FASAB

Federal Accounting Standards Advisory Board

Reclassification of Stewardship Responsibilities and Eliminating the Current Services Assessment

Statement of Federal Financial Accounting Standards

Exposure Draft

Written comments are requested by May 20, 2002

February 19, 2002

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THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

The Federal Accounting Standards Advisory Board (FASAB or "the Board") was established by the Secretary of the Treasury, the Director of the Office of Management and Budget (OMB), and the Comptroller General in October 1990 It is responsible for promulgating accounting standards for the United States Government These standards are recognized as generally accepted accounting principles (GAAP) for the federal government

An accounting standard is typically formulated initially as a proposal after considering the financial and budgetary information needs of citizens (including the news media, state and local legislators, and analysts from private firms, academe, and elsewhere), Congress, Federal executives, Federal program managers, and other users of Federal financial information The proposed standard is published in an exposure draft for public comment In some cases, a discussion memorandum, invitation for comment, or preliminary views document may be published before an exposure draft is published on a specific topic A public hearing is sometimes held to receive oral comments in addition to written comments The Board considers comments and decides whether to adopt the proposed standard, with or without modification After review by the three officials who sponsor FASAB, the Board publishes adopted standards in a Statement of Federal Financial Accounting Standards

Additional background information is available from the FASAB or its website

- *Memorandum of Understanding among the General Accounting Office, the Department of the Treasury, and the Office of Management and Budget, on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board," Amended October 1, 1999*
- *Mission Statement Federal Accounting Standards Advisory Board*

Exposure drafts, Statements of Standards and Concepts, FASAB newsletters, and other items of interest are posted on FASAB's website, at www fasab gov

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FASAB

Federal Accounting Standards Advisory Board

February 19, 2002

To Users, preparers and auditors of federal financial information

The Federal Accounting Standards Advisory Board seeks comments on this proposed Statement of Federal Financial Accounting Standards, *Reclassification of Stewardship Responsibilities and Eliminating the Current Services Assessment* Stewardship responsibilities include

- **risk assumed** information required by SFFAS 5, *Accounting for Liabilities of the Federal Government*
- the **current services assessment** (CSA) required by SFFAS 8, *Supplementary Stewardship Reporting*, and
- **social insurance** information required by SFFAS 17, *Accounting for Social Insurance*

Information about stewardship responsibilities is currently designated Required Supplementary Stewardship Information (RSSI), a category unique to federal financial reporting

For reasons explained in Appendix A, the Board is in the process of reconsidering the classification of items currently designated RSSI This document proposes that risk assumed information and the CSA be reclassified as required supplementary information (RSI) It also proposes that the requirement to report the CSA be eliminated after FY 2003 Social Insurance information would be reclassified as an integral part of the basic financial statements, essential for fair presentation in conformity with generally accepted accounting principles (GAAP) Classification of other items of information currently designated RSSI (stewardship land and investments, heritage assets, and national defense property, plant and equipment) will be dealt with in separate exposure drafts

Appendix B lists questions to focus comments You may address some or all questions and may comment on any section of this document Respondents are encouraged to consider the issues in light of Statement of Federal Financial Accounting Concepts 1, *Objectives of Federal Financial Reporting* To the extent possible, please provide the conceptual rationale for your comments rather than mere expressions of preference Appendix C discusses some of the practical and conceptual issues involved, it may assist those who wish to comment on the proposed standards Appendix D presents the alternative view of one Board member

Comments should be sent by May 20, 2002 to

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Email communication is preferred If FASAB holds a public hearing on this proposal, the time and location will be announced in FASAB's newsletter and in the Federal Register

David Mosso
Chairman

Reclassification of Stewardship Responsibilities And Eliminating the Current Services Assessment

