

**Executive Office of the President
Office of Management and Budget**

**OBJECTIVES OF FEDERAL FINANCIAL REPORTING
STATEMENT OF FEDERAL FINANCIAL ACCOUNTING CONCEPTS
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CONTENTS

Executive Summary	Paragraphs 1-20
Chapter 1: Federal Financial Reporting and the Role of the Federal Accounting Standards Advisory Board	Paragraphs 21-48
Chapter 2: The Federal Accounting and Financial Reporting Environment	Paragraphs 49-70
Chapter 3: Accountability and Users' Information Needs the Foundation of Governmental Financial Reporting	Paragraphs 71-104
Chapter 4: Objectives of Federal Financial Reporting	Paragraphs 105-150
Chapter 5: Balancing Costs and Benefits in Recommending Standards	Paragraphs 151-155
Chapter 6: Qualitative Characteristics of Information in Financial Reports	Paragraphs 156-164
Chapter 7: How Accounting Supports Federal Financial Reporting	Paragraphs 165-191
Chapter 8: How Financial Reporting Supports Reporting on Operating Performance	Paragraphs 192-212
Appendix A: Basis for Conclusions	Paragraphs 213-248
Appendix B: Users' Information Needs Addressed by Federal Financial Reporting	Paragraphs 249-264
Appendix C: Selected Federal Reports Prepared on a Recurring Basis	Paragraphs 265-266

EXECUTIVE SUMMARY

INTRODUCTION

1 This document is a conceptual statement on the objectives of financial reporting by the federal government.

It focuses on the uses, user needs, and objectives of such reporting. Statements on concepts, such as this document, differ from statements of recommended accounting standards. Statements on concepts are more general than statements of standards and do not contain specific recommendations that would, when issued by the Board's sponsors, become authoritative requirements for federal agencies and auditors.

2 Instead, statements on concepts, after approval by the Board's sponsors, provide general guidance to the Board itself as it deliberates on specific issues. They also help others to understand federal accounting and financial reports.

3 The objectives are designed to guide the Board in developing accounting standards to enhance the financial information reported by the federal government to (1) demonstrate its accountability to internal and external users of federal financial reports, (2) provide useful information to internal and external users of federal financial reports, and (3) help internal users of financial information improve the government's management.

4 The objectives reflect the federal environment. They also reflect many of the needs expressed by current and potential users of federal financial information. They provide a framework for assessing the existing financial reporting systems of the federal government and for considering how new accounting standards might help to enhance accountability and decision-making in a cost-effective manner.

5 The FASAB notes that many information sources other than financial statements help to attain these objectives. The objectives relate to the management and financial reporting systems in the federal government in their entirety.

6 Listing the objectives does not imply a judgment about the extent to which they are now being attained. Indeed, it is presumed that the objectives are being met to some degree now. However, the federal government does not have an integrated mechanism for reporting within the context of these objectives. The FASAB will consider where new accounting standards could make a useful and cost-effective contribution to improving the extent to which these objectives are attained.

7 The Department of the Treasury, the Office of Management and Budget, and the General Accounting Office expect that, to the extent possible, their reporting requirements will be aligned with the Board's objectives and standards.

BACKGROUND AND RATIONALE

8 The federal government derives its just powers from the consent of the governed. It therefore has a special responsibility to report on its actions and the results of those actions. These reports must accurately reflect the distinctive nature of the federal government and must provide information useful to the citizens, their elected representatives, federal executives, and program managers. Providing this information to the public, the news media, and elected officials is an essential part of accountability in government. Providing this information to program managers, executives, and members of Congress is essential to planning and conducting government functions economically, efficiently, and effectively for the benefit of society.

9 Financial reporting is not the only source of information to support decision-making and accountability. Neither can financial reporting, by itself, ensure that the government operates as it should. Financial reporting can, however, make a useful contribution toward fulfilling those goals.

10 The objectives apply to both internal and external financial reports. They are intended to improve the relevance, consistency, and quality of accounting and other data available for a wide variety of applications.

11 The FASAB and its sponsors believe that any statement of objectives of federal financial reporting must

be based on the needs of those who use the reports. Those users include citizens, Congress, federal executives, and federal program managers. Current and potential users of federal financial information want information to help them assess how well the government is doing by answering questions regarding such topics as:

- Budgetary integrity: What legal authority was provided for financing government activities and for spending the monies? Were the financing and spending in accordance with these authorities? How much was left?
- Operating performance: How much do various programs cost, and how were they financed? What outputs and outcomes were achieved? What and where are the important assets, and how effectively are they managed? What liabilities arose from operating the program, and how will they be liquidated or provided for?
- Stewardship: Did the government's financial condition improve or deteriorate? What provision was made for the future?
- Systems and Control: Does the government have cost-effective systems and controls to safeguard its assets? Is it able to detect likely problems? Is it correcting deficiencies when detected?

12 Concerns like these define the following objectives of federal financial reporting.

OBJECTIVES OFFEDERAL FINANCIAL REPORTING Budgetary Integrity

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

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

Operating Performance

14 Federal financial reporting should assist report users in evaluating the service efforts, costs, and accomplishments of the reporting entity; [Footnote 1.] the manner in which these efforts and accomplishments have been financed; and the management of the entity's assets and liabilities. Federal financial reporting should provide information that helps the reader to determine

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

[Footnote 1: The FASAB has not yet considered criteria for defining, and terminology for describing, federal financial reporting components or units. In this document, therefore, the term "entity" is used in a generic way to refer, depending on the context, to the U.S. government as a whole; to organizational component units of the government, such as an agency; and to other kinds of potential reporting units, such as programs.]

Stewardship

15 Federal financial reporting should assist report users in assessing the impact on the country of the government's operations and investments for the period and how, as a result, the government's and the nation's financial conditions have changed and may change in the future.

16 Federal financial reporting should provide information that helps the reader to determine whether

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

Systems and Control

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

- transactions are executed in accordance with budgetary and financial laws and other requirements, consistent with the purposes authorized, and are recorded in accordance with federal accounting standards;
- assets are properly safeguarded to deter fraud, waste, and abuse; and
- performance measurement information is adequately supported.

ORGANIZATION OF THE STATEMENT

The first two chapters of this statement present background information on the Board and the federal environment. Chapter 3 identifies the four groups of current and potential users of federal financial reports and gives

examples of some of their information needs. Chapter 4 states and explains the objectives of federal financial reporting in more detail than does this executive summary.

Chapter 5 explains some limitations of the standard-setting process within the context of user needs. Chapter 6 discusses the desirable qualitative characteristics of financial information. Chapter 7 explains how accounting supports federal financial reporting. Chapter 8 explains how financial reporting supports reporting on operating performance.

Appendix A sets forth the basis for the Board's conclusions. Appendix B presents a categorization of user needs according to types of information identified by the users rather than according to objectives. Appendix C lists some major federal reports that are regularly produced.

CHAPTER 1: FEDERAL FINANCIAL REPORTING AND THE ROLE OF THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

21 Financial reporting by the federal government provides information for formulating policy, planning actions, evaluating performance, and other purposes. In addition, the processes of preparing and auditing financial reports can enhance the government's overall accountability structure by providing greater assurance that transactions are recorded and reported accurately, that consistent definitions are used to describe the transactions, etc. Thus, federal financial reporting helps to fulfill the government's duty to manage programs economically, efficiently, and effectively and to be publicly accountable.

22 Financial reporting is supported and made possible by accounting and accounting systems. "Financial reporting" may be defined as the process of recording, reporting, and interpreting, in terms of money, an entity's financial transactions and events with economic consequences for the entity. Reporting in the federal government also deals with nonfinancial information about service efforts and accomplishments of the government, i.e., the inputs of resources used by the government, the outputs of goods and services provided by the government, the outcomes and impacts of governmental programs, and the relationships among these elements.[Footnote 2.]

[Footnote 2: Except where the context indicates otherwise, the term "government" in this document refers both to the U.S. government as a whole and to its component reporting entities, such as agencies and programs.]

ROLE OF THE FASAB IN FEDERAL ACCOUNTING AND FINANCIAL REPORTING

The mission of the FASAB is to recommend accounting standards [for the federal government] after ... considering the financial and budgetary information needs of congressional oversight groups, executive agencies, and the needs of other users of federal financial information.[Footnote 3.]

[Footnote 3: From the FASAB Mission Statement, approved by the Board and by the Secretary of the Treasury, the Director of OMB, and the Comptroller General of the United States in 1991.]

23 The FASAB and its sponsors believe that any description of federal financial reporting objectives should consider the needs of both internal and external report users and the decisions they make. This implies a different role for the FASAB than for the Financial Accounting Standards Board (FASB) and the Governmental Accounting Standards Board (GASB). The FASB sets financial reporting standards for privately owned entities in the United States. The GASB sets financial reporting standards for state and local governments.

24 Those Boards exist primarily to set standards for general purpose financial reporting to external users of financial reports. This is because those users, by definition, have limited ability to control the nature of the information made available to them. The FASB and the GASB do not need to weigh heavily managers' information needs because those individuals, by definition, are assumed to have ready access to the information they need about the financial transactions and events that affect the financial position, operations, and financial condition of the entities they manage.

25 The FASAB, on the other hand, considers the information needs of both internal and external users. In

part, this is because the distinction between internal and external users is in many ways less significant for the federal government than for other entities. Officials who in theory should have ready access to information often find in practice that it is not available. Factors that contribute to this problem include the size and complexity of the government, the rapid turnover among senior political executives compared with the time required to install information systems in large bureaucracies, and the division of authority in the federal government.

26 The FASAB's dual concern, with both internal and external reporting, is the result of such factors and of the Board's mandate. The FASAB was created to advise OMB and Treasury (agents of the President) and the GAO (an agent of the Congress) on accounting standards for federal agencies and programs in order to improve financial reporting practices.

27 The Board's sponsors have separate constitutional and statutory authorities for setting accounting policy for the government. The division of powers in the U.S. government means that different policymakers with independent authority find it useful to have a mechanism to coordinate their accounting policy activities. The Board and its public deliberative process also provide a new arena for the participants to deliberate and to discover how federal accounting and financial reporting can be improved.

28 Just as the traditional distinction between internal and external report users is less useful in the federal context, some of the traditional ways of classifying financial reports are less relevant. Reports can be intended primarily for a designated special purpose or for general purpose use. In the federal government, as in most entities, internal financial reporting is designed for special purposes. Internal financial reporting helps managers to plan, conduct, and coordinate their activities and to evaluate the economy, efficiency, and effectiveness of their programs.

29 Much external federal financial reporting also is for special purposes, but some is for general purpose use; that is, it attempts to meet the common needs of many different users who have limited power to demand information directly. These reports are known as general purpose

reports.[Footnote 4.]

[Footnote 4: In state and local governmental accounting, the term "general-purpose financial statements (GPFS)" has a quite specific meaning. Standards published by the GASB define in detail the form and content of such reports. The term "general-purpose reports" is used in a more generic sense in this document to refer to a variety of federal financial reports.]

LIMITATIONS OF FINANCIAL REPORTING

30 The FASB and the GASB focus primarily on general purpose financial reporting because that is their mandate and reason for being. Even so, those Boards recognize that general purpose financial reporting is not the only source of financial information. In many cases, users of general purpose financial reports need to consult other sources to satisfy their information needs. This is no less true for the federal government.

31 While certain information is provided by general purpose financial reports, other information is better provided by, or can be provided only by, financial reporting outside such reports. Still other information is provided by nonfinancial reports or by financial reports about segments of the national society other than the federal government and its component entities (e.g., economic reporting).

32 Often, to satisfy the information needs of various individuals, it is necessary to combine and report financial and nonfinancial information. Often, combining information about the government with information about aspects of the national society is necessary to assess past or planned governmental actions. For example, information about the number of people gainfully employed after participating in a vocational education program would be important both in assessing past governmental expenditures for training and in evaluating plans for similar new expenditures.

33 Some questions arise with special force regarding the nature of general purpose reports because, by definition, no user or potential user is able unilaterally to define the requirements for these reports. The FASAB is, by design, well constituted to consider the issues involved with such reports.

