

In 2003, the Board began to actively review and modify its concepts statements as needed. The Board's desire to evaluate its concepts after more than twelve years of successful progress is stimulated by a realization that (a) some critical concepts that have been relied on are not yet included in a concepts statement, (b) certain aspects of the concepts are not widely understood or accepted, and (c) an expansion or modification of its concepts statements will help the Board communicate more effectively with the growing community of federal financial report users, preparers, and auditors. Enhancing the concepts would help guide the Board in consistent decisions as issues evolve.

The FASAB issued its initial reporting model concepts, Statement of Federal Financial Accounting Concepts (SFFAC) 2, *Entity and Display*, in April 1995. Subsequently, complex reporting issues arose that indicated a need to enhance the concepts. For example, the Board noted that with the enactment of the Results Act that performance reporting is evolving and some details of SFFAC 2 may need to be revised.² In addition, conditions developed that elevated the need for sustainability information and the Board is in the process of considering the most useful method for communicating that information. Moreover, the Board developed additional financial statements for the consolidated financial report (CFR)³ which have not been described in the concepts.

As part of the overall project to review and expand its conceptual framework, the FASAB initiated the Financial Report project in October 2006. The project involves reexamining and enhancing the framework to provide criteria for choosing among categories of information and describing the financial statements that should be used to communicate basic information (reporting model).⁴ The Board began developing criteria for choosing among categories of information, in part, because of the issues that developed regarding how to communicate complex information in the most useful manner to financial report users. There are several broad financial reporting objectives each with sub-objectives that require financial and non-financial information. In addition, reporting information to achieve those objectives raises the issue of how the information should be classified.

In March 2008, the FASAB developed proposed concepts to provide guidance in determining whether information should be basic information, required supplementary information or other accompanying information and staff now plans to begin the next step in the Financial Report project - describing the reporting model. Appendix II: Excerpts of SFFAC 2, of the Attachment, shows the financial statements and their descriptions that are currently presented in the concepts.

² Statement of Federal Financial Accounting Concepts (SFFAC) 3, *Management's Discussion and Analysis*, par. 62.

³ Statement of Federal Financial Accounting Standards (SFFAS) 24, *Selected Standards for the Consolidated Financial Report of the United States Government*.

⁴ For the purposes of this project, the term reporting model refers to the financial statements that should be used to communicate basic information.

ISSUE

Does the Board agree with the draft project plan?

1. Does the plan include all the topics the Board would like to discuss?
2. Does the Board wish to omit any topic?
3. Does the Board agree with the proposed approach?
 - a. Does the Board believe that research should begin with the current financial statements?
 - b. Of the current statements, does the Board believe that research should begin with the statement of net cost?

The proposed plan involves reviewing existing financial statements and using the knowledge gained to help identify financial reporting objectives that have not yet been addressed. The plan considers that the broad reporting objectives require statements that serve different roles and, to serve these different roles, some statements are prepared using a different basis than others. For example, currently some statements are prepared using an accrual basis while others are prepared using budgetary principles or involve projections. Research on the existing statements would begin with the accrual basis statements and, upon their completion, staff will review the remaining statements. Because of its importance in assessing government performance, the first statement staff plans to review would be the statement of net cost.

Unlike a business, the federal government does not normally charge fees for the services it provides and expenses cannot be matched against revenue to determine net income.⁵ However, the federal government does incur expenses and disburses funds to pay for the cost of services provided. Statement of Federal Financial Accounting Concepts (SFFAC) 1, *Objectives of Federal Financial Reporting*, par. 124 states, "...Nonetheless, expenses can be matched against the provision of services year by year. The resulting cost can then be analyzed in relationship to a variety of measures of the achievement of results." Also, in November 2006, the Board noted that the operating performance objective is its primary near-term focus objective⁶ and the information provided by the statement of net costs is intended to help achieve it.

In addition, because the statement of net costs articulates with other statements, information gained from research on the statement can be used in evaluating the role of other statements. For example, the need to include depreciation information in the cost of producing outputs was one of the considerations for determining what items to recognize on the statement of financial position (commonly referred to as a balance sheet).⁷

⁵ Statement of Federal Financial Accounting Concepts (SFFAC) 1, *Objectives of Federal Financial Reporting*, par. 124.

⁶ FASAB's Strategic Directions, November 2006, page 16. Available at: <http://www.fasab.gov/stratdirections.html>.

⁷ Statement of Federal Financial Accounting Standards (SFFAS) 23, *Eliminating the Category National Defense Property, Plant, and Equipment*, par.33.

If you have questions or need additional information, please contact me at 202-512-2512 or by email at simmsr@fasab.gov as soon as possible. I will be able to consider and respond to your request more fully in advance of the meeting.

Attachment

**ATTACHMENT
DRAFT PROJECT PLAN**

FINANCIAL REPORTING MODEL PROJECT PLAN

Project Objective

The FASAB's initiative to revisit its conceptual framework has included a project on reexamining the current set of financial statements (reporting model). The objective of the project is to develop concepts that describe the financial reporting model and how it relates to the reporting objectives. Appendix I: Objectives of Financial Reporting, lists the reporting objectives.