Acronyms

AGA	Association of Government Accountants
AICPA	American Institute of Certified Public Accountants
AT	Attestation Standards codified and published by AICPA
AU	Audit Standards codified and published by AICPA
CBO	Congressional Budget Office
CFR	Consolidated Financial Report of the U S Government (formerly the "CFS")
CSA	Current Services Assessment
FAM	Financial Audit Manual published by GAO and the PCIE
FASAB	Federal Accounting Standards Advisory Board
GAAP	Generally Accepted Accounting Principles
GAAS	Generally Accepted Auditing Standards
GAO	General Accounting Office
OAI	Other Accompanying Information (also known as "other supplementary information" – i e , supplementary information not required by GAAP)
OMB	Office of Management and Budget
PCIE	President's Council on Integrity and Efficiency (Inspectors General)
RSI	Required Supplementary Information (as used in SFAS 25 and other accounting standards and in AU Section 558)
RSSI	Required Supplementary Stewardship Information (as used in SFFAS 5, 8 and 17)
SFAC	Statement of Financial Accounting Concepts
SFFAC	Statement of Federal Financial Accounting Concepts
SFAS	Statement of Financial Accounting Standards
SFFAS	Statement of Federal Financial Accounting Standards

Proposed Statement of Federal Financial Accounting Standards
Reclassification of Stewardship Responsibilities
And Eliminating the Current Services Assessment

Introduction

1 Federal accounting standards require the following information to be reported regarding stewardship responsibilities

- **risk assumed** information required by SFFAS 5, *Accounting for Liabilities of the Federal Government*,
- the **current services assessment** (CSA) required by SFFAS 8, *Supplementary Stewardship Reporting*, and
- **social insurance** information required by SFFAS 17, *Accounting for Social Insurance*

2 This information is currently designated Required Supplementary Stewardship Information (RSSI) RSSI is a reporting category unique to federal accounting Pursuant to this proposed standard, risk assumed information and the CSA would become required supplementary information (RSI), and the CSA would not be required after FY 2003 [1] Social insurance information would become an integral part of the basic financial statements, essential for fair presentation in conformity with generally accepted accounting principles (GAAP) Appendix A presents background information and the reasons for these proposed reclassifications Classification of other items of information currently designated RSSI (stewardship land and investments, heritage assets, and national defense property, plant and equipment) will be dealt with in separate exposure drafts

3 The proposed Statement would amend SFFAS 5 and SFFAS 17 by reclassifying risk assumed information and social insurance information Those standards

[1] RSI was added to the accounting literature by Statement of Financial Accounting Standards (SFAS) 25, *Suspension of Certain Accounting Requirements for Oil and Gas Producing Companies*, published by the Financial Accounting Standards Board (FASB) in 1979 That Statement has been amended, but the RSI category continues to be used in a variety of standards published by the FASB, GASB, and FASAB The auditor's responsibility for RSI is discussed in section AU 558 of the codification of professional auditing standards published by AICPA Relevant excerpts from auditing standards were included as appendix B of FASAB's *Preliminary Views on Eliminating the Category "Required Supplementary Stewardship Information,"* which is available at FASAB's web site, www fasab gov For more information about RSI, see appendix C on page 15

would remain unchanged in all other respects, however, the requirement to report the CSA would be eliminated after FY 2003 Because the Board may eventually rescind SFFAS 8 in its entirety rather than amend it, the relevant portions that would continue to be effective (i e , reporting the Current Services Assessment) are incorporated in this proposed Statement of Standards Other than reclassification as RSI and elimination after FY 2003, the provisions for CSA are substantially the same as those in SFFAS 8

Standards of Federal Financial Accounting

Risk Assumed

4 Information about risk assumed, required by SFFAS 5 and previously designated required supplementary stewardship information (RSSI), shall be designated required supplementary information (RSI)

Current Services Assessment

5 A Current Services Assessment (CSA), as originally defined in SFFAS 8, presenting projected receipt and outlay data published in the *Budget of the United States Government* (the President's Budget), shall be presented as required supplementary information in the Consolidated Financial Report (CFR) of the United States Government for periods ending before September 30, 2004 It shall present information for the base year and at least 6 years subsequent to the base year It shall be summarized, but in sufficient detail to identify, at least (1) receipts by major source (e g , individual income taxes, social insurance taxes, etc), (2) outlays for the defense, Social Security, Medicare, and net interest functions, (3) all other receipts and outlays, and (4) the deficit or surplus The "base year" is the year for which the financial statements are being prepared Reporting projected data for additional years is encouraged where it would be useful and relevant