34 Federal accounting also must support special purpose reporting to the Congress, executives, and others that the FASAB represents. Indeed, most federal financial reporting is special purpose reporting. Also, the Board notes that traditional "general purpose" financial reports may serve a larger and more useful purpose for a variety of audiences if traditional designs for such reports are expanded to include a variety of reports addressing budgetary integrity, operating performance, stewardship, and control of federal activities.

EVOLUTIONARY APPROACH

35 The FASAB recognizes that developing and implementing standards that will contribute to achieving certain objectives may take considerable time. Time will be needed to establish information-gathering systems and to gain experience by experimenting with alternative approaches.

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

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

BACKGROUND INFORMATION ON FEDERAL FINANCIAL REPORTING

38 Different people are likely to talk about very different things when asked to describe federal financial reporting or federal accounting. A few examples will illustrate this point.

39 An economist, when asked this question, is likely to refer to reports about the national society as a whole. Among the most important of such financial reports are the national income and product accounts (NIPA) that measure the

nation's aggregate expenditures on currently produced output. Federal government expenditures, of course, constitute a significant fraction of the total expenditures in the economy. The NIPAs, as a system, emerged in the 1940s and were built on work done in the U.S. Department of Commerce beginning in the 1930s and earlier by private organizations.

40 The NIPAs provide a picture of the economic transactions that occur in an accounting period, such as a year. The approach is to provide such a picture through a set of accounts that aggregate the accounts belonging to the individual transactors in the economy workers, businesses, and consumers, among others whether or not formal accounting statements exist explicitly for all of them.

41 The NIPAs provide vital information to policymakers and others who are planning future actions and to individuals who would like to assess the effects of past actions. The NIPAs are recognized as an essential part of economic reporting by national governments. For this reason, the United Nations has developed the System of National Accounts (SNA). The SNA is a comprehensive, integrated, and internationally comparable statistical base for analysis in key policy-making areas, such as economic growth, inflation, and productivity.

This Statement does not deal directly with such accounts of the economic activity of the national society. The focus of this Statement is on accounting systems and financial reports that deal with the budgetary integrity, operating performance, and stewardship of the government as such; that is, of the government as a legal and organizational entity within the national society. However, to report on some aspects of the government's performance and stewardship, economic and other information about the national society is essential. Thus, the FASAB may consider whether such economic information should be included in certain financial reports, such as general purpose financial reports for the U.S. government as a whole.

42 A financial analyst on Wall Street, when asked about federal financial reporting, is likely to think of the "Daily Treasury Statement" and the "Monthly Treasury Statement of Receipts and Outlays of the United States Government." Some financial analysts study these Treasury

reports regularly to assess the effect of cash flows on bank reserves and the size of the government's borrowing requirements. The federal government's borrowing is viewed as free of default risk because of the government's ability to tax and to create money. The power to tax depends on the government's willingness to tax and the strength of the economy.

44 From a longer-term perspective, it is true, however, that borrowers' expectations about such factors as future inflation and the relative value of the dollar compared with other currencies can influence the borrowing costs of the United States. Those expectations, in turn, may be influenced by the deficit reported or projected by the government, the current inflation rate, and other factors.

45 Someone concerned with formulating or executing the U.S. budget, when asked about the "federal accounting model," is likely to think of the budgetary accounting system. This is the system used to keep track of spending authority at various stages of budget execution from appropriation through apportionment and allotment to obligation and eventual outlay. This system is used by Congress and the executive branch for such purposes as "scoring" the budget and for assessing the economic implications of federal financial activity at an aggregate level. It also is used for planning and controlling government operations at more detailed, disaggregated levels. Of course, people involved with the budget also are informed by, and rely on, sources of information other than the budgetary accounting system, e.g., program evaluation and performance measures.

46 Although the FASAB does not recommend standards for the budget or budget concepts, part of its mission is to recommend accounting principles that will help provide relevant and reliable financial information to support the budgetary process. Furthermore, information about budget execution is essential to assessing budgetary integrity.

47 Accountants working for the federal government, individuals auditing government programs, or students in a governmental accounting course are likely to think first of what are known within the federal government as the "proprietary" accounts and the reports prepared, in part, from information in them. These accounts are used to record

assets and liabilities that are not accounted for in the budgetary accounts. These reports are said to present "financial position" and "results of operations" in accordance with some set of accounting standards. The FASAB is most directly concerned with these accounts and with the reports that are prepared, in large part, with information from them.

48 Attention to this and other aspects of federal accounting and financial reporting has been greatly increased by the Chief Financial Officers Act of 1990 (CFO Act). This act mandates improved financial management by requiring, among other things, (1) new financial organizations, (2) enhanced systems, and (3) audited financial reporting. However, the FASAB's area of concern is not limited to the reports required by the CFO Act.

CHAPTER 2: THE FEDERAL ACCOUNTING AND FINANCIAL REPORTING ENVIRONMENT

49 Financial reporting is an important, basic tool in the management and oversight of most organizations. It is particularly important for the federal government because of the government's fundamental nature and responsibilities and because the federal government operates with fewer external restraints than other entities. Federal accounting and financial reporting are shaped by, and need to respond to, the unique characteristics and environment of the federal government, as discussed below.

SOVEREIGNTY

50 The federal government is unique, when compared with any other entity in the country, because it is the vehicle through which the citizens of the United States exercise their sovereign power.[Footnote 5.] The federal government has the power through law, regulation, and taxation to exercise ultimate control over many facets of the national economy and society. All other entities within the nation, both public and private, operate within the context of laws, oversight, and accountability established by the national government. The federal government is accountable only to its citizens. It is politically

accountable to the electorate, but no higher agency has the power to demand an accounting from the government. [Footnote 5: The word "sovereign," much discussed by legal and political philosophers, is used here in its broad, popular sense to imply (1) internally that the people are the ultimate (if indirect) overseer or authority in the decision-making process of a democratic state and (2) externally that the state is autonomous or independent. As noted by one authority on the subject, either type of sovereignty, internal or external, implies that there is no higher agency. In a more limited sense, sovereignty is the power to make or change the law, a power exercised collectively by individuals and institutions operating in a complex system of relationships. See "Sovereignty," W. J. Stankiewicz, "The New Encyclopedia Britannica," 15th. ed. (1976), vol. 17, pp. 309-313.]

SEPARATION OF POWERS

51 Because of their concern about potential abuse of the national government's power, the founders designed a government characterized by the separation of powers. Each branch of government legislative, executive, and judicial is checked and constrained by the others. Paradoxically, this same separation of power can obscure responsibility and reduce accountability. The interrelated responsibilities of the legislative and executive branches, for example, can make it difficult to assign responsibility for the policies that are adopted.

FEDERAL SYSTEM OF GOVERNMENT

52 The federal system of government comprising federal, state, and local levels of government also makes it difficult to pinpoint accountability for many programs. The federal government's responsibility relative to that of the states has gradually expanded. The federal government has undertaken responsibilities in areas such as income redistribution, education, and health care. Often, however, the expansion has come without direct federal control over related operations. Responsibilities and financial resources of the three levels of government have become intermingled. Citizens are not clear about who is in charge, where to press for performance, and whom they should blame for bad results.

RESPONSIBILITY FOR THE COMMON DEFENSE AND GENERAL WELFARE

53 The federal government is unique in that it has continuing responsibility for the nation's common defense and general welfare. As a result, the government's financial condition is necessarily a secondary consideration in many cases. For example, the nation would enter into military conflict to protect its vital national interests despite the fact that doing so would worsen an already large deficit. (Similarly, the government's greatest resource is one that it does not own but can tax: the national economy.)

54 Further, providing for the nation's general welfare is a broad responsibility that involves multiple goals. There is no single measure of success (like "return on investment" or "earnings per share"). Goals often are not explicitly defined in quantifiable terms and sometimes conflict with each other. Relevant measures of performance are usually nonfinancial. For example, many federal loan programs are charged with two conflicting goals: (1) to operate as a fiscally prudent lender and (2) to provide high-risk lenders with credit.

POWER TO TAX, BORROW, AND CREATE MONEY

55 As stated, the federal government has unique access to financial resources and financing. It has the power to tax, to borrow, and to create money. These powers give the government a call on the underlying wealth of the United States a vast but finite pool of resources.

56 There is no constitutional requirement to provide sufficient revenues to fund expenditures of the federal government. There is a statutory limit on the amount of U.S. debt. This limit is routinely increased by Congress and the President. The federal government's ability to finance its debt has not been constrained by capital market assessments of its creditworthiness. It is true, however, that the cost of servicing the U.S. debt now constrains the range of feasible fiscal and monetary policies more than was formerly the case.

57 The federal government through the Federal Reserve also has the power to create money and to control its supply. The Federal Reserve Board functions as a

largely independent entity but is, of course, a government agency created by congressional action.> This ensures that creditors will be repaid, at least in nominal terms. When the government's debt is large, it also provides a temptation to create money, as well as inflation.

INFLUENCE OF ORGANIZED INTERESTS

58 Because of the size and nature of government programs, it is difficult for individuals to evaluate or to influence policies and actions of the federal government. Typically, individuals must organize to exercise influence. Small groups whose members are significantly affected by a common factor or concern can be organized relatively easily, but they may find it difficult to wield much influence. Large groups may be influential, but organizing them is difficult if the members have common but diffuse interests. Once organized, interest groups tend to perpetuate themselves.

59 As a result, most elected and appointed federal officials, and the groups to which they are responsive, have been interested primarily in information about individual government programs, functions, or activities. They have been less interested in information about the government as a whole and even less concerned about intermediate levels of reporting, such as individual departments.

POLITICAL SYSTEM VERSUS PRIVATE MARKETS

60 The federal government is not subject to the discipline of competitive markets for private goods, services, and capital. Generally, transactions between citizens and the government are not individual exchanges between willing buyers and willing sellers. Taxpayers provide resources involuntarily, based on their consumption, wealth, or income rather than on their desire for particular government services. Even when user fees are charged, they often are not intended to represent market clearing prices that would, in markets for private goods, balance supply and demand.

61 Thus, citizens as individuals have little say in selecting the public services they pay for. Decisions on what public services will be provided are collective decisions made through the political process. Politically influential recipients of benefits can force less

influential non-recipients to bear the cost of the benefits.

62 Further, because most governmental revenues are not earned in individual, voluntary, exchange transactions, no private market directly measures the value of output. Consequently, the value added to society's well-being by government programs cannot be gauged by conventional measures of net income, nor is there much competitive market constraint on the quantity or quality of services provided.

ASSETS

63 The government makes significant investments in assets, including public domain assets and large investments intended to produce growth (educational programs and research and development, for example).

64 In government, as in the private sector, assets are expected to provide benefits that outweigh costs. In the private sector, the notion of benefits is relatively straightforward: benefits are measured in terms of cash inflows. Assets are not acquired unless the value of expected cash flows exceeds acquisition costs.

65 In the government, this discipline does not usually exist. Expected benefits often are not cash inflows but rather are the services provided by the asset. Sometimes those services are provided to the government itself (e.g., government office buildings or motor pools). More often, the services are provided to the public (e.g., education and research and development).

RESPONSIBILITY TO THE NEWS MEDIA

66 The federal government is subjected to, and should encourage, scrutiny by the news media. Because of the lack of external restraints and because the government's power ultimately resides in the citizens, it has a special responsibility to citizens and taxpayers to disclose its activities.

IMPORTANCE OF THE BUDGET

67 The budget is the most widely recognized and used financial report of the federal government. It is a

principal surrogate for the missing external restraints discussed above. It is a vehicle for the political process to reach agreement on goals and to allocate resources among competing priorities. It provides a system for controlling expenditures. And it supplies information necessary for assessing the effect on the economy of the government's fiscal policies. The role of budgeting in financial reporting is discussed further in chapter 7 under "Relationship of Financial Reporting to Budgeting."

NEED FOR SPECIAL CONTROL MECHANISMS

68 The lack of external restraints noted above creates a need for special control mechanisms. Some mechanisms exist today. The most important, of course, are the political constraints and accountability imposed by regular elections and the separation of powers and the other constitutional constraints and accountabilities, such as the federal system and freedom of speech.

