



July 12, 2007

Memorandum

To: Members of the Board

From: Ross Simms, Assistant Director

Through: Wendy M. Comes, Executive Director

Subj: Conceptual Framework: The Federal Financial Report (TAB F)¹

The Financial Report project is the third phase of the five-phased conceptual framework acceleration plan and involves reviewing the key components of financial reports that help achieve the financial reporting objectives and reviewing the financial statements used to present the elements critical to meeting them. Information may be presented in financial reports using different methods. Those methods include financial statements, disclosures, management's discussion and analysis (MD&A), required supplementary information (RSI) other than MD&A, and other accompanying information (OAI). The Board has acknowledged that the placement of information in financial reports can be a factor that determines how much attention that information receives. Also, the format of the financial report can matter to certain financial report readers.² The objective of the project is to develop a concepts statement that would:

1. Establish criteria for determining when financial statements, disclosures, MD&A, RSI other than MD&A, and OAI should be used in meeting the reporting objectives (communication methods); and
2. Describe the financial statements used to present the elements critical to meeting financial reporting objectives and explain what constitutes a full set of financial statements (overview of basic financial statements).

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.

² SFFAS 25, par. 38

Staff prepared an outline of planned topics to discuss in a proposed concepts statement focusing on the first of the above objectives. As the project progresses, staff intends to develop sections of the outline to present and obtain the Board's views on the sections and the initial direction of the proposed concepts statement. As the document evolves and the Board's views on topics materialize, some previously prepared sections may be revised or revisited. This approach will facilitate a consistent message throughout the document. Staff began obtaining the Board's feedback at the November 2006 meeting and Attachment I, beginning on page 7, provides a summary of the Board's views to date.

As noted above, staff has focused on the first objective, determining when a means of communication should be used, and has revised the outline to **only** focus on that objective. The main idea for this version is to provide a "model" of the concepts that may be relevant for determining the appropriate methods of communicating information within a financial report, and to determine at the meeting: 1) whether members believe that the approach will lead to a useful tool for guiding the Board as it deliberates the contents of standards; and 2) what issues are most important to members and may need further development. Attachment II, beginning on page 11, provides the current outline which includes the following:

- Preamble – The preamble explains the purpose of concepts statements and notes that the proposed concepts statement is part of a series of concepts statements. It will mirror the preamble in the final *Elements of Accrual Basis Financial Statements and Basic Recognition Criteria* and text will be inserted when that document is finalized.
- A discussion on the General Purpose Federal Financial Report (GPFFR) – provides an overall description of the report and the methods of communicating information within the report. The purpose of the section is to provide the context for discussing each communication method.
- The proposed purpose and features of each method of communication.
- A proposal for choosing among each method.
- Appendix C of the outline provides an overview of the proposed role and other features for each method, except OAI which will be added as the other methods are further developed.

With respect to the first project objective (communication methods), the purpose for the meeting is to discuss the Board's views on the overall approach and proposed concepts presented in the model. Particular questions to consider for the discussion are as follows:

1. Does the Board believe that the overall approach will provide a helpful tool for deliberating in the context of standards which method of communicating information within a financial report is appropriate?
2. What additional tools may be needed to support deliberation on the method of communicating information?

3. Questions regarding some of the key assertions in the proposal.

- a. Does the Board agree with the proposal that financial statements and disclosures communicate information that is essential to the reporting objectives, has the interest of a wide audience, and is expected to possess a higher level of credibility? (see page 19)
- b. Does the Board agree with the proposal that accrual and non-accrual-based financial statements are needed to report on the activities of the federal government? (see page 20)
- c. Does the Board agree with the proposed major purposes of disclosures? (see page 22)
- d. Does the Board agree with the proposed characteristics of RSI? (see page 22)
- e. The MD&A section helps provide a picture of a GPFFR, but it primarily summarizes the concepts stated in SFFAC 3. Does the Board believe that an MD&A section is necessary for this document, considering that it discusses concepts already presented? (see page 24)
- f. Given the FASAB's GAAP status, does the Board wish to explore the development of non-authoritative vehicles for encouraging and assisting agencies in reporting information as OAI? If not, should this concept statement address the Board's intentions with respect to encouraging or not encouraging OAI? (see page 25)
- g. Does the Board believe that each method of communication is important for inclusion in a GPFFR, considering that each method serves a different role? (see page 26)
- h. Does the Board agree with the approach of developing a series of decisions that may be made in selecting a communication method? (see page 27)

To facilitate your analysis, Attachment III, beginning on page 31, provides excerpts of the guidance provided by the Governmental Accounting Standards Board (GASB) and the Financial Accounting Standards Board (FASB) concerning the placement of information. A chart comparing the two sets of guidance is provided on page 32. Staff intends to make revisions to the proposed concepts and further develop sections based on the Board's determinations.

With respect to the second project objective (overview of basic financial statements), we are seeking approval of two recommendations. As you may recall, the Board requested last year that the conceptual framework be accelerated and greater emphasis was placed on conceptual framework projects. After review of the existing concepts (SFFAC 2, *Entity and Display*) and in light of the active projects (Social Insurance and Fiscal Sustainability) that are likely to result in standards related to modifying or adding to the basic financial statements, we suggest that (1) SFFAC 2 be amended as needed rather than being superseded and (2)

that amendments related to ongoing standards projects be accomplished as those standards are developed.

This approach would involve reviewing the SFFAC 2 text related to display and identifying any areas where improvements that would not be accomplished through ongoing standards projects warrant the investment of Board resources at this time. If improvements are desirable, an exposure draft presenting amendments to the text would be prepared.

The amendment of SFFAC 2 through the development of new standards was done with SFFAS 7, *Accounting for Revenue and Other Financing Sources*. SFFAS 7 added text explaining the conceptual basis for the requirement for a Statement of Financing and how it related to the objectives as well as inserting an illustration in SFFAC 2. Similarly, the project on fiscal sustainability is expected to result in both concepts and standards. The concepts would explain the need for any new statements that result (by explaining the general format of the statements and their relationship to the reporting objectives) while the standard would require the information. Staff believes the approach used in SFFAS 7 is an efficient model in light of the existing SFFAC 2.

Staff is seeking your concurrence to approach the overview of basic financial statements portion of this project as described above. I would then proceed with a review of SFFAC 2 and staff assigned to the Social Insurance and Fiscal Sustainability projects would plan to include amendments to SFFAC 2 in the scope of their projects.

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.

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ATTACHMENT I
SUMMARY OF BOARD VIEWS

As of March 2007

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SUMMARY OF BOARD VIEWS		
MEETING	QUESTION/ ITEM FOR DISCUSSION	BOARD VIEW
November 2006	<p>1. Staff presented an outline of planned topics to discuss in a proposed concepts statement. The outline included the following objectives for the project.</p> <ul style="list-style-type: none"> a. Describe the financial statements used to present the elements critical to meeting financial reporting objectives and explain what constitutes a full set of financial statements; and b. Establish criteria for determining when financial statements, disclosures, MD&A, RSI other than MD&A, and OAI should be used in meeting the reporting objectives. 	<p>The order of the proposed objectives should be revised. The project should first establish criteria and second describe the financial statements. The revised order of the objectives is as follows:</p> <ul style="list-style-type: none"> • Establish criteria for determining when financial statements, disclosures, MD&A, RSI other than MD&A, and OAI should be used in meeting the reporting objectives; and • Describe the financial statements used to present the elements critical to meeting financial reporting objectives and explain what constitutes a full set of financial statements. <p>Also, it should be clear that the existing set of financial statements is not the end result. They may serve as a starting point for determining underlying concepts.</p>
January 2007	<p>2. Whether to conduct two types of outreach activities - roundtable meetings to discuss agency Performance and Accountability Report (PAR) issues and an educational session on cost accounting. Constituents had recently raised concerns that PARs have grown too voluminous and that agencies are not developing cost information to integrate with performance reporting, such as reporting the cost of specific programs and the amount spent on achieving results. Staff proposed the outreach efforts as a way to inform constituents on existing FASAB guidance and to gather information on whether additional FASAB guidance is needed.</p>	<p>The financial reporting project involved many broad subjects which required analysis. Consequently, the project needs further development before proceeding with outreach activities.</p>
January 2007	<p>3. Staff noted that management is responsible for the fair presentation of financial statements in accordance with generally accepted accounting principles (GAAP), and management is responsible for assertions that are implicit in financial reporting. Those assertions have an important role in determining what is presented in the financial report. However, much of the discussion on management's responsibility for financial reporting is found in auditing literature rather than in accounting literature.</p>	<p>A concept statement, such as the proposed concept statement on the federal financial report, may not be the best vehicle to discuss these topics. Management's responsibilities should be discussed in a standard or other vehicle because concept statements primarily guide the Board in its standards-setting activities.</p>

SUMMARY OF BOARD VIEWS			
MEETING	QUESTION/ ITEM FOR DISCUSSION	BOARD VIEW	
March 2007	4. Does the Board agree that performance information is an integral part of financial reporting and of general purpose federal financial reports (GPFFR).	Performance information is an integral part of financial reporting and the GPFFR. However, this does not preclude developing alternative formats.	
March 2007	5. Does the Board agree to continue monitoring the progress in performance reporting rather than exploring the performance reporting topic at this time.	Continue monitoring progress in performance reporting rather than exploring the topic at this time. Staff will participate in work groups engaged in reviewing PAR formats and developing strategic directions for a financial reporting model.	
March 2007	6. Does the Board agree that the GPFFR components should be limited to those that are currently defined in professional literature and that are familiar to users, such as financial statements, disclosures, RSI (including MD&A), and other accompanying information. Existing GPFFRs primarily use the established reporting components such as financial statements, disclosures (notes), RSI (including MD&A and performance information), and other accompanying information. Commonly known reporting components will likely help ensure that users understand the importance of the information included in GPFFRs.	The project should focus on the existing components of the GPFFR - financial statements, disclosures, MD&A, RSI, and OAI, rather than exploring other possibilities. Although these components are audit status categories, they are discussed in the FASAB literature and are used by preparers.	