6 The CSA data for the 6-year projection shall be summarized but otherwise identical to projected data published in the President's Budget for the same period "Base year" data shall be actual receipt and outlay data for the last completed fiscal year, projected data shall be the current services estimates of receipt and outlay data that are included in the President's Budget published after the close of the base year

7 Chapter 8 and paragraphs 14-16 of SFFAS 8 are rescinded, as is the associated illustration of the Current Services Assessment in Appendix B of SFFAS 8

Social Insurance

8 Information about social insurance, required by SFFAS 17 and previously designated RSSI, shall be designated an integral part of the basic financial statements, essential for fair presentation in conformity with GAAP

Effective Date

9 This statement shall be effective for reporting periods that begin after September 30, 2002

The provisions of this Statement need not be applied to immaterial items

Appendix A: Basis for Conclusions

This appendix summarizes factors that FASAB members considered in their deliberations It includes reasons for accepting certain approaches and rejecting others Individual Board members gave greater weight to some factors than to others

Reporting Stewardship Responsibilities and the Stewardship Objective

10 In SFFAS 8, FASAB stated

> A key aspect of the stewardship objective requires that Federal reporting provide information that helps users determine (1) whether the Government's financial condition improved or deteriorated over the period and (2) whether future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due Information on 'stewardship responsibilities' will aid in these determinations It will provide an essential perspective on the Government's commitment to discretionary and mandatory programs [2]

These objectives and the information required to be reported have not changed However, for reasons discussed below, the Board believes that information about stewardship responsibilities should be reported in the context of a reporting model that includes only basic financial statements, the associated notes,[3] and required supplementary information The Board will consider in other projects the proper classification of other items that are now classified as RSSI

Concerns about the RSSI category

11 The Board originally contemplated that GAO and OMB would provide special guidance regarding the audit procedures or "fieldwork" to be performed on RSSI At the same time, the Board expected that the auditor would report on this information in much the same way as on the basic financial statements, in the sense that the auditor would qualify or disclaim an opinion when the RSSI was omitted or materially misstated The category was seen as a response to the unique aspects of the federal accounting and reporting environment, and to the broad objectives of federal financial reporting It was intended to permit flexibility

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[2] SFFAS 8, paragraphs 14 and 15

[3] The notes are regarded as an integral part of the basic financial statements, essential for fair presentation in conformity with GAAP

on the part of preparers and auditors that would facilitate reporting relevant, reliable information, including nonfinancial and nonhistorical information [4]

12 Some members became concerned that users (1) may pay insufficient attention to some important information because it is called "supplementary," and (2) may be confused by complicated reports in which information is reported in various places They believed this might impede users' understanding and reduce the credibility of federal financial reports Some members believed that FASAB's use of the RSSI category invites suspicion of accounting in which items that are as important as the basic financial statements are labeled "supplementary" Accordingly, in *Preliminary Views on Eliminating the Category "Required Supplementary Stewardship Information"* (December 2000), the Board proposed to eliminate the RSSI category by reviewing and reconsidering the appropriate classification of each item classified as RSSI

13 In deciding to review the classification of components of RSSI, some members were influenced by the fact that existing audit standards do not discuss RSSI, therefore, auditors do not know what to do with respect to information in this category without consulting federal publications such as OMB's *Audit Bulletin* and the federal *Financial Audit Manual* (FAM) [5] These documents provide additional guidance on how to conduct or engage for audits of federal financial statements Furthermore, as practice evolved, it was not clear that auditors would qualify or disclaim their opinion on the basic financial statements when RSSI was missing or misstated, because it was not clear to everyone that the information was essential to fair presentation in conformity with GAAP Some FASAB members were concerned that, under these circumstances, even sophisticated users might not understand fully the significance of certain information classified as RSSI Some members believed that it would be desirable for FASAB to use categories that are widely understood by the broader accounting and auditing professions, particularly now that FASAB has been recognized by AICPA as a body that promulgates generally accepted accounting principles