69 Accounting and financial reporting also play a role. Budgetary obligation accounting is used to control activities, primarily at the budget account level. Audited financial reports can provide users with assurance that accounting systems are providing consistent and reliable data.

70 However, the need for improvement in financial reporting is widely recognized, as is the fact that financial information alone often is insufficient for decision-making. For example, financial information on costs often must be combined with nonfinancial information on performance to provide a basis for assessing the efficiency and effectiveness of government programs.

CHAPTER 3: ACCOUNTABILITY AND USERS' INFORMATION NEEDS--THE FOUNDATION OF GOVERNMENTAL FINANCIAL REPORTING

71 It may be said that "accountability" and its corollary, "decision usefulness," comprise the two fundamental values of governmental accounting and financial reporting. They provide the foundation for the objectives of federal financial reporting. Because a democratic government should be accountable for its integrity, performance, and

stewardship, it follows that the government must provide information useful to assess that accountability. Similarly, because a democratic government is accountable for operating economically, efficiently, and effectively, for the purposes intended by citizens and their elected officials, certain other conclusions logically follow. Specifically, those who formulate, select, and implement government policies and programs need information useful for planning, controlling, and conducting government functions.

71 The assertion of accountability therefore leads to identifying, first, those to whom government is accountable and, second, the information needed to maintain and demonstrate that accountability. Accordingly, this chapter first discusses the concept of accountability, then identifies the four groups of users of federal financial reports. It concludes by providing some examples of the information needs that may be addressed to some extent by federal financial reports.

ACCOUNTABILITY

73 Several different kinds of accountability can be distinguished, and a given piece of information may be relevant in different ways to judgments about accountability. For example, one authority suggests that there are five levels or types of public accountability:

- Level 1 is policy accountability selection of policies pursued and rejected (value).
- Level 2 is program accountability establishment and achievement of goals (outcomes).
- Level 3 is performance accountability efficient operation (efficiency and economy).
- Level 4 is process accountability using adequate processes, procedures, or measures in performing the actions called for (planning, allocating, and managing).
- Level 5 is probity and legality accountability spending the funds in

accordance with approved budget and/or approved items (compliance).[Footnote 7.]

[Footnote 7: J. D. Stewart, "The Role of Information in Public Accountability," eds. Tony Hopwood and Cyril R. Tompkins, "Issues in Public Sector Accounting" (Oxford, Great Britain: Philip Allan, 1984), pp. 14-15, as cited by the GASB in its "Preliminary Views on Service Efforts and Accomplishments Reporting" (Dec. 1992).]

74 In a democracy, appointed officials are accountable to their superiors, and elected officials are accountable to the citizens for each of these kinds of accountability. Accounting and financial reporting can help elected and appointed officials to maintain and to demonstrate their accountability. The last kind of accountability listed, for "probity and legality," probably is the kind most often associated by the public with accounting. However, the accounting profession has long recognized that accounting can and should contribute to achieving and demonstrating several kinds of accountability, such as

- accountability for financial resources;
- accountability for faithful compliance or adherence to legal requirements and administrative policies;
- accountability for efficiency and economy in operations; and
- accountability for the results of government programs and activities, as reflected in accomplishments, benefits, and effectiveness.[Footnote 8.]

[Footnote 8: "Report of the Committee on Concepts of Accounting Applicable to the Public Sector," American Accounting Association (1970-71), pp. 80-81, as cited by the GASB in "Preliminary Views on Service Efforts and Accomplishments Reporting" (Dec. 1992).]

USERS OF FEDERAL FINANCIAL REPORTS

75 The Board believes that users of financial information about the federal government can be classified in four major groups: citizens, Congress, executives, and

program managers.

CITIZENS: 76 This group includes individual citizens (without regard to whether they are taxpayers, voters, or service recipients). Citizens include the general news media and more specialized users, such as trade journals; public interest and other advocacy groups; state and local legislators and executives; and analysts from corporations, academe, and elsewhere.

77 Citizens are interested in many aspects of the federal government. They are concerned about individual programs, candidates for office, the services the government provides, and the fiscal responsibility of their elected and appointed representatives. Citizens receive and pay for government services and therefore are concerned with the outputs and outcomes of those services and the efficiency with which they are provided. Citizens are concerned about their families and, in particular, with the financial burden their children and grandchildren will inherit. As individuals, citizens typically have limited time and ability to analyze reports about their government; they want and rely on assurances that the government is functioning economically, efficiently, and effectively. As they are organized and represented by analysts working for interest groups and the news media, citizens want more information about the government's activities.

78 Citizens express their interest in the government by discussing issues, by voting, and by writing to their representatives about the quality and quantity of the services they receive. In some cases, citizens may decide whether and when to use services and products provided by the government. They may contribute to political campaigns, demonstrate support or opposition for individuals responsible for past and proposed government actions, and even run for office.

CONGRESS: 79 This group includes elected members of Congress and their staffs, including staff of the Congressional Budget Office (CBO) and the GAO. Congress is concerned with broad policies, priorities, and the programs that implement those priorities. It decides what taxes to impose, what funds should be spent, and for what purpose. Thus, Congress is concerned both with how to finance programs and with how they are executed.

80 Congress participates along with the administration in the basic decisions that describe the intent of government. Such decisions include passing laws in response to public demand, allocating resources among competing programs, and establishing policy that affects various aspects of the country's economic and social life. These decisions often are influenced by assessing costs and benefits and by considering the effect of the government's aggregate financial requirements on the economy.

81 Congress also participates in monitoring government programs. It assesses the management performance of the executive branch and the efficiency and effectiveness of programs.

EXECUTIVES: 82 This group includes the President and those acting as his agents, i.e., program agency heads and their deputy, under, and assistant agency heads; heads of bureaus, administrations, services, and agencies; and the central agency officials in OMB and the Department of the Treasury.

83 Executives, like Congress, are concerned with the government's goals, objectives, and policies. Executives focus on the strategic plans and programs that are intended to achieve presidential and congressional goals and to implement their policies. In particular, they pay attention to budgets that, from the perspective of each agency, are the source of the resources needed to achieve goals and to implement policies. Executives are, of course, directly concerned about the management of programs, that is, with the actual delivery of services and with the efficiency and effectiveness of the delivery process.

84 Executives develop legislative proposals, recommend the necessary level of program funding, and formulate financing and revenue-raising strategies. They help select the method for delivering services. They determine whether program managers have been accountable for the resources entrusted to them and whether programs are operating efficiently and effectively. Executives also provide information that will enable the President and Congress to monitor programs.

PROGRAM MANAGERS: 85 This group includes individuals who manage government programs. Their concerns include operating

plans, program operations, and budget execution.

86 Program managers assist in the design of programs and organize the method selected for delivering services. They recommend program budgets based on detailed plans that set forth needs for money, staffing, facilities, and inventory.

87 Program managers establish operating procedures for their programs and manage them within the limits of the spending authority granted by Congress. They select, supervise, and evaluate personnel. They also make sure that program inventory and facilities are acquired economically, maintained adequately, and used efficiently. Program managers need to provide information to enable executives and Congress to monitor the programs.

THE NEEDS OF USERS OF FEDERAL FINANCIAL REPORTS

88 While the financial information needs of these groups is more diverse than their membership, those needs can be categorized under four broad headings.

Budgetary Integrity

89 All user groups need information about the budget. For citizens, information about budget execution provides assurance that their elected and appointed representatives have fulfilled their most basic fiduciary responsibility: to raise and spend money in accordance with the law.

90 For the President's economic team and for congressional budget committees, information is needed on budget aggregates (total budget authority, total receipts and collections, and total outlays) to establish fiscal policy, including governmental financing needs. These officials need to know that prior-year "actuals" have been accurately recorded in accordance with the same budgetary principles used to prepare estimates.

91 To avoid violations of the Anti-Deficiency Act and the Impoundment Control Act, program managers need information about obligations incurred on their programs. They need periodic information about the status of budgetary resources, that is, the extent to which the resources have been used or remain available. They also want to know

whether budgetary resources are available to be used for other purposes through reprogramming.

Operating Performance

92 Citizens want information about programs that affect them. Veterans, for example, want to know about new hospitals, and defense workers want information about contract awards (and cancellations). Retirees and people planning retirement and their representatives in Congress want to know that the Social Security Administration provides reliable services to the public.

93 Congress and executives want information about the comparative costs of programs (such as the per student cost of the Job Corps Program versus that of other job training programs). For comparisons to be valid, costs must be defined and measured alike.

94 Of course, information on the effectiveness of programs is also needed to make valid comparisons among programs. Information is needed about outputs (e.g., number of students who graduated) and outcomes (e.g., number of students who got and held jobs for which they were trained).

95 Executives and program managers need to know the cost of performing work reimbursed by other government entities or by nonfederal customers. Costs, in this case, would measure the resources (personnel, material, and equipment) used to accomplish the work.

96 Congress and executives often want cost information that would help to compare alternative courses of action. How much more or less would it cost if the Census Bureau used a new approach to taking the census? How much would be saved if an Army division were based in the United States rather than in Europe?

97 Program managers need information on the assets and liabilities related to operations. Managers of loan programs need information on the quality of their loan portfolios. Managers of repair depots want information on inventories, such as their value, quantity, location, age, and condition. Managers of government facilities need to know the facilities' condition and an estimate of future outlays made

necessary by deferring needed maintenance.

98 Congress and executives need information about the market value of assets that could be sold, such as precious metals or other commodities.

Stewardship

99 Citizens, Congress, executives, and program managers need information to assess the effect of the government's activities on its financial condition and that of the nation. Information is needed about the financial outlook for both the short and the long term.

100 Information is needed on the government's exposure and risks associated with deposit insurance, pension insurance, and flood insurance. People need to know about likely future expenditures for cleaning up nuclear weapons sites and military bases. They want information that will help them assess the likelihood and amount of future claims that might arise from government-sponsored enterprises.

101 All users need information on earmarked revenues recorded in trust funds. They want to know, for example, whether the Social Security Trust funds are likely, in the foreseeable future, to need infusions of new taxes to pay benefits. Citizens need to know the implications of investing trust fund revenues in government securities.

102 Users also need trend information on spending on investments in physical and human capital versus spending on consumption.

Systems and Control

103 Users at all levels need information on internal controls and the adequacy of financial management systems. Citizens want assurances that systems and controls are in place to protect the resources they supply to the government. They want to know that operating procedures and processes provide reasonable assurance that those resources are used economically and efficiently for the purposes intended. Congress, executives, and program managers need to demonstrate to those to whom they are accountable that they have, in fact, protected those resources and used them well. Users want to know, for example, that agency heads have

determined that internal controls are adequate, that basic financial statements are auditable, and that high-risk areas have been identified and addressed.

104 The implications of these four broad categories of information needs for the objectives of federal financial reporting are discussed in more detail in the next chapter.

CHAPTER 4: OBJECTIVES OF FEDERAL FINANCIAL REPORTING

105 The federal government derives its just powers from the consent of the governed. It therefore has a special responsibility to report on its actions and the results of those actions. These reports must accurately reflect the distinctive nature of the federal government and must provide information useful to the people, their elected representatives, and federal executives. Providing this information to the public, the news media, and elected officials is an essential part of accountability in government. Providing this information to program managers, executives, and members of Congress is essential to planning and conducting the government's functions economically, efficiently, and effectively for the benefit of society.

106 Financial reporting is not the only source of information to support decision-making and accountability. Neither can financial reporting, by itself, ensure that the government operates as it should. Financial reporting can, however, make a useful contribution toward those objectives.

107 The objectives discussed below apply both to internal and to external financial reports. To some degree, they also apply both to special purpose and to general purpose reports. Users of general purpose financial reports may have difficulty obtaining relevant information to hold the federal government accountable if the government operates without appropriate reporting objectives and accounting standards. The Board also intends that these objectives and the ensuing standards will prove widely useful for other purposes, though they may not apply to every special report or every item in the accounting system. The objectives are intended to improve the relevance, consistency, and quality of accounting and other data

available for a wide variety of applications.

108 The Board expects that its recommendations will be applied to improve information for program management and executive and legislative branch decision-making. The Department of the Treasury, OMB, and the GAO expect that, to the extent possible, their reporting requirements will be aligned with the Board's objectives and standards.