ATTACHMENT II
OUTLINE OF PROPOSED CONCEPTS STATEMENT

OUTLINE OF PROPOSED CONCEPTS STATEMENT COMMUNICATION METHODS IN FEDERAL FINANCIAL REPORTS

- I. Transmittal Letter [To be developed (TBD)]
- II. Preamble – Will be identical to the Elements preamble when it is finalized.
- III. Table of Contents [TBD]
- IV. Executive Summary
 - A. What is the Board proposing?
 - a) Within the framework of general purpose federal financial reports (GPFFR)³ that contain financial statements for component entities and the Federal Government as a whole, this Concepts Statement would establish criteria for determining when a means of communicating information (recognition in financial statements, presentation in disclosures to financial statements,⁴ presentation as required supplementary information (RSI) other than MD&A, presentation in management’s discussion and analysis (MD&A), and presentation as other accompanying information (OAI)) should be used in meeting the reporting objectives.
 - B. Why is the Board making this proposal?
 1. Need to enhance existing concepts, help address emerging issues, and incorporate concepts relied upon that are not yet in a concepts statement
 - a) Enhance existing concepts
 - (1) Existing concepts⁵ describe the GPFFR and identify the types of communication methods that may be used within the report. Those methods include recognition in financial statements, presentation in disclosures to financial statements, presentation as RSI other than MD&A, presentation in MD&A, and presentation as OAI. In addition, the concepts suggest different types of statements that may be used to communicate information about an entity.
 - (2) Given that there are several broad financial reporting objectives each with sub-objectives that require a variety of information, several financial statements and other communication methods may be used to help achieve the objectives. However, the concepts are currently not explicit in the “lines” that separate each method of communication necessary for achieving the financial reporting objectives. Discussing these matters would help to determine the appropriate communication method to use. As a result,

³ The term general purpose federal financial report, abbreviated “GPFFR,” is used as a generic term to refer to the report that contains the entity’s financial statements that are prepared and audited pursuant to the CFO Act of 1990, as amended.

⁴ Disclosures are an integral part of basic financial statements. However, for the purposes of this statement, they are discussed separately.

⁵ SFFAC 2, *Entity and Display*, and SFFAC 3, *Management’s Discussion and Analysis*

clarification is needed to help the Board in selecting and constituents in responding to proposals on the communication method most appropriate for presenting information within GPFFRs.

b) Emerging issues

- (1) Since the issuance of the initial concepts, substantial progress has been made in federal financial reporting and the community of federal financial report users, preparers, and auditors has grown. Along with the progress and growing community came various issues that the concepts needed to address, such as the reporting of sustainability information and the reporting of financial and performance information. Included in the issues are questions regarding what method should be used to communicate the needed information.
 - (a) In its *Strategic Directions* document, the FASAB noted that Operating Performance and Stewardship objectives were its primary near-term focus objectives. These objectives offer the greatest opportunity for the FASAB to play a direct role by developing standards to achieve the stated objectives. The overall Operating Performance objective states that 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.
 - (b) The Stewardship objective of financial reporting states that federal financial reporting should provide information that helps the reader to determine:
 - i) Whether the government's financial position improved or deteriorated over the period;
 - ii) Whether future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due; and
 - iii) Whether government operations have contributed to the nation's current and future well-being.
- (2) Thus, the Stewardship objective includes an analysis of financial position. The objective seeks information on whether the government's financial position improved or deteriorated and the long-term implications of the budgetary process. The information necessary for the analysis is also necessary for achieving the Operating Performance objective. The Operating Performance objective calls for information about assets and liabilities which contributes to information on financial position.
- (3) Conditions have developed that have elevated the need for information concerning fiscal sustainability and its placement in a financial report. Presently, the nation is experiencing a large and growing long-term fiscal imbalance. Financial report users need information to help them understand and evaluate the current status and longer-term sustainability of federal

programs. To determine how to effectively communicate this information and achieve the stewardship reporting objective, the FASAB has requested the recommendations of a group of experts with technical knowledge relevant to the issues and/or communications expertise relevant to the challenge.

- (4) Another topic that has evolved since the FASAB developed its initial set of concepts is the preparation of a report that combines financial statements and other information in a single document. The report is commonly known as a Performance and Accountability Report (PAR) for a Federal agency. The PAR evolved from various financial management reforms that required agencies to prepare several reports in different formats which at times caused duplication of efforts.⁶ The various reports included audited financial statements, an Annual Performance Report required by the Government Performance and Results Act of 1993 (GPRA), and other information. The desire to integrate information contained in separate reports and provide a comprehensive picture of each agency's performance led to the Reports Consolidation Act (RCA) of 2000. The RCA permitted and encouraged agencies to consolidate their annual financial statements and performance information in a single report, a PAR.
- (5) A PAR is comprehensive and includes a wealth of information. For example, it contains information on an agency's mission, goals, achievements, financial results, internal control and compliance, areas needing improvement and plans for improvement, improper payment efforts, and management challenges. However, constituents have noted that the benefits of consolidating information may be countered by the voluminous size of the report and information overload. Information overload may hinder its understandability. In addition, constituents noted that the goal of linking financial and non-financial performance information needs improvement.
- (6) Cost is a financial performance measure and the FASAB issued managerial cost accounting standards to assist in efforts to integrate financial and non-financial performance information. While SFFAS 4, *Managerial Cost Accounting Standards and Concepts* became effective in 1998, agencies continue to experience challenges in fully implementing the requirements⁷ and in reporting reliable cost information.⁸
- (7) Given these and other concerns with the PAR, the financial reporting community is considering methods of improving the format of the information. This may involve issues of where information should be reported within a

⁶ Report of the Committee on Governmental Affairs United States Senate to Accompany S.2712, To Amend Chapter 35 of Title 31, United States Code, to Authorize the Consolidation of Certain Financial and Performance Management Reports Required of Federal Agencies, and for Other Purposes, Report 106-337, July 11, 2000.

⁷ *Financial Management: Achieving FFIA Compliance Continues to Challenge Agencies*, Government Accountability Office, September 2005, GAO-05-881.

⁸ Testimony Before the Subcommittee on Government Management, Organization, and Procurement, Committee on Oversight and Government Reform, House of Representatives, *Fiscal Year 2006 U.S. Government Financial Statements: Sustained Improvement in Federal Financial Management Is Crucial to Addressing Our Nation's Accountability and Fiscal Stewardship Challenges*, Government Accountability Office, March 20, 2007, GAO-07-607T.

financial report and proposals are being considered for ways to streamline the existing report and make it a more useful tool for decision-making. One alternative currently being considered includes separating the document into two reports – a financial report (includes the MD&A, financial statements, disclosures, RSI, and OAI) and a performance report. Agencies that prepare the two reports would also be required to prepare a highlights document. The highlights document would summarize the details in the financial and performance reports.

- c) Concepts relied upon but not included in concepts statements - summarize the Board's consideration of concepts used in developing standards such as
 - (1) Implementation Guide to SFFAS 7, *Accounting for Revenue and Other Financing Sources*
 - (2) SFFAS 25, *Reclassification of Stewardship Responsibilities and Eliminating the Current Services Assessment*
 - (3) SFFAS 26, *Presentation of Significant Assumptions for the Statement of Social Insurance: Amending SFFAS 25*
 - (4) SFFAS 29, *Heritage Assets and Stewardship Land*

 - 2. This concepts statement would provide useful guidance to the Board and its constituents. Important roles of the conceptual framework include identifying methods of communicating information and describing when a method should be used. This statement provides this information and helps those affected by or interested in standards to understand better the purposes, content, and characteristics of information provided in federal financial reports.
- C. How would this proposal improve financial reporting?
- 1. Enhance the framework regarding financial statements and other communication methods
 - a) Help the Board and constituents in understanding the functions and limitations of financial statements and other communication methods within GPFRRs.
 - b) Assist the Board and constituents in understanding how financial statements and other communication methods relate.
 - c) Assist in selecting appropriate means of communicating information within GPFRRs.

 - 2. Facilitate the understandability, consistency, and comparability of financial reporting
- D. How does this proposal contribute to meeting the federal financial reporting objectives?
- 1. Providing guidance on communication methods would contribute to consistency in reporting and assist users in understanding the location and nature of information in financial reports. This also contributes to the overall objective of demonstrating accountability and providing useful information as well as helping to achieve specific

objectives of budgetary integrity, operating performance, stewardship, and internal control.

