FASAB News

Federal Accounting Standards Advisory Board, 441 G St., 6K17V, NW.Washington, DC 20548
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FASAB Reaches Out!

For the first time in its ten-year history, FASAB ventured outside the Washington beltway in July. To be more readily accessible to a wider public, the Board met on July 3rd in conjunction with the annual conference of the Association of Government Accountants in San Francisco. In a further departure from the Board's normal procedures, the Board invited questions and comments from observers after the morning and afternoon deliberations. This led to a constructive dialogue. Highlights of the July 3 meeting follow.

The Consolidated Financial Statements (CFS)

The Board discussed the *Annual Financial Report* of the United States Government, also known as the consolidated financial statements (CFS). Copies of the report were available for the audience. Several members expressed views about the CFS and whether the Board needed one or more projects to establish standards for the CFS. The Statement of Budgetary Resources (SBR) and the Statement of Financing (SoF) were not included in the CFS, though some of the information was reported in other ways. Preparing those statements would require a data collection exercise similar to that used to prepare the other statements in the CFS. Some Board members have concerns about the applicability or relevance of both of those statements at the consolidated level

It was suggested that the CFS might be trying to do too much for too many audiences. A variety of reports may be needed. On the other hand, the financial statements still form the basis for many financial analyses.

Much progress has been made in 10 years and the remaining audit problems should be resolved in 10 years. Observers should remember that the Government has budgetary control now, but is in the process of adding a whole new system. As some problems with the new reporting system are addressed, the "noise" level is expected to be reduced, making it easier to resolve other problems; there is a synergistic relationship. Once reliable annual financial statements can be produced it also should be possible to produce better management reports.

Implementation Guide

Tom Luter, a consultant to FASAB, briefly reviewed with the Board the need to update, revise and correct the *Implementation Guide* for Statement of Federal Financial Accounting Standards 7 (SFFAS 7), *Accounting for Revenue and Other Financing Sources*. Since his retirement Mr. Luter has done considerable speaking and teaching on federal accounting. These actions have revealed the need to correct errors; in other cases clearer explanations have been developed. Also, Mr. Luter has developed different display formats that he believes provide a clearer presentation and make the financial statements tie together better. However, the Board agreed that staff should proceed with revisions to the Codification without including the *Guide*. At a future meeting, the Board will discuss alternatives for dealing with the *Guide*.

Preliminary Views

Ms. Comes briefed the audience in San Francisco on the history of the project to eliminate the Required Supplementary Stewardship Information (RSSI) category and reclassify as basic information or Required Supplemental Information (RSI) the items now classified RSSI. At the June Board meeting, some members had suggested that, before proposing reclassifications, the Board should expose a draft standard to eliminate the RSSI category. This was deemed infeasible because there is no one standard that created RSSI, so there is no one standard to rescind. As an alternative, staff had developed a draft "preliminary views" (PV) document for the Board's consideration.

A preliminary views document is a step in due process before an exposure draft of a specific proposed standard. It describes a proposed change, but does not necessarily provide all the detail found in a draft statement of standards. The Board could publish it simultaneously with, or shortly before the exposure drafts on individual items, and consider responses simultaneously. Ms. Comes noted that the effective dates that the Board considered at the June meeting could be maintained even with a slight delay to accommodate the *PV*.

Some members supported issuing the PV; others would prefer to issue one or more exposure drafts of proposed standards. The Board discussed a variety of procedural options for dealing with the issue but did not reach a final conclusion.

FASAB and Academe

NOTE: This article is intended for those with an interest in what academic research may have to say about issues in federal accounting. FASAB is sending this article to all members of the Government and Not-for-Profit Section of the American Accounting Association (AAA) to encourage further research on federal accounting issues. Nonacademics with an interest in standard setting also may find this of interest.

Background

Academic research sometimes offers insights for the standard-setter. Since its inception ten years ago, FASAB has solicited and received input from the academic community in various ways. These include FASAB's free newsletter and website, participation by AAA members on selected FASAB task forces and in public due process, presentations by FASAB staff at AAA conferences, and the presence of accounting professors on the Board. Also, FASAB cooperates with academics interested in researching federal accounting and financial reporting.

As a result of AICPA's action designating FASAB as the body that promulgates GAAP for the U.S. Government, the Board is taking further steps to assure this dialogue with academic accountants continues. FASAB's rules of procedure have been revised to establish a panel, including a representative of the Accounting Research Foundation, to recommend the three non-federal or "public" members of the Board. **Also, Board member Jim Patton (University of Pittsburgh) and Executive Director Wendy Comes will be speaking at AAA's conference in Philadelphia**.