109 Four major objectives are proposed, around which accounting standards should be organized. These objectives are designed to help ensure the accountability of the federal government and to better inform decisions influenced by financial information about the government. Each objective reflects the federal environment and meets many of the needs expressed by current and potential users of federal financial information. Together, they provide a framework for assessing the existing accountability and financial reporting systems of the federal government and for considering how new accounting standards might be able to enhance those systems in a cost-effective manner.

110 Current and potential users of federal financial information want information to help them assess how well the government is doing by answering questions regarding topics like those below:

- Budgetary Integrity: What legal authority was provided for financing government activities and for spending the monies? Were the financing and spending in accordance with these authorities? How much was left?
- Operating Performance: How much do various programs cost, and how were they financed? What outputs and outcomes were achieved? What and where are the important assets, and how effectively are they managed? What liabilities arose from operating the program, and how will they be provided for or liquidated?
- Stewardship: Did the government's financial condition improve or deteriorate? What provision was made for the future?

- Systems and Control: Does the government have cost-effective systems and controls to safeguard its assets? Is it able to detect likely problems? Is it correcting deficiencies when detected?

111 Concerns like these define the objectives of federal financial reporting. In the following text, objectives and subobjectives are stated in UPPER CASE type [editor's note: in bold italic type in printed text version].

Each of the objectives and subobjectives is followed by a commentary that explains some of the implications of the objective.

BUDGETARY INTEGRITY

Objective 1

112 FEDERAL FINANCIAL REPORTING SHOULD ASSIST IN FULFILLING THE GOVERNMENT'S DUTY TO BE PUBLICLY ACCOUNTABLE FOR MONIES RAISED THROUGH TAXES AND OTHER MEANS AND FOR THEIR EXPENDITURE IN ACCORDANCE WITH THE APPROPRIATIONS LAWS THAT ESTABLISH THE GOVERNMENT'S BUDGET FOR A PARTICULAR FISCAL YEAR AND RELATED LAWS AND REGULATIONS.

113 This objective arises generally from the responsibility of representative governments to be accountable for the monies that are raised and spent and for compliance with law. More specifically it arises from the requirement in Article I, Section 9 of the Constitution of the United States that "No Money shall be drawn from the Treasury, but in Consequence of Appropriations made by Law; and a regular Statement and Account of the Receipts and Expenditures of all public Money shall be published from time to time." Its focus is the Budget of the United States Government, the President's annual budget submission to the Congress, which is the government's principal financial report, and the laws enacting budget authority for a given fiscal year. The Budget of the United States Government is the initial frame of reference within which Congress and the President enact the laws that require the payment of taxes and provide the authority to obligate and spend money.

114 The focus of this objective is retrospective. That is, the focus is on recording actual data from budget

execution against appropriations made by Congress using existing budgetary standards. Thus, it would validate the "actual" column shown in the Budget of the United States Government. It would also provide data that could be shown in other reports as a statement of budget execution or a statement of the status of budgetary resources. The data also could be displayed in analytical tables showing, for example, the historical pattern of receipts and outlays.

115 Certain subobjectives arise from the basic objective of budgetary integrity, as discussed below.

FEDERAL FINANCIAL REPORTING SHOULD PROVIDE INFORMATION THAT HELPS THE READER TO DETERMINE:

116 1A. HOW BUDGETARY RESOURCES HAVE BEEN OBTAINED AND USED AND WHETHER THEIR ACQUISITION AND USE WERE IN ACCORDANCE WITH THE LEGAL AUTHORIZATION.

117 Considering this objective in conjunction with the specific information needs identified by the Board suggests some examples of information that might help meet this objective:

- government receipts and offsetting collections reported in total and by composition;
- obligations according to the nature of services or items procured;
- information about the extent of compliance with the budget and laws, and whether money was expended as intended by the federal government and its grantees; and
- valid data on budget authority, obligations, and outlays by program and for all appropriation and fund accounts (summarized appropriately to fit the intended audience).

118 1B. THE STATUS OF BUDGETARY RESOURCES. Examples of information that could help meet this objective include

- information about the sufficiency of budget authority for covering commitments and the

status of obligated and unobligated balances
of budgetary resources and

- assurances that funds authorized for a given purpose were actually spent for that purpose.

119 1C. HOW INFORMATION ON THE USE OF BUDGETARY RESOURCES RELATES TO INFORMATION ON THE COSTS OF PROGRAM OPERATIONS AND WHETHER INFORMATION ON THE STATUS OF BUDGETARY RESOURCES IS CONSISTENT WITH OTHER ACCOUNTING INFORMATION ON ASSETS AND LIABILITIES.

120 This subobjective arises from the fact that accrual-basis measures of the cost of government programs, functions, and activities may differ from the amounts used in the budget for a variety of valid reasons.

121 Reports primarily intended to address objective 1 and its first two subobjectives would use budgetary measurement. Subobjective 1C would use both budgetary and accrual measures because reconciliation of the two is implied. The basic accounting unit for this objective would be the budget account, although accounts are often aggregated for some reporting purposes.

OPERATING PERFORMANCE

Objective 2

122 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.

123 This objective arises from a democratic government's duty to be accountable to its citizens for managing resources and providing services economically and efficiently and for effectiveness in attaining planned goals. Also, the government should be accountable for raising resources efficiently.

124 Because government services are not usually provided in exchange for voluntary payments or fees, expenses cannot be matched against revenue to measure

"earnings" or "net income" as would be done in business accounting. Moreover, directly measuring the value added to society's welfare by government actions is difficult. Nonetheless, expenses can be matched against the provision of services year by year. The resulting cost can then be analyzed in relationship to a variety of measures of the achievement of results.

125 Certain subobjectives arise from the basic objective of reporting on operating performance, as discussed below.

FEDERAL FINANCIAL REPORTING SHOULD PROVIDE INFORMATION THAT HELPS THE READER TO DETERMINE:

126 2A. THE COSTS OF PROVIDING SPECIFIC PROGRAMS AND ACTIVITIES AND THE COMPOSITION OF, AND CHANGES IN, THESE COSTS.

127 Examples of financial information that can help to address this objective include

- information on the costs of programs and activities;
- cost comparisons with estimates, with similar functions, with targets,[Footnote 9.] and over time; and
- relevant analyses of the composition and behavior of costs, such as full and incremental costs, fixed and variable costs, direct and indirect costs, and reimbursable and other costs, where appropriate.

[Footnote 9: "Performance targets" specify the level of performance that is set as a goal by policy and program officials. Targets may be set in terms of outputs, outcomes, impacts, cost per unit of output, etc.]

128 2B. THE EFFORTS AND ACCOMPLISHMENTS ASSOCIATED WITH FEDERAL PROGRAMS AND THE CHANGES OVER TIME AND IN RELATION TO COSTS.

129 Examples of information that can help to address this objective include

- financial and nonfinancial indicators of service inputs, outputs, and outcomes, including comparisons with goals;
- indicators of program efficiency and effectiveness;
- work load measures and unit costs; and
- total and marginal costs and benefits, the relationship of these to budget requests, and when the benefits will be realized.

130 2C. THE EFFICIENCY AND EFFECTIVENESS OF THE GOVERNMENT'S MANAGEMENT OF ITS ASSETS AND LIABILITIES.

131 This subobjective implies concern with the management of all federal assets and liabilities used by or under the control of agencies. Users of financial reports focus on the use of these resources in program operations, not solely on their financial value. Reports intended to address this objective would provide information to help users assess the efficiency and effectiveness with which

- cash is used;
- loan, loan guarantee, and other receivables programs are conducted;
- inventories of supplies, materials, and similar items are maintained; and
- forfeited and other tangible assets are handled.

132 Other examples of information relevant to this objective might include

- the service life and replacement cost of major systems and equipment;
- backlogs (and budgetary impact) of delayed maintenance, rehabilitation cost or replacement value of assets;
- the market value of forfeited and other

- assets, particularly those held for sale;
- the extent of unpaid expenses; and
- estimates (and ranges of estimates) of other known liabilities (such as leases or deposit and other insurance liabilities) and other exposures to loss.

133 Further discussion of performance measurement and how financial reporting can contribute to reporting on performance is provided in chapter 8.

STEWARDSHIP

Objective 3

134 FEDERAL FINANCIAL REPORTING SHOULD ASSIST REPORT USERS IN ASSESSING THE IMPACT ON THE COUNTRY OF THE GOVERNMENT'S OPERATIONS AND INVESTMENTS FOR THE PERIOD AND HOW, AS A RESULT, THE GOVERNMENT'S AND THE NATION'S FINANCIAL CONDITIONS HAVE CHANGED AND MAY CHANGE IN THE FUTURE.[Footnote 10.]

[Footnote 10: The concepts of "financial position" and "financial condition" are discussed in chapter 7.]

135 This objective is based on the federal government's responsibility for the general welfare of the nation in perpetuity. It focuses not on the provision of specific services but on the requirement that the government report the broad outcomes of its actions. Certain subobjectives arise from the basic objective of stewardship, as discussed below.

FEDERAL FINANCIAL REPORTING SHOULD PROVIDE INFORMATION THAT HELPS THE READER TO DETERMINE:

136 3A. WHETHER THE GOVERNMENT'S FINANCIAL POSITION IMPROVED OR DETERIORATED OVER THE PERIOD.

Examples of information relevant to this objective include

- the amount of assets, liabilities, and net assets (or net position);
- an analysis of government debt, its growth, and debt service requirements;

- changes in the amount and service potential of capital assets; and
- the amount of contingent liabilities and unrecognized obligations (such as the probable cost of deposit insurance).

137 Assessing whether the government's financial position improved or deteriorated over the period is important not only because it has financial implications but also because it has social and political implications. This is because analysis of why financial position improved or deteriorated helps to explain whether financial burdens were passed on by current-year taxpayers to future-year taxpayers without related benefits. The latter notion is sometimes referred to as "interperiod equity." [Footnote 11.] [Footnote 11: In paragraph 61 of its first conceptual statement, "Objectives of Financial Reporting," the GASB noted: "The Board believes that interperiod equity is a significant part of accountability and is fundamental to public administration. It therefore needs to be considered when establishing financial reporting objectives [for state and local governmental entities]. In short, financial reporting should help users assess whether current-year revenues are sufficient to pay for the services provided that year and whether future taxpayers will be required to assume burdens for services previously provided." GASB's Statement 11, "Measurement Focus and Basis of Accounting Governmental Fund Operating Statements," adds "Conversely, [a measure of interperiod equity] would show whether current-year revenues not only were sufficient to pay for current-year services, but also increased accumulated net resources."]

138 Viewed in this broader context, providing information to meet objective 3 and its subobjectives will help to satisfy the needs expressed by financial report users. It will also help to explain the issuance of new debt in relation to expenditures for activities with current benefits versus expenditures for investment-type activities that yield future benefits.

139 3B. WHETHER FUTURE BUDGETARY RESOURCES WILL LIKELY BE SUFFICIENT TO SUSTAIN PUBLIC SERVICES AND TO MEET OBLIGATIONS AS THEY COME DUE.

140 Information about the results of past government operations is useful in assessing the stewardship exercised by the government. Users of financial reports also want help in assessing the likelihood that the government will continue to provide the current level of benefits and services to constituent groups, such as farmers, retirees, and the poor.

141 Information relevant to this objective may include disclosures of financial risks that are likely or reasonably possible from sources such as government-sponsored enterprises, deposit insurance, and disaster relief programs. It could also include information such as

- the long-term financial implications of the budgetary process,
- the status of trust funds, and
- backlogs of deferred maintenance.

142 Providing information of this kind may require the use of reporting mechanisms other than traditional financial statements. For example, special reports may have to be developed to demonstrate whether the level of a particular year's maintenance and rehabilitation expenditures resulted in an improvement or a deterioration of capital assets and infrastructure.

143 3C. WHETHER GOVERNMENT OPERATIONS HAVE CONTRIBUTED TO THE NATION'S CURRENT AND FUTURE WELL-BEING.