V. Acronyms [TBD]

VI. Questions for Respondents [TBD]

VII. Introduction

A. This statement describes the methods of communicating information within a GPFFR and provides conceptual guidance for selecting the method appropriate for the information to be reported.⁹ The complex nature of the federal government and its extensive financial reporting objectives necessitates different methods of communicating information within a GPFFR. The different methods of communicating information include:

1. Recognition in financial statements
2. Presentation through disclosure
3. Presentation as RSI other than MD&A,
4. Presentation in MD&A, and
5. Presentation as OAI

VIII. Proposed Concepts

A. GPFFRs

1. Advantages of GPFFRs

- a) A GPFFR communicates information to meet the common needs of diverse users. These users typically do not have the authority to specify the basis, form, and content of the reports they receive. A GPFFR is also comprehensive and provides information relevant to the financial reporting objectives¹⁰ to help users obtain the information they need for assessing accountability and for decision-making.
- b) The financial reporting objectives are broad and require information on various topics. For example, they call for information to assist users in understanding:

⁹ It should be noted that before deciding which method of communication is most appropriate, a decision must be made regarding whether to include an item of information in a GPFFR. Concepts that provide guidance on whether to include an item in a GPFFR are discussed in earlier SFFACs, such as SFFAC 1, *Objectives of Federal Financial Reporting*, which discusses the financial reporting objectives and the qualitative characteristics of information in financial reports. This statement contains concepts that are consistent with the concepts established in the earlier SFFACs which are not superseded or modified by this Statement.

¹⁰ SFFAC 1, *Objectives of Federal Financial Reporting*, describes the objectives of financial reporting.

- (1) how budgetary resources have been obtained and whether their acquisition and use were in accordance with the legal authorization;
- (2) how much government programs cost, how were they financed, and what did they accomplish;
- (3) whether the government's financial position improved or deteriorated over the period;
- (4) whether future budgetary resources will likely be sufficient to sustain public services and meet obligations; and
- (5) whether the government's internal controls are adequate to safeguard assets, detect likely problems, and adequately support performance measurement information.

2. Limitations of GPFFRs

- a) A GPFFR is not intended to provide all the information necessary for assessing accountability and decision-making or all the information to achieve the reporting objectives. Other reports and information sources may be beneficial to users and help achieve the reporting objectives. For example, the Budget of the United States Government is the foremost vehicle for making decisions such as how much to spend, on what programs to spend, and how to raise money necessary to accomplish goals. Also, the Government Accountability Office (GAO) and Inspectors General investigate how the federal government spends money and provides reports on whether money was spent in accordance with its intended purpose.
- b) Moreover, legislation and administrative directives require information that helps achieve the reporting objectives. For instance, legislation and the Office of Management and Budget's (OMB) directives on performance reporting and internal control resulted in providing information on the efforts and accomplishments of federal programs and the adequacy of internal control.¹¹ Appendix B illustrates the relationship of a GPFFR and other sources of information that contribute to demonstrating accountability and decision-making.
- c) As discussed in SFFAC 1, financial reporting focuses on the performance of the government entity, not necessarily the performance of management. For example, the stewardship objective involves how the "government's" operations have contributed to the nation's well-being. Also, the operating performance objective concerns the efforts, costs, and accomplishments of the "reporting entity." Although management's performance contributes to the performance of the government entity, many events and circumstances are beyond management's control, such as changes in the nation's economic conditions. A GPFFR may be limited in distinguishing management's performance from the performance of the government entity. Additional information sources may be needed to facilitate such an analysis. [May need to discuss more or clarify this paragraph]

¹¹ For example, the Federal Manager's Financial Integrity Act of 1982 and OMB directives require reporting on internal control. In addition, the GPRA requires agencies to prepare strategic plans, annual performance plans, and annual performance reports and the OMB provides guidance and oversight.

3. A GPFFR for the Federal Government as a Whole
 - a) In addition to the above role and limitations, there are unique considerations for a GPFFR for the federal government as a whole. The GPFFR for the federal government is a GPFFR that is consolidated from agency reports and directs users to information in other formats (individual agency reports, websites, etc.).¹²
 - b) While a GPFFR is generally directed to five user groups (Citizens, Citizen Intermediaries, Congress, Federal Executives, and Program Managers), the report is primarily directed to citizens and citizen intermediaries (the media, public interest and advocacy groups). Also, information in GPFFRs should be reliable, relevant, consistent, comparable, understandable and timely. However, considering that the GPFFR for the federal government contains complex, aggregated information directed to citizens and citizen intermediaries, the qualitative characteristics of understandability and timeliness are particularly fundamental.¹³ SFFAC 4, *Intended Audience and Qualitative Characteristics for the Consolidated Financial Report of the United States Government*, provides a detailed discussion of these concepts.
4. Methods of Communicating Information within a GPFFR
 - a) Providing an array of information in the most useful and cost-effective manner requires consideration of the adequacy of existing information and consideration of the types of communication methods. Financial and non-financial information and narrative descriptions may be needed to communicate an adequate picture of the government's budgetary integrity, operating performance, stewardship, and systems and control. For example, to present an agency's performance in delivering a program, information on the number of consumers served and the cost of serving them may be needed. Also, narrative information, including reasons for significantly exceeding goals, may be used to help readers assess the agency's performance. Methods that help the GPFFR to communicate information are financial statements, disclosures, RSI, MD&A, and OAI. Appendix C provides an overview of each method.
 - b) Financial statements and disclosures provide the means of communicating information that is essential to the reporting objectives. This information must be prepared in conformity with standards and existing practices commonly known as generally accepted accounting principles (GAAP).
 - c) The FASAB has a unique influence in federal financial reporting because the FASAB standards are used in preparing financial reports and developing financial management systems. FASAB standards also provide the criteria that independent auditors use in measuring whether financial statements and disclosures are presented fairly in accordance with GAAP.

¹² SFFAC 4, *Intended Audience and Qualitative Characteristics for the Consolidated Financial Report of the United States Government*, par. 6.

¹³ SFFAC 4, par. 9.

- d) The discipline of preparing financial statements and disclosures in accordance with GAAP helps improve federal financial reporting and management. Preparing financial statements and disclosures utilizing a recognized set of standards leads to consistent definitions and measures and meaningful information. It also requires internal control and financial management systems that are capable of achieving the requirements. These processes help lead to reliable information useful for demonstrating the results of government activities and for decision-making.
- e) In light of the overall role of financial statements and disclosures, the other methods accompany financial statements and disclosures to enhance users' understanding of the entity's performance and future prospects. The following provides additional features of each method.

B. Financial Statements and Disclosures¹⁴

1. As noted earlier, financial statements and disclosures provide the methods of communicating information essential to the reporting objectives. This information has the interest of a wide audience who expect the information to possess a higher level of credibility. This information must be prepared in conformity with GAAP and subjected to independent audit.

Question 3 a

Does the Board agree with the proposal that financial statements and disclosures communicate information that is essential to the reporting objectives, has the interest of a wide audience, and is expected to possess a higher level of credibility?

2. Although they are both essential for achieving the reporting objectives, there are characteristics that distinguish financial statements and disclosures. Those characteristics are discussed below.

3. Financial Statements

¹⁴ [Board projects such as Elements and Basic Recognition Criteria of Accrual-Basis Financial Statements and Sustainability Reporting may provide additional concepts that will inform this discussion.]

- a) Financial statements are the principal method of communicating accounting information to users.¹⁵ They recognize¹⁶ elements such as assets, liabilities, revenues, expenses, and budgetary accounting elements. Elements comprise the building blocks of financial statements.
- b) Items that are elements of financial statements and that meet basic recognition criteria are candidates for recognition in financial statements. The basic recognition criteria are (a) the item meets the definition of an element of financial statements and (b) the item is measurable.¹⁷ Unrecognized elements are candidates for disclosure or RSI.
- c) Reporting on the multi-faceted activities of the federal government calls for accrual and non-accrual based financial statements.
 - (1) Accrual-based financial statements are derived from the process of accrual accounting,¹⁸ articulate with one another and present elements recognized in monetary units.
 - (2) Non-accrual basis financial statements also recognize elements in monetary units and present budgetary resources and financial projections related to financial condition.

Question 3 b

Does the Board agree with the proposal that accrual and non-accrual-based financial statements are needed to report on the activities of the federal government?

¹⁵ SFFAC 2, par. 54.

¹⁶ The term recognize refers to the process of formally recording or incorporating an element into the financial statement of an entity. Recognition comprises depiction of an element in both words and numbers, with the amount included in the totals of the financial statements. For an asset or liability, recognition involves recording not only acquisition or incurrence of the item but also later changes in it, including changes that result in removal from the financial statements. Exposure Draft: Elements of Accrual-Basis Financial Statements and Basic Recognition Criteria, par. 4.

¹⁷ Exposure Draft: Elements of Accrual-Basis Financial Statements and Basic Recognition Criteria, par. 5

¹⁸ Accrual accounting records the effects on a reporting entity of transactions and other events and circumstances in the periods in which those transactions, events, and circumstances occur rather than only in the periods in which cash is received or paid by the entity. It starts with raw cash flows and varies the timing of their recognition to coincide with the events that cause the cash flows. Accrual accounting is also concerned with: measuring costs and revenues for a period; measuring asset and liability positions at the beginning and end of the period; and analyzing the reasons for change from one period to another.