General Issues

Research in many fields, including auditing, information systems, public finance, public administration, performance measurement, program evaluation, and political science may potentially be relevant to FASAB's projects. In particular, FASAB is explicitly concerned with managerial accounting as well as external financial reporting. Even traditional financial reporting issues need to be reconsidered in the unique context of federal financial reporting, with potentially interesting consequences for research.

Statement of Federal Financial Accounting Concepts 1 (SFFAC 1), Objectives of Federal Financial Reporting, describes the unique aspects of the federal accounting environment and objectives. The objectives encompass concern with systems and controls as well as operating performance, budgetary integrity, and stewardship. Thus, federal accounting presents ample opportunity for new research and contributions to the accounting policy process both at a general level and regarding a host of specific topics. Researching some of these topics, and properly interpreting the implications for federal accounting of research done in other contexts, presents challenges.

Not the least of these challenges arises from the fact that capital markets do not look for traditional financial accounting information from the Government in order to assess the credit-worthiness of the United States. Many economic and statistical reports from the Government can affect investors. Market participants eagerly await the release of each report on gross domestic product, the consumer price index, and a host of other data. That is not true, however, for financial statements that report on the transactions, assets, and liabilities of the U.S. Government and its component entities. Sovereign debt is rated largely on economic, social, and political factors that, for the most part, are not reflected in traditional financial statements.[i] Yet the capital market is the dominant decision model considered by FASB and is important even for GASB. An interesting question, therefore, is the extent to which inferences from research on reporting to capital markets may be relevant to FASAB's concerns.

Another difference about the federal accounting standards-setting process that may have implications for policy makers and accounting researchers is the reason for the Board's existence. The initial impetus for the creation of FASAB—unlike FASB--did not stem primarily from a perception that people who use federal financial information need a regulator to mandate production of standardized information for their benefit. The principal users of federal accounting information are managers in the executive branch and members of Congress and their staff. These users generally felt they had considerable ability to get the accounting information they needed before FASAB was created. People without power to get information were not "users" of federal financial statements, and did not perceive themselves in need of a federal accounting standards board. They tend to rely on intermediaries or representatives (including elected officials, but also reporters, analysts working for interest groups, etc.).

Instead, the "proximate cause" of FASAB's creation was the fact that two constitutionally independent branches of the Government, the executive and legislative, felt a need for a new mechanism to help them agree on suitable accounting standards.

In the absence of some of the key factors that traditionally shape accounting policy and research, it is helpful to think about the fundamental objectives of accounting. In 1966, a committee of AAA concisely described the objectives of accounting as providing information for:

1. Making decisions concerning the use of limited resources, including the identification of crucial decision areas, and the determination of objectives and goals.
2. Effectively directing and controlling an organization's human and material resources.
3. Maintaining and reporting on the custodianship of resources.
4. Facilitating social functions and controls.[ii]

Reporting to capital markets obviously is encompassed in this list of objectives, but is merely implied as one special case, a subset of the first objective.

In 1977, another committee of the American Accounting Association published a Statement on Accounting Theory and Theory Acceptance. The committee reviewed various approaches that had been used or proposed for understanding accounting and establishing normative accounting standards. These included "classical" inductive and deductive approaches, "decision usefulness" approaches and "information economics." The committee concluded that "issues are continually recycled and closure appears to be no nearer" due to the lack of a "consensus paradigm."

Nearly a generation later, opinions may differ about the extent to which there is today a "consensus paradigm" for accounting standards for the private sector and for state and local governments. It seems clear, however, that such a consensus is still evolving for the federal sector. FASAB staff[iii] has attempted to describe the accounting policy process for the federal government using a model, familiar to accounting academicians, originally proposed by May and Sundem.[iv] That description suggests that "users' information needs" play a large role in FASAB's process.

It also suggests, however, that a focus on "users' needs," at least as traditionally understood, may be a necessary but not sufficient "paradigm." A decade ago Paul Miller suggested that FASB should "align itself with the main justification for securities regulation" by endorsing "the objective of promoting the efficiency of the capital markets in allocating scarce resources by providing information useful for rational decisions."[v] Such an approach, if applied to political markets, might suggest ways to assess federal accounting policy at a high level. At the same time, however, it is possible that federal accounting's role in that regard is destined to be limited, compared with the budget, performance reporting pursuant to the GPRA, and other aspects of federal policy making. If so, more narrowly focused research on topics such as managerial accounting, internal controls, auditing, and systems may turn out to be the dominant themes of research in federal accounting.