144 Objective 3, in general, and subobjective 3C, in particular, imply a concern with "financial condition," as well as "financial position." Financial condition is a broader and more forward-looking concept than that of financial position. Reporting on financial condition requires financial and nonfinancial information about the national economy and society, as well as about the government itself. For example, reports intended to help meet this objective might address users' needs for information about

- investments in (or expenditures for) research and development, military readiness, and

education;

- changes in the service potential of infrastructure assets;
- spending for consumption relative to investments;
- opportunities for growth-stimulating activities; and
- the likelihood of future inflation.

145 Indicators of financial position, measured on an accrual basis, are the starting point for reporting on financial condition but must be supplemented in a variety of ways. For example, subobjective 3B might imply reporting, among other things, a current law budget projection under a range of alternative assumptions. Reports intended to achieve subobjective 3C might disclose, among other things, the contribution that the government is making to national wealth by financing assets that are not federally owned, such as research and development, education and training, and state-owned infrastructure. Information on trends in total national wealth and income is also important.

SYSTEMS AND CONTROL

Objective 4

146 FEDERAL FINANCIAL REPORTING SHOULD ASSIST REPORT USERS IN UNDERSTANDING WHETHER FINANCIAL MANAGEMENT SYSTEMS AND INTERNAL ACCOUNTING AND ADMINISTRATIVE CONTROLS ARE ADEQUATE TO ENSURE THAT

- TRANSACTIONS ARE EXECUTED IN ACCORDANCE WITH BUDGETARY AND FINANCIAL LAWS AND OTHER REQUIREMENTS, ARE CONSISTENT WITH THE PURPOSES AUTHORIZED, AND ARE RECORDED IN ACCORDANCE WITH FEDERAL ACCOUNTING STANDARDS;
- ASSETS ARE PROPERLY SAFEGUARDED TO DETER FRAUD, WASTE, AND ABUSE; AND
- PERFORMANCE MEASUREMENT INFORMATION IS

ADEQUATELY SUPPORTED.

147 This objective arises from the three preceding objectives, in conjunction with the fact that accounting supports both effective management and control of organizations and the process of reporting useful information. Indeed, accounting processes are an integral part of the management control system.

148 The ability to prepare financial reports that report all transactions, classified in appropriate ways that faithfully represent the underlying events, is itself an indication that certain essential controls are in place and operating effectively. The preparation of reliable financial reports also helps to ensure that reporting entities have early warning systems to indicate potential problems and take actions to correct material weaknesses or problems.

149 Sound controls over internal processes are essential both to safeguard assets and to ensure economy, efficiency, and effectiveness in many governmental programs.

150 Information relevant to this objective helps financial report users to determine whether the entity has established reasonable, cost-effective programs to safeguard assets, prevent and detect waste and abuse, and reduce error rates. An example of information that would address this objective is management's assertion about the effectiveness of the internal accounting and operational control system.

CHAPTER 5: BALANCING COSTS AND BENEFITS IN RECOMMENDING STANDARDS

151 Users' information needs define financial reporting. Even so, the process of articulating financial reporting objectives and then recommending accounting standards is not a simple progression from canvassing users of federal financial information to recommending standards. This is partly because such users, when asked about their information needs, may give answers that are limited by their past needs and experiences. More fundamentally, it is because articulating objectives and recommending accounting standards necessarily involve judgments about the costs and benefits of producing more information or of reporting it

differently.

152 The standard-setting process is further complicated by the fact that any given accounting standard can have many different kinds of effects that must be considered. For example, accounting standards can influence the activities of agency accountants and the auditors who review reports prepared by those accountants, as well as the decisions of those who read the financial statements. Thus, a standard may influence which physical assets are under accounting control and the extent of work the auditor does to provide assurance about those assets. The accountants' and auditors' reports, in turn, may influence various decisionmakers in different ways as they select policies regarding the assets and the systems used to control them, decide how to implement the policies, and evaluate the results.

153 The standard setter must, to some extent, be aware of these potential effects when considering the costs and benefits of any given accounting alternative. As an added complication, the same piece of information may be used in different ways for different decisions. In other words, there are different kinds of "use." In some cases, the information may be consciously used in well-defined ways; in other cases, it may subtly influence the way people see the world, understand their options, and assess their priorities.

154 For example, the size of the deficit may have a very specific meaning with quite explicit implications (e.g., sequestration) under certain rules for scoring the budget. The deficit may also influence the economy because it affects aggregate demand and the government's financing requirements in a variety of ways that economists can only partially explain and quantify. Finally, the deficit may influence people's perceptions of their own well-being or of the nation's financial condition in more subjective or symbolic ways that can affect both private and collective behavior (e.g., willingness to undertake various new commitments, to pay more in taxes, or to accept reductions in program benefits).

155 Finally, as noted earlier, accounting and financial reporting cannot satisfy every need for information and accountability. For many purposes, other

information sources and other techniques to maintain and demonstrate accountability are either essential or more cost-effective. This constraint pervades any discussion of the objectives of federal financial reporting.

CHAPTER 6: QUALITATIVE CHARACTERISTICS OF INFORMATION IN FINANCIAL REPORTS

156 Financial reporting is the means of communicating with those who use financial information. For this communication to be effective, information in financial reports must have these basic characteristics: understandability, reliability, relevance, timeliness, consistency, and comparability.[Footnote 12.] [Footnote 12: For the most part, these characteristics are similar to those described by the FASB and the GASB.]

UNDERSTANDABILITY

157 Special purpose reports are prepared to meet the needs of specified users. Understandability is rarely a problem in such cases because mutual understanding of what information is needed can generally be assumed between report preparer and report user. Information in general purpose financial reports, however, should be expressed as simply as possible. Users of general purpose financial reports, including internal users, tend to have different levels of knowledge and sophistication about government operations, accounting, and finance.

158 To be publicly accountable, the federal government and its component entities should issue general purpose financial reports that can be understood by those who may not have a detailed knowledge of accounting principles. Those reports should include explanations and interpretations to help report users understand the information in the proper context. However, general purpose financial reports should not exclude essential information merely because it is difficult to understand or because some report users choose not to use it.

159 For reports to be understandable to different audiences, different reports may be necessary to provide

information relevant to the needs of the expected report users, with suitable amounts of detail, explanation, and related narrative. To be fully intelligible, financial information in general purpose reports may need to be presented in relation to the goals, service efforts, and accomplishments of the reporting entity.

RELIABILITY

160 Financial reporting should be reliable; that is, the information presented should be verifiable and free from bias and should faithfully represent what it purports to represent. To be reliable, financial reporting needs to be comprehensive. Nothing material should be omitted from the information necessary to represent faithfully the underlying events and conditions, nor should anything be included that would likely cause the information to be misleading to the intended report user. Reliability does not imply precision or certainty, but reliability is affected by the degree of estimation in the measurement process and by uncertainties inherent in what is being measured. Financial reporting may need to include narrative explanations about the underlying assumptions and uncertainties inherent in this process. Under certain circumstances, a properly explained estimate provides more meaningful information than no estimate at all.

RELEVANCE

161 Relevance encompasses many of the other characteristics. For example, if the information provided in a financial report is not timely or reliable, it is not relevant. Information can, however, meet all other characteristics and still not be relevant. To be relevant, a logical relationship must exist between the information provided and the purpose for which it is needed. Information is relevant if it is capable of making a difference in a user's assessment of a problem, condition, or event. Relevance depends on the types of financial information needed by the various users to make decisions and to assess accountability.

TIMELINESS

162 In some circumstances, the mere knowledge that a report eventually will be made public can influence behavior

in desirable ways, just as the knowledge that one's tax return might eventually be audited can influence the behavior of people when they report their income. In other circumstances, however, if financial reports are to be useful, they must be issued soon enough to affect decisions. Timeliness alone does not make information useful, but the passage of time usually diminishes the usefulness that the information otherwise would have had. In some instances, timeliness may be so essential that it requires sacrificing a certain amount of precision or detail; a timely estimate may then be more useful than precise information that takes longer to produce.

CONSISTENCY

163 Financial reports should be consistent over time; that is, once an accounting principle or reporting method is adopted, it should be used for all similar transactions and events unless there is good cause to change. The concept of consistency in financial reporting extends to many areas, such as valuation methods, basis of accounting, and determination of the financial reporting entity. If accounting principles have changed or if the financial reporting entity has changed, the nature and reason for the change, as well as the effect of the change, should be disclosed.

COMPARABILITY

164 Financial reporting should help report users make relevant comparisons among similar federal reporting units, such as comparisons of the costs of specific functions or activities. Comparability implies that differences among financial reports should be caused by substantive differences in the underlying transactions or organizations rather than by the mere selection of different alternatives in accounting procedures or practices.

CHAPTER 7: HOW ACCOUNTING SUPPORTS FEDERAL FINANCIAL REPORTING

165 This chapter explains the focus of the FASAB's concern by showing how accounting supports financial reporting and thus how accounting standards recommended by

the FASAB can influence federal financial reporting. This chapter shows how the FASAB's recommendations can influence a wide variety of financial reports. Additionally, it lays a foundation for the discussion (in chapter 8) of how financial reporting in general, and cost information in particular, contribute to performance reporting. In effect, chapter 7 outlines parts of a conceptual framework for federal accounting but is limited to those ideas, such as "financial position" and "financial condition," that will help readers understand the Board's proposed statement of objectives for federal financial reporting.

FINANCIAL CORE DATA

166 The accounting process begins with recording information about transactions between the government (or one of its component entities) and other entities, that is, inflows and outflows of resources or promises to provide them. These may involve flows of economic goods, cash, or promises. These comprise the "core" data of the accounting discipline. This initial step in the accounting process is depicted at the bottom of figure 1, in the box numbered 1. To enhance the usefulness of this core set of data about transactions with other entities, accountants make various accruals, classifications, interpretations, etc.

[Figure 1, "How Accounting Contributes to Information Used by Citizens, Congress, Federal Executives, and Program Managers," appeared in the hard-copy Statement.]

167 Many accounting entries recorded in the accountant's general ledger data base are such rearrangements of data about previously recorded transactions with other entities rather than new transactions involving flows of resources or promises between entities.[Footnote 13.]

[Footnote 13: See William J. Schrader, Robert E. Malcom, and John J. Willingham, "A Partitioned Events View of Financial Reporting," *Accounting Horizons* (Dec. 1988), p 10-20. For a more academic exploration of the ideas involved, see Yuji Ijiri, "Theory of Accounting Measurement," *Studies in Accounting Research* # 10, American Accounting Association (1975).]

168 In the branch of accounting called financial accounting, the most noteworthy interpretations or

classifications are those about which data pertain to the past and which pertain to the future. In other words, financial accounting is largely concerned with assigning the value of past transactions to appropriate time periods.

169 Transaction data assigned to a period that has elapsed are said to be "recognized" in the statement of operations (or income statement), e.g., as an expense or a revenue of that period. Transaction data pertaining to the future are recognized in the statement of financial position (or balance sheet) as assets and liabilities.

170 Together with the statement of cash flows, the income statement (or statement of operations or activities) and the balance sheet comprise the three "basic" general purpose financial statements for privately owned entities. Other statements, such as a comparison of actual results with the budget, may be regarded as part of the basic statements for governmental entities.

171 At the initial stage of the accounting process, the information about assets and liabilities is merely the result of assigning all or part of the value of certain transactions to the future. "Assets" and "liabilities" at this stage are not statements about future benefits or sacrifices that can be proven or disproven. They are allocations of the cost of past transactions based on assumptions about future benefit and sacrifice.

172 This has been a common source of confusion when accountants communicate with nonaccountants, for whom the word "asset" typically implies something of value that can be sold or used. Much of the evolution of accounting under the FASB and the GASB has been to reduce this confusion, to improve communication, and to make financial reports more faithfully represent economic reality in terms meaningful to report users. This evolution has involved adding increasing amounts of information to the core set of transaction data. That process is discussed later.

173 In other words, the amount of "equity" or "net assets" based on the core data in a bookkeeper's trial balance is not a direct measure of either the market value or the service potential of the entity. In some circumstances, however, net assets can be a meaningful indicator of that value or potential. (The word "indicator"

is used deliberately to avoid the implication of precision that may be associated with the word "measure.")[Footnote 14.]