- d) In the Federal Government, there are several types of reporting entities (organizations, suborganizations, programs, and the government as a whole) and several financial reporting objectives (budgetary integrity, operating performance, stewardship, and systems and control). Each reporting objective can be met to a certain degree by the statements prepared by or for one type of entity and to a greater or lesser degree by the statements prepared by or for the other types of reporting entities. (SFFAC 2, par. 56)
4. Disclosures to Financial Statements
- a) Disclosures are items reported in notes that are integral to financial statements. Disclosures help in achieving the financial reporting objectives by providing:
 - (1) Explanations that are essential to a users' understanding of items recognized in financial statements, including relevant measures of those items other than the measure in the financial statements and descriptions of accounting policies supporting amounts recognized;
 - (2) Details on items that do or do not meet recognition criteria, which may include a useful measure of those items; Note, however, that disclosure is not a substitute for recognition.
 - (3) Information to help users assess risks associated with recognized and unrecognized items; and
 - (4) Information to assist in comparing budgetary and accrual basis measures used in reporting, such as reconciling the use of budgetary resources information with accrual-basis cost information.

Question 3 c

Does the Board agree with the proposed major purposes of disclosures?

- b) Disclosures may be narrative presentations or a quantitative presentation, such as a schedule with explanations.
- c) Disclosures focus on financial statement elements. They are not intended to provide an overall analysis of past performance and future prospects.

C. RSI¹⁹

1. RSI is information required to accompany financial statements. However, unlike disclosures, this information is not considered essential for fair presentation in accordance with GAAP. RSI may communicate important information that may be experimental in nature. This permits the communication of information that is relevant and important to the reporting objectives while additional accounting issues are being further researched. The information may be non-monetary or include information expressed in monetary units.

Question 3 d

Does the Board agree with the proposed characteristics of RSI?

2. Additional Considerations for RSI [TBD]

¹⁹ [Board projects such as Elements and Basic Recognition Criteria of Accrual-Basis Financial Statements and Sustainability Reporting may provide additional concepts that will inform this discussion.]

D. MD&A²⁰

1. To enhance the overall understandability and usefulness of a GPFFR, information is presented in the MD&A. The MD&A provides context for the financial statements and disclosures and may include items that do not meet the definition of elements. It integrates information to provide a concise analysis of an entity's financial and performance results and prospects for the future and information on compliance and management systems and internal control. It also provides readers with insights into the key information used in managing the entity. The basic concepts for MD&A are discussed in SFFAC 3, *Management's Discussion and Analysis*. It states that:
 - a) The MD&A is an important vehicle for (1) communicating managers' insights about the reporting entity, (2) increasing the understandability and usefulness of the general purpose federal financial report (GPFFR), and (3) providing understandable and accessible information about the entity and its operations, service levels, successes, challenges, and future.²¹
 - b) It should address the reporting entity's performance measures, financial statements, systems and controls, compliance with laws and regulations, and actions taken or planned to address problems. The discussion and analysis of these subjects may be based partly on information contained in reports other than the GPFFR. MD&A also should address significant events, conditions, trends and contingencies that may affect future operations.²²
2. Providing the above information contributes to the reporting objectives. For example, discussing the entity's performance measures provides information on the operating performance objective, and discussing the financial statements informs users on stewardship. Also, presenting information about systems and control and compliance helps achieve the systems and control and budgetary integrity objectives.
3. Although MD&A provides information for each of the objectives, it is not intended to be a verbose discussion vehicle. In presenting information, MD&A discusses the most important matters that will probably affect the judgments and decisions of users relying on the GPFFR.²³ For example, the MD&A may discuss the most important results during the period, the cost of achieving them, and how the results relate to goals, e.g. where the goals met? In addition, management may discuss the challenges that could affect performance and how those challenges are being addressed. Relevant charts and other graphics may be used to support narrative discussions, emphasize information, show trends, or illustrate proportions.

²⁰ [Board projects such as Elements and Basic Recognition Criteria of Accrual-Basis Financial Statements and Sustainability Reporting may provide additional concepts that will inform this discussion.]

²¹ SFFAC 3, Executive Summary.

²² SFFAC 3, par. 1

²³ SFFAS 15, Management's Discussion and Analysis, par. 6.

4. The MD&A is also useful as a stand-alone highlights document for a novice reader with little technical background. SFFAC 3 provides additional concepts and discusses the relationship of the reporting objectives to information in the MD&A.

Question 3 e

The MD&A section helps provide a picture of a GPFFR, but it primarily summarizes the concepts stated in SFFAC 3. Does the Board believe that an MD&A section is necessary for this document, considering that it discusses concepts already presented?

E. OAI²⁴

1. OAI includes information that may be presented beyond the minimum reporting requirements. Preparers may consider this information necessary for demonstrating accountability and decision-making and may elect to present it along with the MD&A, basic financial statements and disclosures, and RSI.

²⁴ [Board projects such as Elements and Basic Recognition Criteria of Accrual-Basis Financial Statements and Sustainability Reporting may provide additional concepts that will inform this discussion.]

Question 3 f

In 1996, prior to the FASAB's designation as the accounting standards-setting body for the federal government, the Board issued a standard that provided guidance for reporting information in OAI. SFFAS 7, *Accounting for Revenue and Other Financing Sources*, included guidance for reporting tax gap information (taxes or duties due from non-compliant tax payers or importers) and other items as OAI. The information was considered necessary to help users understand the extent of non-compliance with laws, but constituents believed that the information was too imprecise to be "required." Subsequently, FASAB received the designation from the American Institute of Certified Public Accountants and auditors began considering FASAB standards as the highest level of federal GAAP. However, the guidance for OAI remained in the standard.

Given the status of FASAB standards, constituents may not be clear whether OAI information is required supplemental or information that the Board encourages agencies to report. Other accounting standards-setting bodies, such as the Canadian Public Sector Accounting Board (PSAB), use non-GAAP vehicles to provide guidance on voluntarily reported information. The PSAB uses statements of recommended practices (SORP) rather than standards. SORPs provide general guidance to encourage and assist entities in reporting relevant information. They also assist in developing a common approach to reporting issues and facilitate comparability while permitting practice to evolve.

Given the FASAB's GAAP status, does the Board wish to explore the development of non-authoritative vehicles for encouraging and assisting agencies in reporting information as OAI? If not, should this concept statement address the Board's intentions with respect to encouraging or not encouraging OAI?

2. Relationship to the objectives of financial reporting [TBD]
 - a) Component entity
 - b) Federal Government

3. Purposes and limitations [TBD]
 - a) Component entity
 - b) Federal Government

F. Selecting a Method of Communicating Information

- a) Each communication method is important for inclusion in a GPFFR. However, some information may be better communicated by one method while other information may be better communicated by another method. The process of selecting among the methods of communication involves following a series of steps.

Question 3 g

Does the Board believe that each method of communication is important for inclusion in a GPFFR, considering that each method serves a different role?

- (1) Consider the nature of the information. Different processes may be considered based on whether the information is derived from accrual-basis or non-accrual basis reporting.
- (a) Accrual Basis Items
- i) Determine whether the information can be recognized in a financial statement, e.g. meets recognition criteria. If not, the information may be a candidate for a disclosure, RSI, MD&A, or OAI.
 - ii) Determine whether the information comprises a disclosure, such as meeting the definition of an element, but not meeting recognition criteria. If not, the item may be a candidate for RSI, MD&A, or OAI.
 - iii) For items not comprising financial statements and disclosures, determine placement by considering the purpose and features of RSI, MD&A, and OAI. For example, the MD&A provides an overview of the entity.
- (b) Non-accrual Basis Information
- i) Determine whether there are factors that indicate presentation as a financial statement or presentation in disclosures versus RSI and MD&A. Those factors include:
 - a. Significance, relevance, or importance of the item in light of the financial reporting objectives. High significance, relevance, or importance implies basic financial statement information.
 - b. Relevance to fair presentation. Can a set of financial statements be said to present fairly if information is missing or materially misstated?
 - c. The strength of the signal the Board wishes to be sent in the financial report. The stronger the signal, the more likely the

information should be considered a part of the financial statements.

- d. The strength of the signal the Board wishes to be sent in the auditor's report. The stronger the signal, the more likely the information should be considered a part of basic financial statements.
 - e. Whether a wide audience is interested in the information. Wide interest implies basic financial statement information.²⁵
- ii) Consider the distinguishing purpose and features of financial statements, disclosures, RSI, MD&A, and OAI.

Question 3 h

Does the Board agree with the approach of developing a series of decisions that may be made in selecting a communication method?

