

FASAB Exposure Draft: *Classified Activities*

Questions for Respondents due March 16, 2018

Please select the type(s) of organization responding to this exposure draft. If you are not responding on behalf of an organization, please select "individual."

Accounting Firm	<input checked="" type="checkbox"/>	
Federal Entity (user)	<input type="checkbox"/>	
Federal Entity (preparer)	<input type="checkbox"/>	
Federal Entity (auditor)	<input type="checkbox"/>	
Federal Entity (other)	<input type="checkbox"/>	If other, please specify: _____
Association/Industry Organization	<input type="checkbox"/>	
Nonprofit organization/Foundation	<input type="checkbox"/>	
Other	<input type="checkbox"/>	If other, please specify: _____
Individual	<input type="checkbox"/>	

Please provide your name.

Name: Jamie Cox

Please identify your organization, if applicable.

Organization: KEARNEY & COMPANY

Your responses should be sent to fasab@fasab.gov. If you are unable to respond by email, please fax your responses to 202-512-7366.

Q1. Classified information is prohibited from public release and the Board is proposing an approach for protecting classified information from unauthorized disclosure. The proposed Statement would provide general guidance for protecting classified information and, when detailed guidance is needed, the Board proposes to provide classified Interpretations¹ of existing standards. GPFFR modified pursuant to this Statement and related Interpretations would be considered in accordance with generally accepted accounting principles.

Do you agree or disagree with the Board's overall proposed approach for protecting classified information? Please provide the rationale for your answer.

Disagree. Generally Accepted Accounting Principles (GAAP) should not be modified to limit reporting of classified activities. Rather, GAAP reporting should remain the same as other Federal entities and redacted for public release or remain classified. This

¹ With respect to Interpretations, the Board would follow its due process and appropriate protections would be applied to classified information.

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approach retains the benefits of GPFFR and audited financial statements in terms of improving underlying processes, systems, and controls, as well as the usefulness of GPFFR to users, even if those users are limited.

The FASAB's proposed approach could result in material omissions in GPFFR. By FASAB's own definition, "The determination of whether an item is material depends on the degree to which omitting or misstating information about the item makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or the misstatement." If GPFFR can be modified so material activity is no longer accurately presented to the reader of financial statements, its usefulness to public users is limited and subject to misinterpretation.

Further, there is nothing precluding a GPFFR from broadly describing activity in a summary manner, which would allow classified information to be protected. The items listed in A.3 are not required to be disclosed under existing GAAP in such detail that classified information would be jeopardized.

- Military plans, weapons systems, or operations*
- Foreign Government information*
- Intelligence activities (including covert actions), intelligence sources or methods, or cryptology*
- Foreign relations or foreign activities of the U.S., including confidential sources*
- Scientific, technological, or economic matters relating to national security*
- U.S. Government programs for safeguarding nuclear materials or facilities*
- Vulnerabilities or capabilities of systems, installation, infrastructures, projects, plans, or protection services*
- Development, production, or use of weapons of mass destruction.*

We offer two alternative approaches to reporting classified activities, in order of preference, below for your consideration:

- 1. Include all required activity in the face of the financial statements. At the financial statement and line item level, classified activity is easily concealed within financial statement line item balances.*
 - Disclosure requirements alone could be modified to protect classified information within the financial statements and line items from being publicly made available.*
 - The standard should require reporting entities to first attempt to comply with existing standards and not use the classified activities standard. In coordination with the IPA, the reporting entity should attempt to broadly describe financial information, such that classified data is protected*
 - The disclosure modification should be disclosed to make users aware that relying on the information within the footnotes should be done so understanding that certain disclosures have been modified for the protection of classified information.*
- 2. Exclude the classified information from the GPFFR and disclose to readers the exclusion.*
 - Audit reports would be issued over the full and complete GPFFR. A separate audit report for the scaled down GPFFR would be separately issued and included in the*

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publicly available GPFFR. Such an audit report could be issued in accordance with AU-C Section 805, Special Considerations – Audits of Single Financial Statements and Specific Elements, Accounts, or Items of a Financial Statement.