[Footnote 14: The term "measure" is commonly used in accounting literature regarding cost and in other literature (including the GASB's) regarding performance. This document follows that practice. In a conceptual discussion, however, it is important to note that "cost," "performance," and "financial condition" are all multidimensional concepts. It may be more precise to think in terms of multiple indicators that provide information about these concepts instead of a single-valued "measure" of any of them.]

174 Accounting data may be further assigned, allocated, or associated with units of activity or production, segments of organizations, etc., within the same time period. These kinds of intraperiod allocations are developed most extensively in the branch of accounting called cost or managerial accounting. Neither the FASB nor the GASB has devoted much attention to this branch of accounting, but the FASAB, because of its unique mission, will need to do so. One reason for performing cost accounting is to assist in performance measurement.

NONFINANCIAL CORE DATA

175 Traditionally, financial accountants record and describe transactions in terms of money. At the most detailed level, however, their records usually include information about the associated physical inputs and outputs of goods, labor, etc. This nonfinancial information is an important part of the data available for reporting and evaluating the economy and efficiency of the organization's performance.

BUDGETARY CORE DATA

176 In government the data on transactions with other entities include information on the budget authority, obligations, outlays, receipts, and offsetting collections for the transactions. This information is maintained in what are called budgetary accounts to distinguish them from the "proprietary" accounts that record other information on transactions. The budgetary and proprietary accounts at this level are said to be "integrated." In effect, they maintain information about different stages of a transaction.

FINANCIAL ENVIRONMENTAL DATA AND THE CONCEPT OF FINANCIAL POSITION

177 The core set of accounting data is expanded with a variety of what may be called "environmental" data to distinguish them from the data that arise from transactions (flows of resources or promises) with other entities. Box 2 in figure 1 depicts this step of the accounting and reporting process. Many events within the environment of a reporting entity may have economic consequences for the entity. Examples of environmental data that may be relevant to financial reporting for some purposes include current market prices, net realizable values, changes in discount (interest) rates, and impairment of assets (either in terms of market value or in terms of service potential). Judgments about what environmental data should be added are made by considering the specific information needed for specific purposes.

178 At this level of the accounting and financial reporting process, the information reported in the balance sheet transcends bookkeeping. It can now represent more of what is known about future economic benefits and sacrifices. To the extent that this is accomplished, the balance sheet may be said to represent the "financial position" of the reporting entity. The concept of financial position is that of a point-in-time snapshot of an entity's economic resources and the claims on those resources.

NONFINANCIAL ENVIRONMENTAL INFORMATION

179 Nonfinancial information about program efforts, accomplishments, and outcomes may be collected and associated with the financial environmental data. This information is particularly important for governments because there is no direct analogue to "net income" or "earnings" to gauge the economy, efficiency, and effectiveness or net value of governmental activity.

THE CONCEPT OF FINANCIAL CONDITION

180 As more environmental data are added to the core data, a concept that is broader and more forward-looking than "financial position" emerges. That concept is "financial condition." For the U.S. government, the

additional data could include financial and nonfinancial information about current conditions and reasonable expectations regarding the national and even the global society. For example, the expected implications of environmental degradation; the relative competitiveness and productivity of the U.S. economy; or expected changes in the population's composition in terms of age, gender, longevity, education, health, and income all might affect judgments about the government's financial condition.

181 Information about financial condition can be conveyed in a variety of schedules, notes, projections, and narrative disclosures. Among the most important of these is management's "discussion and analysis" of known trends, demands, commitments, events, and uncertainties. For federal reporting entities, management's discussion and analysis might address such topics as

- budgetary compliance;
- internal control systems;
- capital resources and investments;
- service efforts, accomplishments, and results of operations; and
- the reasonably possible future impact of known trends, risks, demands, commitments, events, or uncertainties that may affect future operations.[Footnote 15.]

[Footnote 15: Such a discussion and analysis is required in federal financial reports prepared pursuant to the CFO Act of 1990. In these reports, the discussion and analysis is referred to as the "overview" section. OMB Bulletin 92-03 provides guidance on preparing the overview section.]

182 Increasingly, managers and investors in the private sector are attending to other factors that may sometimes be useful indicators of an entity's financial condition, including such intangible factors as the quality of the entity's

- information and analysis capabilities,
- strategic planning,

- human resource development and management,
and
- constituent satisfaction.

Similar factors may be relevant for many federal reporting entities.

KINDS OF FINANCIAL INFORMATION NEEDED AND PROVIDED

183 The information produced by these accounting processes supports the overall reporting process. Traditionally, the items of information included in financial statements are classified in various "elements" of financial reporting, such as "assets," "liabilities," "revenues," or "expenses." In future projects, the FASAB may consider the definition of elements of federal financial reporting. For the purposes of this Statement of Concepts, however, it is not necessary to do so. It is sufficient to note that needed financial information identified by some current and potential users of federal financial reports can be classified under six broad headings:

- information on the sources and uses of budgetary resources,
- information about operations and the related resources,
- information about the government's assets,
- information about the government's liabilities and financial responsibilities,
- information that addresses concerns with the future, and
- information that discloses the levels of financial controls.

184 Examples and further discussion of such information needs are provided in appendix B.

HOW THIS INFORMATION FLOWS INTO FINANCIAL REPORTS

185 The core and environmental financial information, often supplemented with information from other sources, is the basis for a variety of general purpose and special purpose reports. For this reason, figure 1 culminates with the preparation of useful reports. A direct relationship exists between the accounting and reporting processes both for general purpose financial reports and for budget execution reports. The dotted line in figure 1 leading to other kinds of reports emphasizes that other kinds of information are often more heavily involved in producing them. Accounting contributes to these reports but has less influence over the nature, scope, and content of them. (Appendix C lists selected federal reports that are regularly prepared.)

RELATIONSHIP OF FINANCIAL REPORTING TO BUDGETING

186 "The budget" is a broad term that may include, among other things, a projection of spending authorities and means of financing them for a future period and a report of the actual spending and associated financing for a past period. The FASAB's recommendations may influence the reporting of actual budgetary data.

187 The Budget of the United States Government is the most widely recognized and used financial report of the federal government. The budget process is the government's principal mechanism for reaching agreement on goals, for allocating resources among competing uses, and for assessing the government's fiscal effects on economic stability and growth. Most attention is paid to these future-oriented roles of the budget.

188 Budget execution is designed to control and track tax receipts and the use of resources according to the purposes for which budget authority was approved. Actual receipts, obligations, and outlays are recorded by account, as is the status of budgetary resources at the end of each fiscal year.

189 Budgetary measurement is designed to assist in the control and allocation of resources by showing the cash outlays implied by each decision when the decision is made. In some cases, the budget now also includes accruals for costs in advance of the required cash outlay. Budgetary concepts are under continual review. They may be changed by

law or, after consultation with the Congress, in the annual revision of OMB Circular A-11, "Preparation and Submission of Budget Estimates."

190 The Board's authority does not extend to recommending budgetary standards or budgetary concepts, but the Board is committed to providing reliable accounting information that supports budget planning and formulation. The Board also supports efforts to ensure the accuracy and reliability of reporting on the budget.

191 The Board's own focus is on developing generally accepted accounting standards for reporting on the financial operations, financial position, and financial condition of the federal government and its component entities and other useful financial information. This implies a variety of measures of costs and other information that complements the information available in the budget. Together with budgetary reports, these reports will provide a more comprehensive and insightful understanding of the government's financial position, results of operations, and financial condition than either set of reports alone.

CHAPTER 8: HOW FINANCIAL REPORTING SUPPORTS REPORTING ON OPERATING PERFORMANCE

192 The second objective and its subobjectives concern reporting on performance. References to measuring cost pervade this objective and its supporting narrative. The topics of cost and performance measurement are related because it is by associating cost with activities or "cost objectives" that accounting can make much of its contribution to reporting on performance.

193 Setting performance targets is a function of management, not of accountants. That is, elected and appointed officials, including both program and policy officials, decide what the government will do, how much the government will do, and how it will be done. These officials consider the relevant constraints and other factors when establishing the performance targets. Measuring performance against those goals is an essential part of management. On the other hand, measuring cost is an important part of measuring performance, and measuring cost and reporting the results is a function of accounting and the financial

reporting system. Financial reporting standards deal with what information is reported and how it is reported, not with the target levels of performance.

194 This chapter first discusses cost measurement in general terms, then outlines a framework for reporting on performance to show how cost information can assist in that endeavor. Both cost measurement and performance measurement are complex subjects. Difficult problems arise during attempts to implement the ideas involved. For example, meaningful interpretation may require disaggregation of information or adjustment of targets for differences in client characteristics, for local conditions, and for other factors beyond the government's control. Such problems are beyond the scope of this conceptual document. This Statement does not purport to present a comprehensive discussion of how to measure cost or performance. Neither does this Statement address the problems of implementation; it merely shows the relationship between financial reporting and performance reporting in conceptual terms.

COST MEASUREMENT

195 As used in this Statement of Concepts, "cost" is the monetary value of the resources used. Thus far, the FASAB has considered the recognition and measurement of certain assets and liabilities that could influence the amount of cost recognized in a given period by a federal reporting entity. For example, the Board's Statement on "Accounting for Direct Loans and Loan Guarantees" implements accrual accounting for these programs, similar to the accrual budgeting mandated for them by the Credit Reform Act of 1990.

196 A "cost objective" is a program, a function, an activity, an organizational subdivision, a contract, or another work unit for which cost data are desired and for which provision is made to accumulate and measure the cost of processes, products, jobs, capital projects, etc. The basic premise of cost accounting has been described by saying that the measurement, assignment, and allocation of costs to cost objectives should be based on the beneficial or causal relationship between those costs and the cost objectives. In defining the proper measurement, assignment, and allocation of cost for a given purpose, selecting the appropriate accounting method and whether to use full

costing should be carefully considered.

METHOD OF ACCOUNTING: 197 The accrual basis of accounting generally provides a better matching of costs to the production of goods and services, but its use and application for any given purpose must be carefully evaluated.

FULL COSTING: 198 Full assignment of all costs of a period, including general and administrative expenses and all other indirect costs, is an important basis for measuring cost of service. However, full cost is not necessarily the relevant cost for making all decisions. For example, incremental cost is more appropriate for many kinds of decisions, while opportunity cost is more appropriate for others. Similarly, cost that is controllable at a given management level is more appropriate for most evaluations of the performance of those managers. Accordingly, accounting systems should permit the calculation of the relevant costs needed for a range of decisions, as determined by the specific situation, and financial reports should reflect costs suitable to the purpose intended.

PERFORMANCE MEASUREMENT

199 Performance reporting is broader than financial reporting, but good financial reporting is essential to support performance reporting. The GASB has identified three broad categories of measures for reporting on performance of state and local governmental entities: those that measure service efforts, those that measure service accomplishments, and those that relate efforts to accomplishments. Although some performance measures may not be clearly assignable to one of these categories, the categories are helpful for understanding how and where financial reporting can contribute to performance reporting by providing relevant financial information.

200 To clarify this relationship, the FASAB may wish to change or expand parts of the following discussion in future projects. At this time, however, the FASAB believes this basic framework is appropriate for the limited purpose of explaining how financial reporting can contribute to performance reporting.[Footnote 16.]

[Footnote 16: The following discussion is based largely on the GASB's Preliminary Views on Service Efforts and

Accomplishments Reporting, December, 1992.]

MEASURES OF EFFORTS: 201 Efforts are the amount of financial and nonfinancial resources (in terms of money, material, and so forth) that are put into a program or a process. Measures of service efforts also include ratios that compare financial resources with other measures that may indicate potential demand for services, such as the number of potential service recipients.

202 Financial information includes financial measures of resources used. They include the cost of salaries, employee benefits, materials and supplies, contract services, equipment, etc., used in providing a service. The FASAB's Statement on "Accounting for Inventory and Related Property" is an example of how the FASAB's recommendations could affect information reported on resources used.

203 Nonfinancial information includes the following:

- Number of personnel: Because personnel are a major resource for many federal agencies and programs, indicators that measure the number of full-time equivalent employees or employee-hours used in providing a service often provide a significant measure of resources used.
- Other measures: These may include the amount of equipment (such as number of vehicles) or other capital assets used in providing a service. Because some federal programs use large amounts of capital assets, measures of the use of such assets can be important indicators of resources used.