How this Project would Improve Federal Financial Reporting

Concepts would provide a framework for guiding the Board in determining the financial statements necessary to achieve the broad reporting objectives. Knowledge of these concepts should help preparers, auditors, and users to understand the purposes of each statement and the information that they are designed to provide. Also, enhancing readers' understanding may assist them in selecting and evaluating the information they need for assessing accountability and decision-making.

The need to enhance readers' understanding of the statements is demonstrated in current practice. Although not required, federal entities are describing the role of each financial statement in their financial reports. Many agencies include a description of the financial statements in the introduction to the statements, while others include it in management's discussion and analysis or in the notes.⁸ Also, the consolidated financial report (CFR) includes discussions on the purpose of each financial statement and a chart showing how the statements relate to each other.⁹ In addition, in September 2005, the Government Accountability Office issued a document entitled, *Understanding the Primary Components of the Annual Financial Report of the United States Government* (GAO-05-958SP) to help readers gain an understanding of the information in the CFR, including the financial statements. Providing guidance may help constituents understand the FASAB's intent for financial statements.

Scope

The project will focus on describing the set of financial statements for agencies and the CFR. Also, staff will review existing concepts to determine the need for enhancements. Appendix II: Excerpts of SFFAC 2, *Entity and Display*, shows the financial statements that are discussed in the current concepts and their description.

⁸ *Accountability Reporting Trends and Techniques: A Survey of Federal Agencies' Accountability Reporting Practices*, KPMG LLP, Summer 2007, pp. 46-47.

⁹ *2007 Financial Report of the United States Government*, Department of the Treasury, p. 8.

Milestone I: Review Current Accrual Basis Financial Statements

Milestone Objective

The objective for this milestone is to review the existing accrual basis financial statements and determine what statements are necessary for meeting the reporting objectives.

Milestone Approach

Staff plans to consider progress on other FASAB projects and conduct the following:

1. Revisit the existing statement of net cost and determine:
 - a. What is the purpose of the statement?
 - b. How does the statement contribute to achieving the reporting objectives?
 - c. Can readers use the information it provides to assess accountability and facilitate decision making?
 - i. If so, how?
 - ii. If not, what enhancements may be needed?
 - d. How does the statement relate to other statements?
2. Based on the above, develop a description of the financial statement's role.
3. Considering the results of the review of the statement of net costs, revisit the other existing accrual basis statements and determine:
 - a. What is the purpose of the statement?
 - b. How does the statement contribute to achieving the reporting objectives?
 - c. Can readers use the information it provides to assess accountability and facilitate decision making?
 - i. If so, how?
 - ii. If not, what enhancements may be needed?
 - d. How does the statement relate to other statements?
4. Based on the above, develop descriptions of the other accrual basis statements' role.

Milestone II: Review Other Current Statements

Milestone Objective

The objective for this milestone is to review the existing statements prepared using budgetary principles or based on projections and determine how each relates to the reporting objectives.

Milestone Approach

Staff plans to consider progress on other FASAB projects and conduct the following:

1. Revisit other existing statements and determine:
 - a. What is the purpose of the statement?
 - b. How does the statement contribute to achieving the reporting objectives?
 - c. Can readers use the information it provides to assess accountability and facilitate decision making?
 - i. If so, how?
 - ii. If not, what enhancements may be needed?
2. Based on the above, develop a description of each financial statement's role.

Milestone III: Assess the Need for Additional Statements

Milestone Objective

The objective for this milestone is to identify “gaps” or reporting objectives that are not adequately addressed through existing and proposed financial statements.

Milestone Approach

Considering the results of the previous milestones and on-going projects such as Social Insurance and Fiscal Sustainability Reporting, staff plans to review each reporting objective and assess whether existing and proposed financial statements adequately contribute to achieving them. For those objectives that are not being adequately addressed through existing and proposed financial statements, staff plans to develop suggestions to help achieve them.

Milestone IV: Develop Enhancements to Concepts

Milestone Objective

The objective of this milestone is to develop enhancements to existing concepts that describe the reporting model.

Milestone Approach

Review the descriptions developed in the previous milestones, assess the need for enhancements to existing concepts, and develop amendments to existing concepts statements.

Appendix I: Objectives of Federal Financial Reporting

Objective 1--Budgetary Integrity

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

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

Objective 2--Operating Performance

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

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

Objective 3--Stewardship

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

- 3A. Whether the government's financial position improved or deteriorated over the period.
- 3B. Whether future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due.
- 3C. Whether government operations have contributed to the nation's current and future well-being.

Objective 4--Systems and Control

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

- 4A. Transactions are executed in accordance with budgetary and financial laws and other requirements, consistent with the purposes authorized, and are recorded in accordance with federal accounting standards;
- 4B. Assets are properly safeguarded to deter fraud, waste, and abuse; and
- 4C. Performance measurement information is adequately supported.