G. TBD

1. performance reporting
2. RSSI – Stewardship Investments

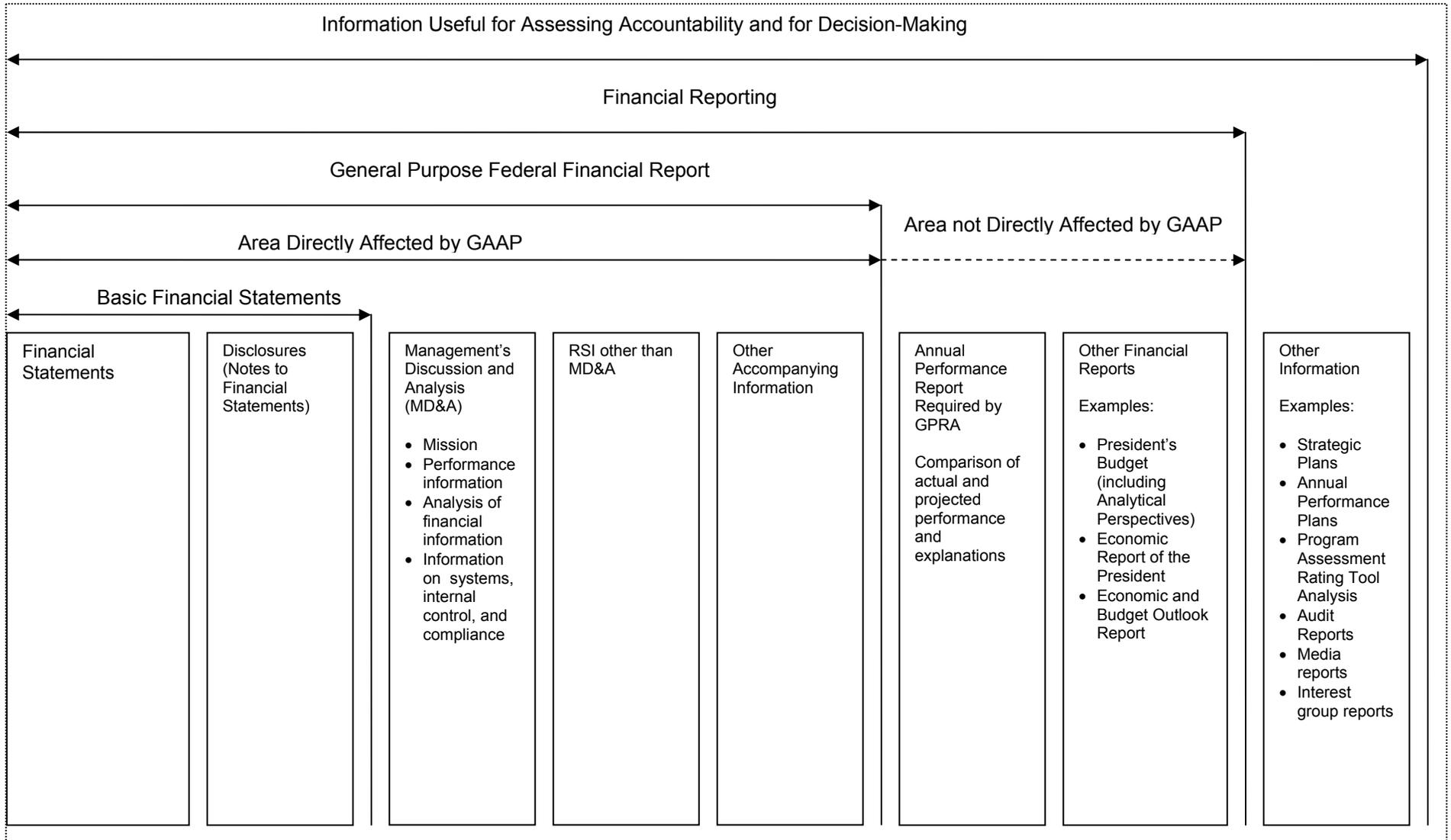
IX. Glossary

X. Appendix A: Basis for Conclusions [TBD]

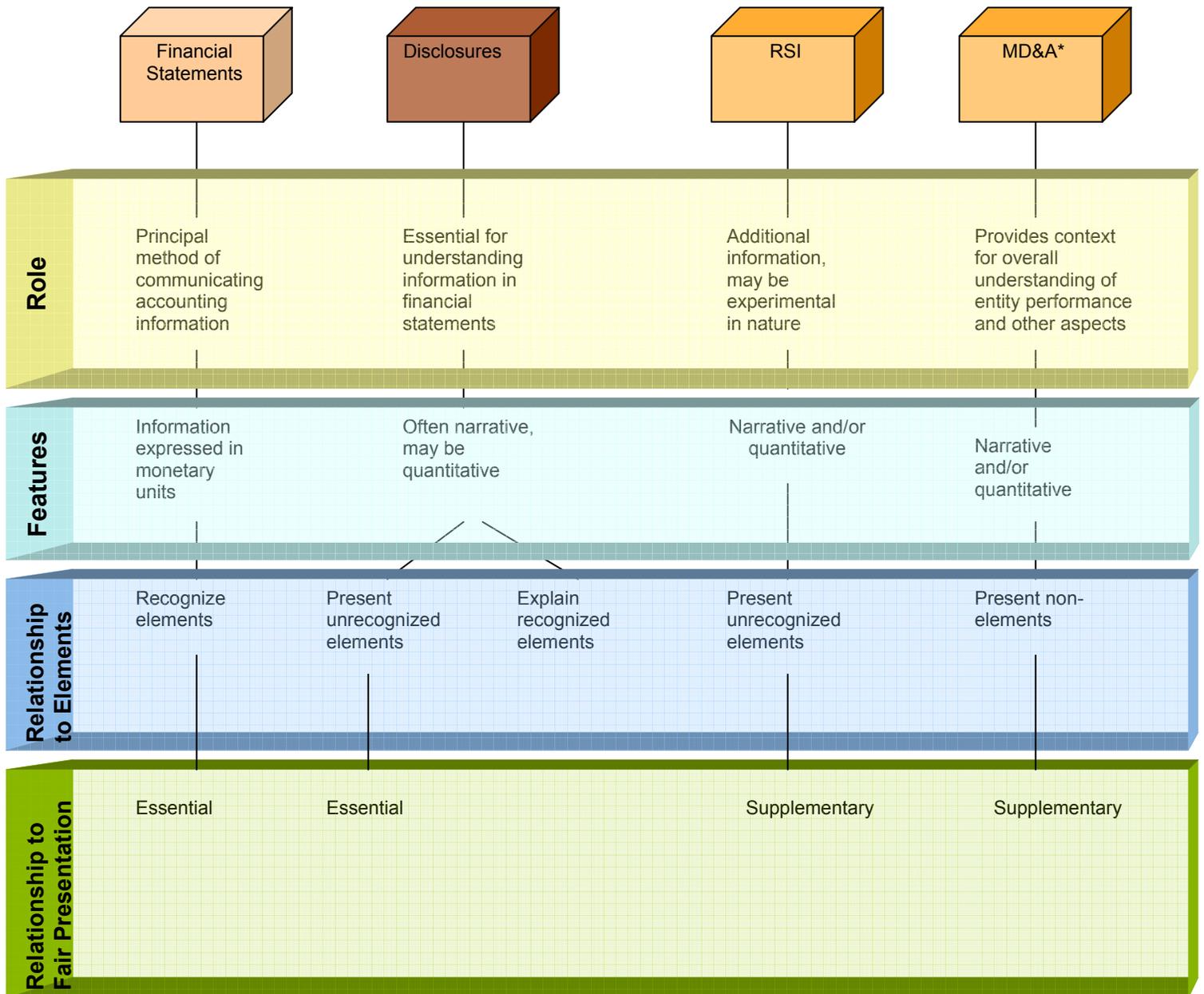
²⁵ SFFAS 25, *Reclassification of Stewardship Responsibilities and Eliminating the Current Services Assessment*, paragraph 40 and Figure 2.

Basis for Conclusion [TBD]

Appendix B: Information Useful for Assessing Accountability and for Decision-Making



Appendix C: Methods of Communicating Information in a Financial Report
 [OAI to be added later]



*Treated as RSI for audit purposes.

ATTACHMENT III
OTHER STANDARDS SETTERS' GUIDANCE ON PLACEMENT

Excerpts from Other Standards Setters

The GASB and FASB developed conceptual guidance regarding the placement of information within financial reports. The GASB developed Concepts Statement 3, *Communication Methods in General Purpose External Financial Reports That Contain Basic Financial Statements* and the FASB developed concepts in Statement of Financial Accounting Concepts (SFAC) No. 5, *Recognition and Measurement in Financial Statements of Business Enterprises*. A comparison of excerpts from the two statements is provided in the table below.

TOPIC	GASB	FASB
Scope	Focuses on financial reports that contain financial statements, notes, and supporting information. [Allows for the possibility of developing other general purpose reports that are not structured around financial statements ²⁶]	Limited to recognition and measurement in financial statements (par 8), but does discuss other methods of reporting.
Communication methods/means of financial reporting described	<ul style="list-style-type: none"> • Basic financial statements • Notes to basic financial statements • Required supplementary information (supporting information) • Supplementary information (supporting information) 	<ul style="list-style-type: none"> • Financial statements • Notes to financial statements • Supplementary information
Overall Approach	<p>Focuses on the characteristics of information and discusses a hierarchy for considering the placement of information.</p> <p>Provides a definition and criteria for each method (par. 31 – 46) and discusses the order in which each method should be considered, beginning with recognition in financial statements (par. 29).</p>	<p>As part of the guidance for recognition and measurement, provides definition of financial statements, notes to financial statements, and supplementary information (par.5-9).</p> <p>Implies a hierarchy for selecting a communication method by noting that recognition is not a substitute for disclosure by other means and the most useful information should be recognized in the financial statements (par. 9.)</p>
Regarding financial statements and disclosures (basic financial statements and notes to basic financial statements)...	“...are essential for communicating with users the financial position or inflows and outflows of resources of the reporting unit in conformity with generally accepted accounting principles. ” (emphasis added, par.39)	<p>“Financial statements are a central feature of financial reporting—a principal means of communicating financial information to those outside an entity.” (par. 5)</p> <p>“...financial statements have essentially the same objectives as financial reporting...” (emphasis added, par.7)</p> <p>“Information disclosed in notes or</p>

²⁶ Paragraph 3 of the concepts statement states, “Additional communication methods not discussed in this Statement may be needed if other general purpose external financial reports that are not structured around basic financial statements are developed in the future, such as economic condition or service efforts and accomplishments reports.”