Two specific topics of interest to academics and to FASAB are (1) whether disclosure of information has the same impact as recognition and (2) the use of cost information in government. The rest of this article focuses on those topics. It is not a comprehensive review of recent literature, but is intended to show how the work of academic accountants can be relevant to FASAB, and to solicit more academic input regarding the Board's current and future concerns.

Specific Topics of Concern

Recognition versus disclosure: implications for the federal reporting model

Like FASB and GASB, FASAB frequently discusses the merits of recognition on the face of the basic financial statements versus note disclosure or supplementary reporting. Currently, FASAB is reconsidering whether certain items of "required supplementary stewardship information" (RSSI) should be classified as "basic information" (i.e., elements recognized on the face of the basic financial statements plus footnotes that are regarded as an integral part of the statements) or as required supplementary information (RSI). Part of the motivation for this reconsideration is some Board members' belief that items designated RSSI are perceived as less important than items recognized on the face of the financial statements or disclosed in notes to the statements. Another reason is that RSSI is a category unique to federal accounting, not defined in AICPA's or GAO's auditing standards. Now that federal accounting principles are regarded as generally accepted accounting principles, some believe this situation is confusing.

An article in Accounting Review for October 1999 is a good example of research potentially of interest, even though it deals with a nonfederal environment.[vi] It lends some support for the view that disclosure is not equivalent to recognition, at least in a specific context. The authors report:

> This study examines whether the market values financial statement data differently if it is disclosed instead of recognized in the body of the financial statements. We identify a sample of 229 SFAS No. 106 adopters who disclose an estimate of their anticipated liability for retiree benefits other than pensions (PRB) in their financial reports prior to the year of recognition. We then test whether the disclosed estimate of the PRB liability is valued differently by the market than is the subsequently recognized PRB liability. We provide modest and model-sensitive evidence that the recognized PRB liability receives more weight than the disclosed liability in market value association tests.

Of course, there have been other studies that suggested contrary conclusions. No one study can answer such a question. Furthermore, as noted earlier, there is the added question of how to interpret implications of research on capital market effects in an environment where the traditional way of thinking about financial reporting to capital markets is not relevant.

Studies of how individual decision-makers are affected by different formats for information (a common experimental design) do not involve measuring capital market reactions, and may therefore be more directly relevant to federal reporting.

A recent example of such research potentially relevant to FASAB's deliberations about the federal financial reporting model is an article in the April 2000 issue of Accounting Review.[vii] The authors report:

> Statement of Financial Accounting Standards (SFAS) No. 130 requires companies to report comprehensive income in a primary financial statement, but allows its presentation in either a statement of comprehensive income or a statement of stockholders' equity… In an experiment, we examine whether and how alternative presentation formats affect nonprofessional investors' processing of comprehensive-income information, specifically, information disclosing the volatility of unrealized gains on available-for-

sale marketable securities. The results show that nonprofessional investors' judgments of corporate and management performance reflect the volatility of comprehensive income only when it is presented in a statement of comprehensive income. We provide evidence consistent with our psychology-based framework that these findings occur because format affects how nonprofessional investors weight comprehensive-income information and not whether they acquire this information or how they evaluate it.

This research suggests a way to think about some reporting model issues, especially if FASAB expects (or wants to encourage) people other than professional analysts to read federal financial reports. Even so, opinions may differ about the relevance of this kind of study to the standard setter because individual decision makers acting alone may react differently than the group dynamic one observes in real-world capital and (presumably) political markets.

Some people may believe that studies like those cited above have implications for a variety of FASAB projects. But such research can, at most, illuminate the factors to consider. Individual members are likely to interpret the implications differently. For example, some Board members believe that "national defense PP&E" (weapons systems) should be recognized on the face of the balance sheet; others believe that some other alternative is superior. Research may suggest that at least some users will assign greater weight to information that is reported on the face of the basic financial statements, but—even if that conclusion is accepted--Board members may have very different views about whether that would be desirable. Those members who believe the information is irrelevant, or even misleading, would also believe that assigning more weight to it would be detrimental.