Appendix II: Excerpts from SFFAC 2, *Entity and Display*

Appendix II: Excerpts from SFFAC 2, *Entity and Display*¹⁰

Financial Statements Discussed	Current SFFAC 2 Description
Balance sheet	The financial reporting objectives are also met with different types of financial statements. A financial statement that presents financial information for an entity as of a particular point in time, however the information is measured, i.e., budgetary, cash, or accrual, is often characterized as a stock statement. An example of a stock statement is a balance sheet . It presents the total balances of assets, liabilities, and net position of an organization as of a specific time. (Par. 57)
Statement of Net Cost	The Federal Government and most of the other reporting entities in the Federal Government are spending entities whose objective is to provide services, some of which are financed by revenues received from the recipients of the service, and some of which, if not all or most of which, are financed by taxes and other unearned revenues. ⁸ Thus, the most useful information a flow statement could present is the total and net costs of the services, i.e., how much of the services provided by the entity was financed by the taxpayers. This type of statement, which would be a statement of net costs , would support the achievement of Federal financial reporting objective 2A. Objective 2A states that “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.” (Par. 59)
Statement of Changes in Net Position	As indicated, revenues provided in exchange for the services, i.e., earned revenues, are not the only manner in which a Federal Government entity finances the services it provides. Other sources of financing are the appropriations received from the Congress, and such various non-exchange revenues as fines, donations, and transfers from other agencies. Therefore, another useful flow statement would be a statement of changes in net position that presents the manner in which the entity’s net costs were financed and the resulting effect on the entity’s net position. This also would be consistent with Federal financial reporting objective 2: “Federal financial reporting should assist report users in evaluating. . .the manner in which these efforts and accomplishments have been financed....” (Par. 60)
Statement of Custodial Activities	The collection of the major sources of funds for the appropriations, e.g., taxes, royalty payments, and fines, is the responsibility of just a few reporting entities, especially the Internal Revenue Service, the Customs Service, and the Minerals Management Service. These entities are functioning in a custodial capacity and are required to turn the taxes or other monies they collect over to the Treasury or other organizations. The results of these entities’ custodial activities could be reported in a flow statement that provides an understanding of from whom the taxes or other monies were collected and to whom they were distributed. This would be called a statement of custodial activities . (Par. 61)
Statement of Budgetary Resources	<p>Meeting the first objective of SFFAC No. 1, “Objectives of Federal Financial Reporting,” namely the budgetary integrity objective, necessitates that the reader receive assurance that</p> <ul style="list-style-type: none"> •the amounts obligated or spent did not exceed the available budget authority, •obligations and outlays were for the purposes intended in the appropriations and authorizing legislation, •other legal requirements pertaining to the account have been met, and •the amounts are properly classified and accurately reported. (Par. 63) <p>This information is provided in other reports, but there needs to be auditor involvement to provide assurance as to the reliability of the information. The assurance as to reliability of the information could be accomplished by including a statement of budgetary resources in the reporting entity’s financial statements, recognizing that the statement will likely be subject to audit. The presentation of data could be for the reporting entity as a whole, for the major suborganization units (assuming there is congruity among the major suborganization units and the budget accounts), or for the aggregations of the major budget accounts, rather than for the individual budget accounts of the entity or other types of entities. Violations of budgetary integrity at the account level occurring during the current year could be disclosed on an exception basis. (Many violations of budgetary integrity would also be violations of the Anti-Deficiency Act. Disclosure in the financial statements notwithstanding, these violations would also have to be reported as required by the Act.) (Par. 64)</p>

¹⁰ The excerpts are intended to show the financial statements discussed in the concepts statement. Presently, SFFAC 2 does not discuss all the basic financial statements presented in practice, such as the Statement of Social Insurance.

Appendix II: Excerpts from SFFAC 2, *Entity and Display*

Financial Statements Discussed	Current SFFAC 2 Description
Statement of Financing	<p>Subobjective 1C of the budgetary integrity objective states that information is needed to help the reader to determine “how information on the use of budgetary resources relates to information on the costs of program operations and whether information on the status of budgetary resources is consistent with other accounting information on assets and liabilities.” This objective arises because accrual-based expense measures used in financial statements differ from the obligation-based measures used in the budgetary reports. (Par. 64A)</p> <p>To satisfy this objective, information is needed about the differences between budgetary and financial (i.e., proprietary) accounting that arise as a result of the different measures. This could be accomplished through a Statement of Financing that reconciles the budgetary resources obligated for a federal entity’s programs and operations to the net cost of operating that entity. The data presented could be for the reporting entity as a whole, for the major suborganization units, for major budget accounts, or for aggregations of budget accounts, rather than for each individual budget account of the entity. (Par. 64B)</p>
Statement of Program Performance Measures	<p>The second objective of Federal financial reporting states, in part, that Federal financial reporting should provide information that helps readers of the financial reports determine the efforts and accomplishments associated with Federal programs and the changes over time and in relation to costs. This suggests that a statement of program performance measures,⁹ i.e., one or more statements presenting service efforts and accomplishments measures for each of a reporting entity’s significant programs, is necessary. Par. 65</p> <p>⁹ The Board does not consider the Statement of Program Performance Measures to be a basic financial statement.</p>