Table: Comparison of Guidance		
TOPIC	GASB	FASB
		parenthetically on the face of financial statements, such as significant accounting policies or alternative measures for assets or liabilities, amplifies or explains information recognized in the financial statements. That sort of information is essential to understanding the information recognized in financial statements and has long been viewed as an integral part of financial statements prepared in accordance with generally accepted accounting principles. (emphasis added, par. 7)
Regarding accrual and non-accrual basis financial statements...	Does not discuss the notion of accrual and non-accrual basis financial statements.	Does not discuss the notion of accrual and non-accrual basis financial statements, but notes that financial statements articulate ²⁷ (par. 5).
Regarding RSI...	Discusses two types of supporting information – RSI and supplementary information. RSI is essential for placing basic financial statements and notes to basic financial statements in a context and is required to be presented with basic financial statements and notes. (par. 42)	“Supplementary information, such as disclosures of the effects of changing prices, and other means of financial reporting, such as management discussion and analysis, add information to that in the financial statements or notes, including information that may be relevant but that does not meet all recognition criteria.” (par. 7)
Regarding MD&A...	Not discussed as a separate method	Not discussed as a separate method, but notes other means of financial reporting, such as MD&A, adds information to that presented in financial statements or notes, including information that does not meet all recognition criteria. (par.7)
Regarding OAI	Discusses supplementary information – “useful for placing basic financial statements and notes to basic financial statements in an appropriate operational, economic, or historical context.” While the GASB does not require SI to be presented, entities are expected to follow GASB guidance regarding the format and content of that information. (par. 46)	Not discussed as a separate method, but notes other means of financial reporting adds information to that presented in financial statements or notes, including information that does not meet all recognition criteria. (par.7)

²⁷ SFAC 5, par. 23 explains that, “financial statements interrelate (articulate) because they reflect different aspects of the same transactions or other events affecting an entity.”

Excerpt from GASB Concept 3: Communication Methods in General Purpose External Financial Reports That Contain Basic Financial Statements²⁸

6.

Purpose

The principal user of the concepts in this Statement is likely to be the GASB itself. The GASB intends to apply these concepts in its deliberations of financial reporting standards in order to select the communication method or methods that will most appropriately convey the kinds of information to be required by a standard and as a framework for evaluating communication methods used under existing standards and practices. Application of the concepts in this Statement should enhance the consistency and understandability of governmental financial reporting standards and of the resulting information included in general purpose external financial reports.

7. The definitions and criteria in this Statement will also help preparers select appropriate communication methods for items of information that they choose to present in general purpose external financial reports but for which the GASB does not specifically prescribe a communication method. Greater consistency within and comparability among governments in the use of the various communication methods will enhance the usefulness of reported information.

8. The ultimate beneficiaries of improved communication of information in general purpose external financial reports are the users of those reports. The concepts in this Statement will enhance users' understanding of the functions and limitations of the various communication methods and the relationship between the method used and the information being reported. A greater understanding of these concepts will enhance users' ability to select and interpret the information they need for their decisions.

GENERAL PURPOSE EXTERNAL FINANCIAL REPORTING AND BASIC FINANCIAL STATEMENTS

9. General purpose external financial reporting (GPEFR) is a means of communicating financial information to meet the common information needs of the primary users of a government's financial report.¹ Because of the diverse nature of the information that needs to be communicated to users to meet the various objectives of financial reporting,² no single general purpose external financial report may be sufficient to adequately meet all the objectives. Information that is relevant for meeting certain financial reporting objectives may be better provided by basic financial statements, notes to basic financial statements, and supporting information presented with basic financial statements, but other information may be better provided by using other methods of communication. Therefore, some general purpose external financial reports will contain basic financial statements, notes to basic financial statements, and supporting information (the methods of communication that are the subject of this Concepts Statement), whereas other general purpose external financial reports that may be developed in the future may use other methods of communication.

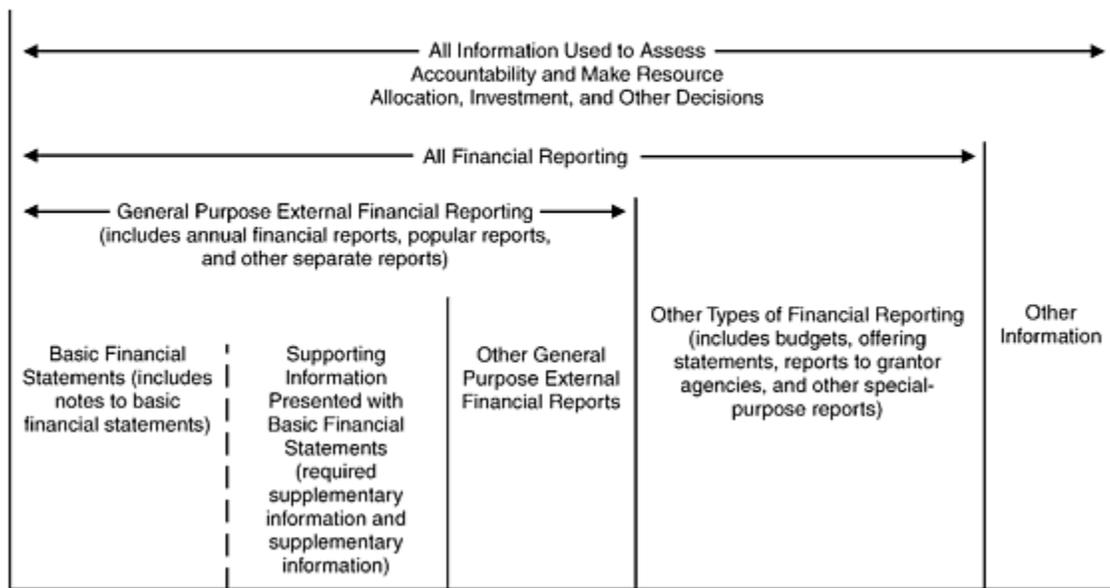
10. In a general purpose external financial report that contains basic financial statements, the *basic financial statements* and *notes to basic financial statements* are the principal means of communicating financial information to users. Supporting information—that is, required supplementary information and supplementary information—accompanies the basic financial statements and notes to place them in context.

11. Figure 1 illustrates the roles of financial reporting and GPEFR in providing information used to assess accountability and to make decisions. The figure shows the relationship between the basic

²⁸ The Concepts Statement was subsequently amended by Concepts Statement No. 4, *Elements of Financial Statements*, in June 2007. The last sentence of paragraph 31 was revised as follows: Amounts recognized in financial statements are assets, liabilities, deferred outflows of resources, deferred inflows of resources, and net position, as well as inflows of resources and outflows of resources.

financial statements, notes to basic financial statements, and the supporting information that is presented with basic financial statements in a general purpose external financial report. Other general purpose external financial reports also may be used to meet the common needs of users for other information that is necessary to assess accountability and make decisions. Information presented in "other" general purpose external financial reports may or may not have a clear and direct relationship to the information presented in general purpose external financial reports that contain the basic financial statements, notes to basic financial statements, and supporting information presented with basic financial statements.

**Figure 1
Information Used by Financial Report Users**



COMMUNICATION AND FINANCIAL REPORTING

12.

Communicating with Users of General Purpose External Financial Reports ³

Effective reporting requires the communication of relevant and reliable messages. All communication requires that a sender (that is, a communicator) generate a message or messages, which are received and understood by a recipient. In the communication of accounting information, the sender of messages is the preparer. ⁴ Messages are contained in financial reports. The recipient of messages is the user of financial reports.

13.

Preparer

The preparer is responsible for producing financial reports that recognize relevant events in the financial statements or that disclose or present messages about such events elsewhere in the financial report. Relevant events are happenings of economic or financial consequence to a reporting unit that the preparer believes have the potential to make a difference in a user's assessment of the reporting unit and should be considered within the context of the reporting objectives of a financial report.

14. The preparer is responsible for selecting events that are essential to assist the user in assessing accountability and making decisions. In selecting the events to be presented in a general purpose external financial report, the preparer is primarily guided by financial reporting standards established

by the GASB. Other factors that affect the selection of events are the decision-making tasks for which financial reports are commonly used, the information needed for these decision-making tasks, and the information that can be provided in financial reports that will help such decision making.

15. The preparer observes and makes quantifiable measurements of the events that have been selected for recognition in financial statements. The preparer also is responsible for observing and gathering the data necessary for disclosures in the notes or presentations in supporting information about such events.

16. An understanding of accounting and financial reporting principles applicable to state and local governments and the exercise of due professional care help the preparer present messages in financial reports in a clear and understandable manner. For a particular message, a preparer may choose, within the confines of financial reporting standards, the method of presentation—narrative, tabular, or graphic—that has the greatest potential to clearly transmit a message. ⁵

17.

Financial Reports

Financial reports contain messages that have been generated by the preparer for transmission to and interpretation by the user. Financial reports are not the messages themselves, but rather contain messages, which are the representations of events, depicted in the form of words and numbers. To be useful, these messages require receipt and interpretation by the user.