Q2. The proposed Statement permits reporting entities to modify unclassified financial statement presentations, disclosures, and required supplementary information (RSI) to protect classified information. The modifications are (1) those that do not change the net results of operations and net position and (2) the inclusion of an organization in a manner that would not reveal classified information.

- a. Do you agree or disagree with permitting reporting entities to modify presentations to protect classified information when it does not change net results of operations and net position? Please provide the rationale for your answer.

Disagree. This approach limits the value, usefulness, and benefits of financial statements as currently defined by GAAP. Financial statements of classified entities should remain classified or redacted like other classified documents before release to the public. Please reference response to Q1.

- b. Do you agree or disagree with permitting certain modifications when applying the provisions of SFFAS 47, *Reporting Entity*, when necessary to protect classified information? Please provide the rationale for your answer.

Disagree. The integrity of current GAAP as it applies to all Federal entities should be retained. As an alternative, management of the reporting entity could opt to prepare a special purpose financial statement, or special purpose GPFFR, disclose this fact, and appropriately exclude the component. Under this scenario, the corresponding audit report would have to be for the special purpose financial statement, and not for the full and complete GPFFR.

As referenced in Q1, an audit report over the full and complete GPFFR could still be offered in the appropriate classified setting. The separate audit report would simply be over management's elected special purpose financial statements.

- c. Do you agree or disagree with permitting modifications to disclosures and required supplementary information? Please provide the rationale for your answer.

Disagree. Please reference response to Q1.

Q3. In the future, the Board may issue classified Interpretations of existing standards. The Interpretations would permit other presentation and disclosure options as needed to produce unclassified GPFFR. The other options would protect specific financial statement elements from unauthorized disclosure in an unclassified GPFFR. The classified Interpretations would be developed following a due process involving:

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- a. development of classified proposals,
- b. comment on the proposals from individuals and organizations holding appropriate clearances,
- c. consideration of comments, and
- d. issuance of Interpretations to individuals and organizations holding appropriate clearances.

Do you agree or disagree with the proposed approach? Please provide the rationale for your answer.

Disagree. Allowing only select individuals to view and accept the interpretations would limit due process and transparency. Both of these elements are crucial to the process of developing GAAP.

- Q4. The Board is proposing that recorded amounts related to classified information reconcile in aggregate to schedules or other documentation subject to audit. Documentation must be retained in the appropriate environment and/or domain to adequately support classified information.

Do you agree or disagree with the conditions necessary to apply the proposed Statement? Please provide the rationale for your answer.

Agree.

Should the Board proceed with the standard, additional requirements should be considered for the purpose of audit support, such as:

- *Formalized crosswalks of the unmodified financial statements to modified/condensed financial statements*
- *Further parameters for classification of a line item or disclosure should be included in the standard, if possible.*

It should be noted that added costs will be incurred with the development of new financial reporting infrastructure to develop two sets of financial statements (modified and unmodified), as well as additional audit costs, as both sets of financial statements will have to be reviewed and considered as part of the audit.

- Q5. The Board has considered how to inform readers of GPFRRs regarding the potential modifications given the classified nature of the modifications themselves.

- a. Do you agree or disagree with the disclosure requirements (see par. 10-14)? Please provide the rationale for your answer.

Disagree. Paragraph (par.) 11, in particular, is concerning.

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“11. Alternatively, the component reporting entity may omit disclosure of the fact that modifications in accordance with this Statement and related Interpretations were made.”

GAAP serves the purpose of providing complete, consistent and reliable information to users of financial statements. Permitting these omissions would seem to go against these purposes.

In par. 10, we believe this should be a required disclosure, not an optional disclosure when this standard is used in GPFRR. Additionally, if the standard is adopted and used, the word “may have” should be removed so as to provide full transparency to the users of the financial statements. Users of the financial statements must be informed that decisions and judgments made using the financial statements should be done so understanding that certain material information was modified for the purpose of protecting classified information.

b. Do you agree or disagree that component reporting entities may choose to consistently disclose that certain presentations may have been modified? Please provide the rationale for your answer.

Disagree.

c. Alternatively, do you believe every component reporting entity of the federal government should be required to disclose that certain presentations may have been modified? Please provide the rationale for your answer.

No, this does not seem to be necessary within the current GAAP and independent audit framework.