Using cost information in the governmental environment

FASAB is concerned with managerial accounting as well as external financial reporting. Indeed, Statement of Federal Financial Accounting Standards No. 4 (SFFAS 4) is titled Managerial Cost Accounting Concepts and Standards for the Federal Government. FASAB does not currently have an active project on cost accounting, but some Board members expect eventually to look more closely at the intersection of performance reporting and financial reporting. The combined effects of the CFO Act, federal accounting principles, and GPRA, would seem to imply that federal entities will need to associate costs with activities, outputs, and possibly even outcomes.

It seems intuitively plausible that such endeavors can enhance the Government's economy, efficiency, and effectiveness, and thereby—perhaps--enhance social welfare. As accountants we would like to think so. After all, without that kind of information, rational decision making would seem clearly to be hampered. There is plenty of anecdotal evidence to support this belief. For example:

- Vijay Jog and James McCrindell, in Costing Government Services for Improved Performance Measurement and Accountability,[viii] report several successes in encouraging better management in governmental entities by means of better cost information.
- Michael Granof, David Platt, and Igor Vaysman discuss some similar issues in a recent study titled "Using Activity-Based Costing to Manage More Effectively."[ix]

(SFFAS 4 recommends that agencies consider using ABC but does not specifically require use of ABC as such.) Also, two largely favorable articles on activity based costing and management appear in the summer 1999 issue of Public Budgeting and Finance:

- "Activity-Based Costing in Government: Possibilities and Pitfalls" by Richard E. Brown, Mark J. Myring, and Cadillac G. Gard.
- "Is ABCM Destined for Success or Failure in the Federal Government" by Clif Williams and Ward Meluish.

At the same time, these authors acknowledge that there is also plenty of anecdotal evidence that suggests elected and appointed officials don't always want, or act upon, cost information and quantitative performance indicators. And a third article in the same issue of Public Budgeting and Finance is distinctly more cautious.

The article, titled “Is Activity-Based Costing Up to the Challenge When It Comes to Privatization of Local Government Services?” is by Daniel R. Mullins and C. Kurt Zorn. They examine the use of cost information in Indianapolis. They also discuss some conceptual challenges or limitations in using cost information in government. These include questions about measurability and definition, external effects, accountability to public objectives, scale economies, and market efficiency. They conclude that:

> In most instances, ABC is not appropriate for public sector applications due to the nature of publicly provided services. While cost allocation can be done, there are serious questions about the accuracy of the allocations.

Likewise, a recent article in Accounting, Organizations and Society suggests some reasons why caution may be warranted, at least with regard to implementing Activity Based Costing (ABC).[x] The authors cite a 1995 estimate that only 10% of firms that adopt ABC continue to use it. Such data would seem to suggest that the effective use of managerial cost information is not a simple matter. Of course, some of these data are old, and may be based on limited studies. Also, findings regarding ABC may not necessarily apply to other types of cost accounting, which are permissible under SFFAS 4. Even so, it seems reasonable to suggest that, to use cost information effectively in government, we may need to learn more about the specific features that result in success and failure. It also seems reasonable to expect that special challenges may arise for governments, where not all consumers of the financial information are trained in managerial accounting concepts.

Conclusion

Federal accounting is as old as the nation, but promulgating GAAP for federal entities with a process similar to that used by FASB and GASB is still a new endeavor. Federal accounting offers a new field for research, and can benefit from input based on that research. FASAB looks forward to input from members of the academic community regarding the policy implications of their work.

[1] Some market participants and economists have, however, begun to focus on information about social insurance obligations of national governments similar to information that will be reported in the *Annual Financial Report* of the U.S. Government next year, pursuant to SFFAS 17. See, for example, Anne Swardson, “Pensions Threaten European Economies: Governments Ill-Prepared for Crisis of Retiring Baby Boomers,” *Washington Post*, April 26, 2000; William Pesek Jr., “Unfunny Money,” *Barron’s*, June 5, 2000; and “The Danger of Incomplete Pension Reform in Japan,” *Sentaku Magazine*, May 3, 2000, available at www.smithers.co.uk/sentaku.html.

[1] *A Statement of Basic Accounting Theory*, AAA, 1966.

[1] Robert Bramlett and Frank Rexford, “The Federal Accounting Standards Advisory Board: a view of its role one year later,” *Public Budgeting and Finance*, Winter 1992.

[1] Robert G. May and Gary L. Sundem, “Research for Accounting Policy: An Overview,” *Accounting Review*, October 1976.

[1] Paul B.W. Miller, “The Conceptual Framework as Reformation and Counterreformation,” *Accounting Horizons* , June 1990.