18. Financial reporting may take many forms depending on numerous factors, such as whether the messages are intended for use by internal management or by external users or whether the messages are intended for a specific use or a general use. General purpose external financial reports are intended to meet the common needs of various external users.

19. Concepts Statement 1 (paragraph 30) identifies three groups as the primary users of general purpose external financial reports: "(a) those to whom government is primarily accountable (the citizenry), (b) those who directly represent the citizens (legislative and oversight bodies), and (c) those who lend or who participate in the lending process (investors and creditors)." In addition, that paragraph makes it clear that internal management may also use external financial reports: "Internal managers in the executive branch of government who have ready access to financial data through internal reporting are not considered *primary* users...; however, internal users also have many uses for external financial reports."

20. Financial reports may be transmitted through various channels. One channel of communication is a report printed on paper. However, other channels, such as various forms of electronic media, are available for transmitting financial reports.

21.

User

The messages contained in financial reports are intended for users. To effectively interpret these messages, the user is responsible for obtaining a reasonable understanding of government and public finance activities and of the fundamentals of governmental financial reporting, for studying the messages with reasonable diligence, and for applying relevant analytical skills. The user's interpretation of messages may be affected by a variety of other factors including the user's past experiences and preferences (for example, risk preferences), as well as prevailing economic conditions and the availability of relevant information outside the financial report.

22. The user draws conclusions and makes decisions based on the user's interpretation of messages in financial reports or statements. Effective communication occurs when the user receives the messages that were intended to be sent and is able to draw conclusions or make decisions based on the messages.

23.

The GASB's Role in the Communication Process

A mission of the GASB is to establish and improve standards of state and local governmental accounting and financial reporting that will result in useful information for users of financial reports. Standards setters act as intermediaries between preparers and users to help ensure that relevant information is communicated in a consistent manner. The credibility and comparability of governments' financial reports are enhanced when a user knows that the reports are prepared in conformity with publicly promulgated standards established by independent standards setters regarding the selection of relevant events and the measurement and presentation of the effects of those events on the reporting unit.

24. Standards setters help preparers fulfill their role in the communication process by studying the needs of users of financial reports, by identifying the types of information needed by users in making decisions and assessing accountability, and by requiring specific messages to be included in financial reports. To provide guidance for preparers and itself when selecting the messages that should be included, the GASB determined in Concepts Statement 1 paragraphs 62-68) that information in financial reports should have certain basic characteristics.

25. Standards setters help preparers not only by providing guidance on the content of financial reports⁶ but also by selecting the communication method that should be used to convey a particular message. A communication method is a financial reporting construct that conveys information to users of general purpose external financial reports that helps meet one or more of the objectives of financial reporting (Concepts Statement 1, paragraphs 74-79).

COMMUNICATION METHODS IN GENERAL PURPOSE EXTERNAL FINANCIAL REPORTS THAT CONTAIN BASIC FINANCIAL STATEMENTS

26. The following definitions of and criteria for communication methods are intended to inform decisions regarding the placement of a particular item of information within general purpose external financial reports that contain basic financial statements, notes to basic financial statements, and supporting information. A decision to include an item of information in general purpose external financial reports precedes a decision about the placement of the information in those reports. An item of information is a candidate for inclusion in general purpose external financial reports if it (a) is consistent with the objectives of state and local government financial reporting and (b) meets the basic characteristics for the communication of information in financial reports.

27. Concepts Statement 1 (paragraphs 77-79) identifies the specific objectives of state and local governmental financial reporting. These objectives generally indicate that governmental financial reporting should provide information to assist users in (a) assessing accountability and (b) making economic, social, and political decisions (Concepts Statement 1, paragraph 76).

28. Concepts Statement 1 (paragraphs 62-68) identifies the basic characteristics that are required to exist for effective communication of information in financial reports. Those characteristics are understandability, reliability, relevance, timeliness, consistency, and comparability. Although an item of information may contain all of those characteristics to some degree, the GASB would not require its presentation in general purpose external financial reports if the perceived cost of such information exceeds the expected benefit to users. Costs that should be considered in the cost-benefit analysis include the costs of preparing, auditing, and using information (Concepts Statement 1, paragraph 73).

Hierarchy for Selecting Communication Methods

29. The selection of an appropriate communication method to convey information to users of general purpose external financial reports enhances the consistency, comparability, and understandability of information in those general purpose external financial reports. The communication method to be used to convey a particular item of information should be determined based on the following order:

- a. Recognition in basic financial statements
- b. Disclosure in notes to basic financial statements

- c. Presentation as required supplementary information
- d. Presentation as supplementary information.

30. For example, in determining the communication method that should be used to convey a particular item of information, the GASB would begin by considering whether the item of information met the definition and criteria for recognition in basic financial statements. If so, the GASB would require recognition of the item in the basic financial statements. If the item did not meet the definition and criteria for recognition in the basic financial statements but it did meet the definition and criteria to be disclosed in the notes to basic financial statements, the GASB would require the item to be disclosed in the notes. If the item did not meet the definition and criteria for disclosure in the notes but it did meet the definition and criteria for presentation in required supplementary information (RSI), the GASB would require the item of information to be presented in RSI. If the item did not meet the definition and criteria for presentation in RSI, the GASB may choose to establish standards regarding its format and content for those preparers who elect to present (or are otherwise required by law or regulation to present) the item as supplementary information.

Financial Statement

31. A governmental financial statement is a tabulation of amounts, derived from accounting records and expressed in words and dollars, that displays either (a) the financial position⁷ of the reporting unit (that is, the group of activities covered by the financial statement) at a moment in time or (b) inflows and outflows of resources from transactions or other events during a period of time. Amounts recognized in financial statements are assets, liabilities, and residual balances and the effects of transactions and other events that result in changes in those assets, liabilities, and residual balances.

32. A reporting unit may be a governmental unit (that is, it has separate legal standing), part of a governmental unit (such as governmental activities or business-type activities, a major fund, an aggregation of funds, or a segment), or an aggregation or consolidation of two or more governmental units (such as a primary government and its component units). When the reporting unit is only part of a governmental unit, the assets, liabilities, residual balances, and changes in those amounts that are included in the reporting unit's financial statements have been assigned by the governmental unit to that reporting unit for control, management, or financial reporting purposes.

33.

Criteria for Reporting Information Items in a Financial Statement

Items recognized in a financial statement are intended to provide reliable representations of the effects of transactions and other events. The term *recognition* means recording or incorporating an item into a financial statement as an asset, liability, revenue, expense, expenditure, or other element of financial statements. Recognition comprises both initial recognition and recognition of subsequent changes in or removal of previously recognized items. Recognized items are both described in words and measured in dollars. Recognized items are displayed in financial statements either individually or aggregated with similar items.

34. Items that are elements of financial statements and are measurable with sufficient reliability are recognized in financial statements. Disclosure in the notes to financial statements or presentation as supporting information is not an adequate substitute for recognition in the financial statements. Information disclosed in the notes to financial statements may provide more details about amounts recognized in the financial statements.

35.

Notes to Financial Statements⁸

Notes to financial statements are integral to financial statements and are essential to a user's understanding of financial position or inflows and outflows of resources. Notes provide:

- a. Descriptions of the accounting and finance-related policies underlying amounts recognized in financial statements
- b. More detail about or explanations of amounts recognized in financial statements
- c. Additional information about financial position or inflows and outflows of resources that does not meet the criteria for recognition.

Notes may be narrative or quantitative with appropriate explanations and may include measures other than dollars.

36.

Criteria for Disclosing Information Items in Notes to Financial Statements

Notes have a clear and demonstrable relationship to information in the financial statements to which they pertain and are essential to a user's understanding of those financial statements. In this context, "essential to a user's understanding" means so important as to be indispensable to a user (a) with a reasonable understanding of government and public finance activities and of the fundamentals of governmental financial reporting and (b) with a willingness to study the information with reasonable diligence. The use of professional judgment may be necessary for making a determination about whether an item of information is "essential to a user's understanding."

37. Unlike financial statements, notes may include management's objective explanation of recognized amounts and related known facts, contingencies, certain risks that affect financial statements, subsequent events, measurement methods, accounting policies, and other information essential to understanding the financial statements and to assess compliance with finance-related legal or contractual requirements. However, notes do not include either (a) subjective assessments of the effects of reported information on the reporting unit's future financial position or (b) predictions about the effects of future events on future financial position.

38. Items of information that meet the definition of and criteria for notes to financial statements are reported in that manner. Presentation as supporting information is not an adequate substitute for disclosure in notes to financial statements.

Basic Financial Statements and Notes to Basic Financial Statements

39. Basic financial statements and notes to basic financial statements are presentations of information that (a) meet the definition of and criteria for a financial statement or for notes to financial statements, respectively, *and* (b) are essential for communicating with users the financial position or inflows and outflows of resources of the reporting unit in conformity with generally accepted accounting principles.

Supporting Information

40. Supporting information places basic financial statements and notes to basic financial statements in an appropriate operational, economic, or historical context. By providing context, supporting information enhances the decision-usefulness of the basic financial statements and notes to basic financial statements it accompanies. This information either is required by the GASB to be presented with the basic financial statements and notes to basic financial statements, is required by laws or regulations to be presented, or is presented at the election of the preparer.