MEASURES OF ACCOMPLISHMENTS: 204 Measures of accomplishments report what was provided and achieved with the resources used. There are two types of measures of accomplishments outputs and outcomes. Outputs measure the quantity of services provided. Outcomes measure the results of providing those outputs. For some kinds of programs, financial information can provide measures of accomplishments. For example, for some government business-type activities, just as for profit-seeking businesses, the revenue earned can be used as an indicator

of accomplishments. In most government programs, however, the important indicators of accomplishments are based on nonfinancial information, as discussed below.

205 Outputs, which can be measured in these ways:

- Quantity of service provided: These indicators measure the physical quantity of a service provided.
- Quantity of a service provided that meets a certain quality requirement: These indicators measure the physical quantity of a service provided that meets a specified criterion or a set of criteria. (Quality requirements can also be defined and measured regarding inputs.)

206 Outcomes, for which indicators measure accomplishments or results that occur (at least partially) because of the service efforts. Some authorities use terms like "impact," "effect," or "results" to distinguish the change in outcomes specifically caused by the governmental activity from the total change in outcomes that can be caused by many factors. Though it is not always feasible, in theory performance evaluation should focus on results or effects in the sense of impacts, i.e., on the differences between program outcomes and the outcomes that would have occurred in the absence of the program. Results also include measures of public perceptions of outcomes.

207 Outcome measures are particularly useful when presented as comparisons with previous years, established targets, goals and objectives, generally accepted norms and standards (in the sense of "targets"), other parts of the entity, or other comparable entities.

208 Sometimes, the secondary and/or unintended effects of a service on the service recipients, community, or nation can be identified and may warrant reporting.

MEASURES THAT RELATE EFFORTS TO ACCOMPLISHMENTS: 209 For profit-seeking entities and for some business-type government programs, the amount of net income can be thought of as a single indicator that relates organizational efforts to accomplishments. For most government activities, however,

relating efforts with accomplishments in a meaningful manner is more complex. Two types of such indicators are discussed below.

- Efficiency measures that relate efforts to outputs of services: These indicators measure the financial resources used or the cost (in dollars, employee-hours, or equipment) per unit of output. They provide information about the production of an output at a given level of resource use and demonstrate an entity's relative efficiency when compared with previous results, established goals and objectives, generally accepted norms or targets, or results achieved by similar entities.

- Effectiveness or cost-outcome measures that relate efforts to the outcomes or results of services: These measures report the cost per unit of outcome or result. They relate costs and results to help managers, executives, Congress, and citizens assess the value of the services provided by an entity.

210 As is evident, financial or cost information is an important component of both types of measures that attempt to relate efforts to accomplishments.

LIMITATIONS OF PERFORMANCE MEASUREMENT: 211 Performance measurement is an essential part of good management, and performance reporting is an essential part of government accountability. Important limitations and difficulties associated with performance measurement and reporting should be noted, although they cannot be fully explored in a brief outline of the subject such as this. For example: performance usually cannot be fully described by a single measure; indicators of service efforts and accomplishments do not, by themselves, indicate why performance is at the level reported; and reporting quantifiable indicators can sometimes have unintended consequences.

212 For these and other reasons, the three categories of performance measures generally need to be accompanied by suitable explanatory information. Indeed, narrative information is an essential part of reporting on

performance. Explanatory information includes both quantitative and narrative information to help report users understand reported measures, assess the reporting entity's performance, and evaluate the significance of underlying factors that may have affected the reported performance. (As noted, the reporting entity may be the federal government as a whole or any of its component reporting entities.) Explanatory information can include, for example, information about factors substantially outside the entity's control, as well as information about factors over which the entity has significant control.

APPENDIX A: BASIS FOR CONCLUSIONS

INTRODUCTION

213 This appendix summarizes some of the considerations that were deemed significant by members of the Board in reaching the conclusions in this Statement. It includes reasons for accepting certain approaches and for rejecting others. Individual Board members gave greater weight to some factors than to others.

214 The Board used several methods to arrive at the knowledge base and conclusions that shape this Statement. Its staff conducted focus group discussions, interviewed users and preparers of financial information, and performed other research.

215 Based on this work, the Board published an exposure draft on January 8, 1993, as called for by the Board's rules of procedure. Forty-six letters were received in response. The Board also held a public hearing on the exposure draft on April 21-22, 1993, at which it received valuable comments.

216 The Board wishes to thank everyone who participated in the process.

RELATIONSHIP BETWEEN FINANCIAL REPORTING AND THE BUDGET

217 The Board considered whether it should modify the exposure draft's discussion of the relationship between financial reporting and the budget. Several respondents

commented on this subject, but often in different ways. Some alluded to budgetary and proprietary (or "accrual" or "financial") accounting in a context that implied each should be on a different basis but reported in an integrated fashion. Others suggested that using the same basis for reporting and for budgeting was essential to achieve the objectives stated for federal financial reporting.

218 Many recommendations have been made over the years that information on expenditures be arranged to permit better perception of the relationship between the expenditures and national policy objectives. Some of those recommendations have related to the budget. Some have called for an "accrual-basis" budget. Those who would like to change the organization and/or the basis of the budget, e.g., to more of a "program" organization or to more of an "accrual" basis, might regard financial reporting from a program perspective and/or on an accrual basis as a valuable first step before considering restructuring the budget.

219 Others may have fundamentally different views. For example, some believe there is merit in maintaining a distinction between accrual accounting and budgeting, except to the extent that those involved in preparing and approving the budget elect to use an accrual convention, as in the Credit Reform Act of 1990. These persons believe that the budgetary basis of measurement should, in principle, sometimes be different from the accrual basis. They infer this from the different purposes of budgeting and financial reporting.

220 The Board concluded that there was no reason to change the discussion of this topic in this Statement, because the Board has no jurisdiction regarding the budget.

STATE AND LOCAL GOVERNMENTS AND OTHER NONFEDERAL ENTITIES

221 Some respondents expressed concern about the potential impact of federal accounting standards on state and local governmental accounting. These respondents would like to minimize the cost of compliance with federal requirements. To the extent possible, they would like to avoid the need to report on a basis different from that specified by the GASB. Presumably their comments dealt with general purpose reporting because grantees must now prepare various special purpose reports pursuant to the requirements

of granting agencies, OMB, the Single Audit Act, etc.

222 The FASAB has no intent to recommend standards for general purpose external financial reporting by nonfederal entities. The FASAB's mission is to consider and recommend accounting principles for the federal government. The FASAB's work, therefore, will have no direct effect on nonfederal entities. It is true, however, that the FASAB's recommendations could eventually result in increased demand for information from recipients of federal funds. This could happen when such information was necessary for federal reporting entities to achieve the stated objectives of federal financial reporting. Such requirements would be "special purpose" reporting requirements, from the perspective of grant and contract recipients.

223 These requirements most likely would be imposed by program officials in contracts and grant agreements with the recipients of the federal funds. The Board acknowledges that the federal government has a responsibility to consider the cost imposed on nonfederal entities when making decisions to impose such requirements. At the same time, benefits to all entities and to all citizens involved also must be considered.

REPORTING ON PERFORMANCE AND USING NONFINANCIAL INFORMATION

224 Most respondents who addressed reporting on performance supported the exposure draft, but some thought the language was too encompassing. The Board concluded that their concern was stimulated in part by the wording of the first three objectives in the exposure draft. Each began with the phrase "federal financial reporting should assist . . ." However, each of these objectives subsequently included a phrase "Federal financial reporting should enable the reader to determine . . ." that perhaps implied more than the Board intended.

225 Accordingly, the Board substituted the phrase "provide information that helps the reader . . ." for "enable . . ." The Board also made certain other changes recommended by some respondents. In particular, the Statement now uses the phrase "performance target" to refer to desired levels of performance defined by elected and appointed officials. This term is used instead of "performance standard" to avoid possible confusion with

"financial reporting standards," which deal with what information is to be reported in designated reports and with how it is reported.

226 The Statement also makes it clear that performance targets should be set by program and policy officials working together. Financial officials have a role to play in this process, especially where financial data are involved. That role is based on their expertise in cost measurement and their responsibility to ensure the integrity of the data.

227 One authority on public administration has explained the relationship in this way:

Government accountants are responsible in part for capturing, reporting, and analyzing actual financial information important for both policy making and management. Policy analysts and budget professionals deal primarily with what should occur and accountants deal primarily with capturing and recording what did occur. In addition, government accountants have auditors reviewing their work professionally to further ensure the integrity of the accounting process.[Footnote 17.]

[Footnote 17: Thomas D. Lynch, "President's Column," "ASPA Times, vol. 16, No. 6 (June 1, 1993), p. 5, American Society for Public Administration.]

228 The Board believes that accounting supports financial reporting and that, in the government, financial reporting goes hand in hand with accountability and performance evaluation. Financial accounting and financial reporting have a special role in assuring compliance with finance-related requirements for transactions. This is most directly relevant to objectives 1 and 4.

229 Financial reporting, however, also provides useful information about costs, assets, and liabilities. This information is especially relevant to objectives 2 and 3. Routine reporting of outputs, outcomes, and their costs is an important part of a performance monitoring system. Assessments of impacts (also referred to as effects, or results) specifically caused by governmental action are more likely to be performed in less-frequent program evaluations

and special studies. Those studies draw upon the output, outcome, and cost information that is (or should be) more frequently published.

230 Federal accounting and financial reporting exist within the context of various laws intended to foster accountability and performance evaluation. Neither the FASAB nor federal financial reporting can independently accomplish the objectives of evaluating performance or assuring accountability, but they can contribute to achieving them. Furthermore, to make their essential contribution to these ends, accountants, auditors, and financial managers must understand the overall framework for achieving these objectives.

231 For nongovernmental entities, competitive markets for goods, services, and capital provide an independent assessment of the economy, efficiency, and effectiveness with which those entities use resources to meet their customers' needs. There is no similar proof of value for federal output independent of the political process. To report on the results of operations of a governmental entity, nonfinancial information is essential, in conjunction with financial information.

232 In concept, this fact could imply that a complete financial report of a federal reporting entity should include indicators of economy, efficiency, and cost effectiveness if the report is to fairly present the entity's financial position and results of operations. Paragraph 210 notes that financial or cost information is an important component of both types of measures that attempt to relate efforts to accomplishments. In practice, the extent to which it is feasible and cost effective to present such information can be decided only after careful study of the specific circumstances.

233 While specific decisions will require further study, the Board notes its belief that any attempt to demonstrate accountability beyond probity (level 5) and process (level 4) requires performance measures.[Footnote 18.] The Board's user needs study, its public hearings, and similar sources of information suggest a widespread belief that the federal government needs to make a more systematic attempt to measure and report outputs, outcomes (including impacts), and the costs of producing them. To do this, the

Board believes, accounting and financial reporting play an essential part throughout the cycle of planning, budgeting, financial management, and evaluation of federal activities.

[Footnote 18: Levels of accountability are discussed in chapter 3.]

STEWARDSHIP

234 A few respondents said that the stewardship objective described in the exposure draft was too broad. They felt that information on the effects on the nation of policy decisions was outside the scope of federal financial reporting. The Board concluded that this concern like the preceding one regarding reporting on performance stemmed in part from the wording and structure of the first three objectives in the exposure draft.

235 Accordingly, the Board substituted the phrase "provide information that helps . . ." for "enable . . ." As noted earlier, federal financial reporting cannot by itself accomplish the objectives of evaluating or assuring stewardship; it can only contribute to those goals.

236 The Board notes that the federal government has two levels of stewardship. One is for its own assets and liabilities and its ongoing ability to operate. The other is its constitutional responsibility for the nation's wealth and well-being. It is unique in this respect. If the nation's wealth and well-being are deteriorating, the government's financial condition is, or soon will be, deteriorating also and vice versa. The financial condition of a sovereign national government and that of the nation itself are inextricably intertwined. Some information about the overall context must be provided, therefore, when reporting on the government as a whole, and perhaps when reporting on selected programs. As explained in chapter 1, the FASAB does not recommend standards for economic reporting, but it may consider whether such information should be included in certain financial reports.