[1] Paquita Y. Davis-Friday, L. Buky Folami, Chao-Shin Liu, and H. Fred Mittelstaedt, “The Value Relevance of Financial Statement Recognition vs. Disclosure: Evidence from SFAS No. 106,”

[1] Laureen Maines and Linda McDaniel, “Effects of Comprehensive-Income Characteristics on Nonprofessional Investors’ Judgments: The Role of Financial-Statement Presentation Format.”

[1] Canadian Institute of Chartered Accountants, 1999.

[1] The PricewaterhouseCoopers Endowment for The Business of Government, 2000.

[1] Shannon W. Anderson and S. Mark Young, "The impact of contextual and process factors on the evaluation of activity-based costing systems ," *Accounting, Organizations, and Society*, October 1999.

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Board Continues Discussing National Defense Property, Plant, and Equipment (PP&E)

At its June meeting, the Board continued its ongoing research and discussion of the most effective manner in which to report on National Defense Property, Plant, and Equipment (PP&E). Members reviewed a staff paper proposing that the benefits of capitalizing National Defense PP&E on the balance sheet would support the Board’s reporting objectives and would provide the kind of qualitative information that would help support accountability. Several Board members requested that staff expand the paper to discuss possible shortcomings of this capitalization approach and compare the approach to other approaches that the Board is considering. The Board also asked staff to research possible approaches to: (1) depreciating/amortizing the capitalized amounts; (2) separating in-process from in-service items and from modifications, and (3) accounting for spare parts.

Point of contact: Rick Wascak, 202-512-7363, wascakr.fasab@gao.gov, or Andrea Palmer, 202-512-7360, palmera.fasab@gao.gov.

Stewardship Reporting Discussion Continues

In June, the Board continued its discussion of how best to report on items currently categorized as stewardship items and reported under the category of Required Supplementary Stewardship Information (RSSI) (See FASAB News Issue 61 for background). The Board discussed early drafts of two separate exposure drafts to reclassify 1) stewardship responsibilities and 2) heritage assets and stewardship land

The Board first addressed the exposure draft on stewardship responsibilities. That exposure draft proposed that risk assumed information required by Statement of Federal Financial Accounting Standards 5 (SFFAS 5), *Accounting for Liabilities of the Federal Government*, and the current services assessment required by SFFAS 8, *Supplementary Stewardship Reporting*, would become required supplementary information (RSI). The Statement of Social Insurance required by SFFAS 17, *Accounting for Social Insurance*, as RSSI would become a basic financial statement. The Board expects to issue this exposure draft later in the year. It will discuss how to categorize other items of social insurance information, required by SFFAS 17 but not reported on the Statement of Social Insurance, at the August Board meeting.

Next, the Board addressed the exposure draft proposing that, except for information on condition, all elements of heritage assets and stewardship land would be reported as basic information. Some of the Board members asked staff to clarify its wording on parts of the standards. The Board will discuss the staff changes to this draft exposure draft at its August meeting.

In addition to discussing specific issues on the above two exposure drafts, a few Board members suggested that the Board might wish to separately address its desire to eliminate the reporting category of RSSI. The Board will discuss this issue at its special July 3 Board meeting in San Francisco at the Association of Government Accountants Professional Development Conference.

Points of contact: Stewardship responsibilities: Robert Bramlett, 202-512-7355, bramlettr.fasab@gao.gov and heritage assets and stewardship land: Lucy Lomax, 202-512-7359, lomaxm.fasab@gao.gov.

FASAB's Upcoming Meetings

August 30-31
October 5-6
December 7-8

Location: Room 7C13 of the General Accounting Office, 441 G Street, NW, Washington, DC 20548 (unless we post information to the contrary). Agendas are posted to the FASAB web page, http://www.financenet.gov/fasab.htm one week prior to meetings.

AAPC Upcoming Meetings

September 14
November 9

Location: General Accounting Office, 441 G Street, NW, in Room 4N30, beginning at 1:30 PM. Point of contact: Monica R. Valentine, 202-512-7362, valentinem.fasab@gao.gov,

Note: ***FASAB News*** **is published by the staff of the Federal Accounting Standards Advisory Board. This newsletter, highlighting recent Board actions, is issued after Board meetings to provide the public with an understanding of issues that the Board is considering. When an article refers to a Board decision, it should be understood that Board decisions are tentative until FASAB issues a Statement of Federal Financial Accounting Concepts (SFFAC) or Statement of Federal Financial Accounting Standards (SFFAS).**
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Please direct FASAB and AAPC administrative questions to Dick Tingley, 202-512-7361.

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