41. *Operational context* relates financial information to the activities, policies, and nonfinancial resources of a government. *Economic context* describes a government's economic environment or facilitates a comparison of financial information among governments. *Historical context* depicts a government's financial status over time and explains why a government's financial position or inflows and outflows of resources have changed. Providing historical context often involves referring to certain

information presented in prior-period statements; however, it generally should not result in repeating the entire prior-period statements.

Required Supplementary Information

42. Required supplementary information (RSI) is supporting information that the GASB has concluded is essential for placing basic financial statements and notes to basic financial statements in an appropriate operational, economic, or historical context. RSI is required to accompany the basic financial statements and notes to basic financial statements in a government's general purpose external financial report. Criteria for Presenting Information Items in RSI

43. RSI has a clear and demonstrable relationship to information in the basic financial statements or notes to basic financial statements to which it pertains.

44. RSI may include explanations of recognized amounts, analysis of known facts or conditions, or other information essential for placing the basic financial statements and notes to basic financial statements in context. However, RSI does not include (a) subjective assessments of the effects of reported information on the reporting unit's future financial position, (b) predictions about the effects of future events on future financial position, or (c) information unrelated to the financial statements.

45. Items of information that meet the definition of and criteria for RSI are presented in that manner. Information presented in RSI is distinguished from supplementary information because the RSI is *essential* for placing basic financial statements and notes to basic financial statements in a context and is required to be presented with basic financial statements and notes.

Supplementary Information

46. Supplementary information (SI) is supporting information that is useful for placing basic financial statements and notes to basic financial statements in an appropriate operational, economic, or historical context. SI is presented with the basic financial statements, notes to basic financial statements, and RSI in a government's general purpose external financial report. Although the GASB does not require SI to be presented, preparers of governmental financial reports who elect to present SI (or are otherwise required by law or regulations to present SI) with their basic financial statements, notes to basic financial statements, and RSI should follow any applicable GASB-issued or GASB-cleared guidance regarding the format and content of that information.

Endnotes

¹

Concepts Statement 1, paragraphs 7, 8, and 30.

²

Concepts Statement 1, paragraphs 74-79.

³

The discussion of the communication of accounting information in this section of the Concepts Statement benefits from the definitive contributions of communication and accounting scholars and researchers. These contributions include those of Norton M. Bedford and Vahe Baladouni, "A Communication Theory Approach to Accountancy," *The Accounting Review* (October 1962), pp. 650-659; Vahe Baladouni, "The Accounting Perspective Re-Examined," *The Accounting Review* (April 1966), pp. 215-225; and Jacob G. Birnberg, "An Information Oriented Approach to the Presentation of Common Shareholders' Equity," *The Accounting Review* (October 1964), pp. 963-971.

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Preparers produce financial reports that contain messages that are the assertions of management. Management of a government, therefore, is the ultimate sender of messages in financial reports.

⁵

A narrative presentation presents information using words (and possibly numbers) in the form of sentences and paragraphs. A tabular presentation presents information using rows and columns in the form of a table. A financial statement is one form of a tabular presentation that expresses in words and

dollars either the financial position of the reporting unit at a moment in time or the inflows and outflows of resources during a period of time. A schedule is any other tabular presentation of information expressed in words (and possibly numbers). A graphic presentation presents information using pictorial representations, diagrams, graphs, or charts.

6

Standards setters typically set minimum reporting requirements. Preparers may include additional information in their financial reports to meet the needs of users.

7

The term *financial position* is used in a broad sense and does not refer to specific financial statements, such as a "statement of financial position." In this Statement, financial position refers to the state or status of assets, liabilities, and residual balances at a moment in time.

8

Notes to financial statements are considered to be an integral part of financial statements. However, for purposes of this Statement, both a financial statement and notes to financial statements are defined as separate communication methods because each is a financial reporting construct used to convey information to users.

Excerpt from FASB Statement of Financial Accounting Concepts 5: Recognition and Measurement in Financial Statements of Business Enterprises

5. Financial statements are a central feature of financial reporting—a principal means of communicating financial information to those outside an entity. In external general purpose financial reporting, a financial statement is a formal tabulation of names and amounts of money derived from accounting records that displays either financial position of an entity at a moment in time or one or more kinds of changes in financial position of the entity during a period of time. Items that are recognized in financial statements are financial representations of certain resources (assets) of an entity, claims to those resources (liabilities and owners' equity), and the effects of transactions and other events and circumstances that result in changes in those resources and claims. The financial statements of an entity are a fundamentally related set that articulate with each other and derive from the same underlying data. ¹

6. Recognition is the process of formally recording or incorporating an item in the financial statements of an entity as an asset, liability, revenue, expense, or the like. Recognition includes depiction of an item in both words and numbers, with the amount included in the totals of the financial statements. For an asset or liability, recognition involves recording not only acquisition or incurrence of the item but also later changes in it, including changes that result in removal from the financial statements. ²

7. Although financial statements have essentially the same objectives as financial reporting, some useful information is better provided by financial statements and some is better provided, or can only be provided, by notes to financial statements or by supplementary information or other means of financial reporting: ³

Information disclosed in notes or parenthetically on the face of financial statements, such as significant accounting policies or alternative measures for assets or liabilities, amplifies or explains information recognized in the financial statements. ⁴ That sort of information is essential to understanding the information recognized in financial statements and has long been viewed as an integral part of financial statements prepared in accordance with generally accepted accounting principles.

Supplementary information, such as disclosures of the effects of changing prices, and other means of financial reporting, such as management discussion and analysis, add information to that in the financial statements or notes, including information that may be relevant but that does not meet all recognition criteria. ⁵

8. The scope of this concepts Statement is limited to recognition (and measurement) in financial statements. That limitation on scope does not alter the status of notes, supplementary information, or other means of financial reporting; those types of information remain important and useful for the reasons discussed in the preceding paragraph. To clarify the scope of this concepts Statement, the following diagram illustrates the types of information used in investment, credit, and similar decisions. [The diagram has been deleted in the electronic version of *Original Pronouncements*. If there is a need to reference this diagram, please refer to the printed version of *Original Pronouncements*.]

9. Since recognition means depiction of an item in both words and numbers, with the amount included in the totals of the financial statements, disclosure by other means is *not* recognition. Disclosure of information about the items in financial statements and their measures that may be provided by notes or parenthetically on the face of financial statements, by supplementary information, or by other means of financial reporting is not a substitute for recognition in financial statements for items that meet recognition criteria. Generally, the most useful information about assets, liabilities, revenues, expenses, and other items of financial statements and their measures (that with the best combination of relevance and reliability) should be recognized in the financial statements.

Endnotes

¹

CON5, Footnote †— Rule 203 prohibits a member of the American Institute of Certified Public Accountants from expressing an opinion that financial statements conform with generally accepted accounting principles if those statements contain a material departure from an accounting principle promulgated by the Financial Accounting Standards Board, unless the member can demonstrate that because of unusual circumstances the financial statements otherwise would have been misleading. Rule 204 requires members of the Institute to justify departures from standards promulgated by the Financial Accounting Standards Board for the disclosure of information outside of financial statements in published financial reports.

¹

FASB Concepts Statement No. 1, *Objectives of Financial Reporting by Business Enterprises*, [Group 'con1(am), par. 6'] [Group 'con1(am), par. 18'] pars. 6 and 18; Concepts Statement 3, pars. 6 and 14 and 15. *Financial position* and *changes in financial position* are used here in a broad sense and do not refer to specific financial statements. "Used broadly, financial position refers to state or status of assets or claims to assets at moments in time, and changes in financial position refers to flows or changes in assets or claims to assets over time" (Concepts Statement 3, par. 14, footnote 6). "Through the financial accounting process, the myriad and complex effects of the economic activities of an enterprise are accumulated, analyzed, quantified, classified, recorded, summarized, and reported as information of two basic types: (1) financial position, which relates to a point in time, and (2) changes in financial position, which relate to a period of time" (APB Statement No. 4, *Basic Concepts and Accounting Principles Underlying Financial Statements of Business Enterprises*, par. 10).

²

Concepts Statement 3, pars. 83, 6, 25, 26, and 34 and 35.

³

Concepts Statement 1, [Group 'con1(am), par. 5'] par. 5.

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For example, notes provide essential descriptive information for long-term obligations, including when amounts are due, what interest they bear, and whether important restrictions are imposed by related covenants. For inventory, the notes provide information on the measurement method used—FIFO cost, LIFO cost, current market value, etc. For an estimated litigation liability, an extended discussion of the circumstances, counsel's opinions, and the basis for management's judgment may all be provided in the notes. For sales, useful information about revenue recognition policies may appear only in the notes (FASB Statement No. 47, *Disclosure of Long-Term Obligations*; ARB No. 43, [Group 'arb43(am), ch.4, par. 15'] Chapter 4, "Inventory Pricing," Statement 8; FASB Statement No. 5, *Accounting for Contingencies*, [Group 'fas5(am), par. 10'] par. 10, and APB Statement 4, par. 199).

⁵

Concepts Statement 1, [Group 'con1(am), par. 6'] [Group 'con1(am), par. 7'] [Group 'con1(am), par. 22'] pars. 6, 7, and 22. Supplementary financial statements, complete or partial, may be useful, especially to introduce and to gain experience with new kinds of information. Criteria for including information in supplementary statements may have much in common with recognition criteria for primary statements discussed here, but the criteria discussed in this Statement apply specifically to primary financial statements.