SYSTEMS AND CONTROL

237 Most respondents who addressed the fourth objective, originally titled "Deterring Fraud Waste and Abuse," supported the exposure draft, though some suggested that it could be phrased in a more positive fashion. Several

emphasized the need for this objective and for standards to achieve it, but a few thought that internal control should not be regarded as an element of financial reporting. Others suggested that a separate objective on this topic was not necessary because it could be inferred from the other objectives.

238 The Board agreed that the objective should be stated in more positive terms. Accordingly, it replaced "Deterring Fraud, Waste, and Abuse" with the new heading "Systems and Control" and made other changes in wording the objective. With regard to the fundamental point, however, the Board continues to believe that systems and control are topics of sufficient importance and relevance to warrant addressing in their own right.

239 The Board's user needs study, public hearings, and other sources of information make abundantly clear that users want assurance that reported information is credible and reliable. They also want to know that reasonable controls are in place to deter fraud, waste, and abuse. Independent audit can help provide this assurance, but whether information is audited or not, effective systems and controls are essential to providing such assurance in a cost-effective way. Furthermore, effective systems and controls are essential to achieving the other objectives.

240 Perhaps the unique contribution of accounting-based reports for objectives 1 and 4 is the "core" accounting data base on transactions, especially on controlled transactions subject to finance-related restrictions. Systems of accounting control are integral parts of this special role for financial reporting. Similarly, regarding objective 2 and, to some extent, objective 3, systems and controls are important because direct observation of outcomes and impacts is often infeasible or expensive. In these cases, reliance on accounting and administrative controls to ensure compliance with good practices and processes is often a cost-effective surrogate for trying to measure the value added by governmental activities.

241 Finally, the fundamental notion of accountability pervades the entire set of objectives. Effective systems and controls are essential prerequisites to accountable government. Thus, the Board regards systems and controls as

an integral part of accounting, accountability, and financial reporting.

DUAL FOCUS ON INTERNAL AND EXTERNAL USERS

242 Several respondents mentioned users, but no consensus about a change to the exposure draft was evident. For example, some respondents urged greater emphasis on the information needs of external users or on objectives of general purpose, external financial reporting. Others urged greater emphasis on information needs of lower-level program managers and employees. These comments are not necessarily contradictory, nor are the competing perspectives necessarily mutually exclusive. The Board continues to believe that it must consider both external and internal users. The Board itself is the agent of officials who, in turn, are agents of the public. This organizational fact contributes to the dual focus.

243 Also, as noted in chapter 1, the distinction between internal and external users is not clear for the federal government. Except in degree of detail, virtually all federal financial information is of interest to at least some segments of the public.

244 The Board acknowledges that this dual focus will often create the need to balance various considerations to arrive at an optimal result. For example, as one respondent properly noted, there could be a danger of emphasizing what he termed "comparable consistency" for uniform reporting to users who want comparable information across agencies. He was concerned that this might interfere with "relevant customization" of information systems to meet the unique needs of agencies in response to their specific environments. It is understood that "comparable consistency" of information is needed for some purposes and "relevant customization" for others.

245 The Board is primarily concerned with the former class of uses and reports, i.e., with ensuring the provision of comparable data where it is relevant and cost-effective to do so. Individual preparers often are not in a good position to judge the cost-benefit ratio of such information governmentwide. They are aware of the costs they incur to produce information, but they often are not aware of the potential benefit of producing that information. Neither are

they in a position to establish standards that would produce such information.

246 On the other hand, there should be less need for outsiders like the Board or its sponsors to mandate relevant customization within agencies. Presumably each preparer can and will take care of that, provided that resources are available to do so and that there are no bureaucratic impediments.

247 In concept, therefore, there need be no conflict between "comparable consistency" and "relevant customization." Furthermore, in theory, properly designed accounting systems should facilitate both internal and external reporting. In practice, however, because administrative resources for information processing systems are limited and because new systems take time to install, externally-imposed requirements for comparable consistency could compete with addressing internally perceived needs for relevant customization. The Board acknowledges this trade-off. This is just one of many cost-benefit factors that the Board will need to consider as it addresses each specific issue in subsequent projects.

OBJECTIVES FOR GOVERNMENTWIDE AND COMPONENT ENTITY REPORTS

248 Some respondents suggested there should be separate sets of objectives for governmentwide and component entity reports. Similarly, it might also be possible to distinguish objectives for reporting by organizational unit components from those for functional or program components. Alternatively, one might imagine separate sets of objectives for reports to different audiences. The Board concluded that different reports are likely to emphasize different objectives but that there is no need to prepare separate statements of objectives. The Board will give due consideration to variations in emphasis among the objectives for different types of reports in subsequent statements and projects.

APPENDIX B: USERS' INFORMATION NEEDS ADDRESSED BY FEDERAL FINANCIAL REPORTING

249 This appendix is consistent with the discussion in

Chapter 3 of users' needs for financial information. It represents an intermediate step in the Board's consideration of the financial reporting objectives implied by those needs. The appendix is included to aid the reader in understanding the reporting objectives by providing another perspective on the issues.

250 The financial information needs of the four user groups can be classified into six categories:

1. Information on the sources and uses of budgetary resources
2. Information about operations and the related resources
3. Information about the government's assets
4. Information about the government's liabilities and financial responsibilities
5. Information that addresses concerns with the future
6. Information that discloses the levels of financial controls

251 In some cases, the specific nature of the information would be basically the same for all four groups of users; only the level of detail would vary. For example, the amount of unobligated budgetary authority available to be obligated would be of interest to program managers wanting to avoid violations of the Anti-Deficiency Act and to executives wanting to know the availability of budgetary resources that can be reprogrammed for other purposes.[Footnote 19.]

[Footnote 19: "Obligations" has a meaning in federal accounting similar to that of "encumbrances" in state and local governmental accounting; that is, it reflects a reservation of appropriated spending authority that will be used to pay for a specific contract, a purchase order, or another item.]

252 In other cases, the specific nature of the information would vary, depending on the reporting entity, the report user and the use to which the information was put. For example, "error rates" could refer to errors in determining the monthly payment an individual was entitled

to receive from the government or errors in calculating fees that a company was required to pay the government.

INFORMATION ON THE SOURCES AND USES OF BUDGETARY RESOURCES

253 The budget is the starting point for the government's finances. All users want to know the makeup of the budget, i.e., the budget authority, the obligations, the outlays, the receipts and offsetting collections, etc. They want to know how the budget was executed and particularly whether it was executed in accordance with the appropriation statutes and other laws affecting the entity's finances. They want to know the status of the budgetary resources, including the extent of obligated and unobligated budget authority. Finally, they want to know the sufficiency of the budget authority for covering future commitments.

INFORMATION ABOUT OPERATIONS AND THE RELATED RESOURCES

254 Accompanying the need for information about budgetary resources is a need for information about the operations of the government's programs. This includes information about the costs of the programs, classified in ways that provide further understanding, such as by program or activity, direct or indirect, fixed and variable, in comparison to estimates, or by object (e.g., personnel). Information that discloses unit, total, and marginal costs and changes in costs is also useful.

255 Cost information reflects the inputs for government services. Equally useful is information about the outputs, outcomes, efficiency, and effectiveness of government services, by themselves or in relation to a budget or goals, and any changes. This would include an identification of the periods in which the accomplishments would be realized. Such information helps form a basis for voting, funding, and management decisions.

INFORMATION ABOUT THE GOVERNMENT'S ASSETS

256 Financial statement users want considerable information about the government's assets. They want to know whether the balances in the trust and revolving funds will be sufficient for fulfilling the fund's purposes. They want to know the nature and amounts of receivables owed the government and whether the receivables will be paid. They

are interested in the size and condition of the inventories and whether they can be used as intended or, if not, how much would be received for their disposition. There is much the users want to know about the government's physical assets: their value, their expected service life, the replacement costs, and the impact of the maintenance that has been deferred.

257 The government also holds assets as a custodian or only until the assets can be sold. Examples are seized or forfeited assets. Information about these assets helps to establish accountability for them and to make decisions about the best time and method for their disposal.

INFORMATION ABOUT THE GOVERNMENT'S LIABILITIES AND FINANCIAL RESPONSIBILITIES

258 Users want to know what the government owes and whether the amounts are short term and precisely definable, long term and only an estimate, or just a contingency related to an enterprise or activity that is not a direct and current government responsibility, e.g., government-sponsored enterprises. This information helps the reader assess the government's ability to continue to operate at its current levels over a period of time and/or whether a tax increase is likely.

259 The changes in the amounts owed from year to year are also important. The user often is willing to settle for (or may actually prefer) ranges rather than point estimates and/or net present values rather than nominal (undiscounted) amounts.

INFORMATION THAT ADDRESSES CONCERNS WITH THE FUTURE

260 The federal government is responsible for the country's well-being. Its financial actions affect that well-being, both currently and in the future. Thus, users look not just for information to evaluate the condition of the trust funds upon which they rely for future security. They also want information to assess the likelihood of tax increases, service reductions, and changes in the inflation rate.

261 They therefore want information about possible sources of additional financial resources. They want to see

the amounts of resources expended on consumption activities in comparison to investment activities, such as research and development. They want information on other growth-stimulating activities. On the other hand, they still want to be able to assess where spending can be reduced significantly.

262 Finally, they want to know the magnitude of the probable future deficits, the cost burden this will place on taxpayers, and the potential effect that this burden might have on the quality of life.

INFORMATION THAT DISCLOSES THE LEVELS OF FINANCIAL CONTROLS

263 Because the government spends such large amounts of monies, taxpayers and other citizens are naturally concerned that the resources they supply are being protected from fraud, waste, and abuse and that the errors are minimal. They want to know that controls are in place and operating effectively and that problems are being quickly identified and corrected. They are particularly concerned that identified high risks are addressed and that adequate funds are devoted to eliminating the risk.

264 This concern is not just with the monies expended directly by the government. It also extends to the monies expended by the individuals and organizations that receive government contracts or grants.

APPENDIX C: SELECTED FEDERAL REPORTS PREPARED ON A RECURRING BASIS

265 This appendix classifies some well-known reports according to the categories set forth in figure 1 in chapter 7. Reports are classified according to whether they are primarily financial or nonfinancial and whether they have primarily a special or a general purpose. The classification is somewhat subjective. It is based on the general nature or emphasis of the reports. Many reports combine information and functions from different categories.

266 All these reports contribute to meeting the Board's reporting objectives for some users. However, many of the specific reports listed economic reports dealing with

the nation as a whole, for example will be influenced only indirectly, if at all, by the Board's standards. Indeed, because they deal with transactors other than the government (such as private citizens and corporations, states and local governments, and not-for-profit entities), economic reports fit within the context of figure 1 only to the extent that they may provide information to assess the government's operating performance and stewardship.

FINANCIAL INFORMATION SPECIAL PURPOSE

Budget of the U.S. Government

Analysis of the President's Budget Proposals (CBO)

Economic and Budget Outlook Report (CBO)

Economic and Budget Outlook Report Update (CBO) Midsession

Review of the Budget

Budget Enforcement Act Reports: Preview, Update, and Final

Sequestration

Request for Apportionment (SF 132)

Report on Budget Execution (SF 133)

Economic Report of the President

Federal Reserve Bulletin

OPM Forms 1351 A-D: Work years and personnel costs reports
Prompt Payment Report

FINANCIAL INFORMATION GENERAL PURPOSE

Annual financial statement (principal financial statements, including footnotes and combining financial statements if applicable) required by the CFO Act on revolving funds, trust funds, substantial commercial functions, and pilot federal agencies

Annual financial reporting by agencies required by Treasury
(SF 220 series)

Prototype Consolidated Financial Statements of the U.S.

The U.S. Government Annual Report and Appendix (Treasury)

Monthly Treasury Statement of Receipts and Outlays of the
U.S.

Monthly Statement of Public Debt

Daily Treasury Statement (on cash and debt)

NONFINANCIAL INFORMATION GENERAL PURPOSE

Annual departmental reports to the President and Congress

Nonfinancial information required by the CFO Act in the
overview, supplemental information, and other portions of
the reports

NONFINANCIAL INFORMATION SPECIAL PURPOSE

Reports required by the Federal Managers' Financial
Integrity Act of 1982.