14 The Board received 29 written comments on its December 2000 proposal from the following sources

[4] See the *Implementation Guide to Statement of Federal Financial Accounting Standards No 7 Accounting for Revenue and Other Financing Sources*, June 1996, paragraphs 22-24, the diagram on page 15, and minutes of associated Board discussions See also SFFAS 8, *Supplementary Stewardship Reporting*, June 1996, paragraphs 21, 34, 111-115, and minutes of associated Board discussions

[5] The FAM is published by GAO and the President's Council on Integrity and Efficiency (PCIE), which is comprised of the Inspectors General of major federal agencies

- 16 preparers (all federal),
- 8 auditors (three nonfederal, including AICPA),
- 5 others (This category includes academics, retired federal employees, and the Association of Government Accountants (AGA), a professional association of federal and nonfederal accountants and auditors)

15 The comments reflect the views of more than 29 people Comments from the PCIE, AGA, federal agencies, and AICPA are the work of numerous individuals Twenty of the respondents would retain the RSSI category, at least for some period Some typical concerns expressed include the following

- Elimination of the category would provide less stewardship information to users, lead to a qualified opinion that would send a less-clear signal to users than is available with current and potential alternatives, and raise audit costs The category provides a clear and unique method to prominently display stewardship information essential to meeting taxpayer accountability The category has been successful in communicating our financial condition
- The separate category and section of the report is an effective and practical means of reporting It is appropriate for the unique environment and objectives of federal financial reporting Approaches to providing audit assurance over RSSI are evolving FASAB should work with specialists in the relevant disciplines to define common units of reporting for items not expressed in monetary terms
- Unique aspects of the federal financial reporting environment and objectives led the Board to create the new category If used properly, the category should be a mechanism to provide much-needed information to decision makers, including citizens, when they consider the consequences of decisions relating to public lands, heritage assets, and similar items

16 In April 2001 the Board held a public hearing to discuss this proposal with interested parties Fourteen individuals, representing seven organizations, made presentations and discussed issues with the Board Comments were similar to those expressed in the 29 comment letters

17 After considering these comments, the Board continues to believe that federal accounting standards may be able to address the objectives of federal financial reporting, including accountability and reporting on stewardship, without a unique category The Board notes that, pursuant to the standard proposed here, none of the information now required to be reported about stewardship responsibilities would be eliminated due to the reclassification from RSSI (The CSA would be

eliminated after FY 2003 for other reasons) Thus, eliminating the RSSI category need not result in a reduction of information required by existing standards Furthermore, preparers will continue to have the option of voluntarily presenting supplementary information beyond what is required This "other accompanying information" would be unaudited, unless special arrangements were made to extend the auditor's work in the context of a particular audit

18 Avoiding use of the RSSI category where it is not essential will eliminate some potential confusion and ambiguity In particular, it should clarify the Board's expectation that when material information that is essential to fair presentation is missing or materially misstated, the auditor should consider whether a qualified or adverse opinion is appropriate regarding whether the basic financial statements are prepared in conformity with GAAP After consultation with AICPA staff, the Board believes this result can best be assured by designating such information as an integral part of the basic financial statements

19 Accordingly, the Board has agreed to reconsider the classification of items that are currently classified as RSSI In doing so, the Board will consider the cost as well as the benefit of alternative classifications, and will be mindful of the concerns expressed by those who commented on FASAB's *Preliminary Views* If, upon reconsideration, the Board concludes that the RSSI category is appropriate for certain items, the Board will work with the auditing profession to address confusion and ambiguity related to information presented in the new category If, for other items, the Board concludes that a category other than RSSI would be superior, the Board will publish an exposure draft that will propose to change the classification from RSSI to the other category The Board has discussed these issues with representatives of the AICPA, and is confident that the auditing profession can accommodate any implications of this approach The Board will work with the auditing profession to that end

Reclassifying Stewardship Responsibilities

20 Because of its concerns about the RSSI category, the Board reconsidered how information about the various items referred to as stewardship responsibilities should be classified Figure 2 on page 19 presents a list of general factors that were considered relevant for the classification choices by one or more Board members Individual members gave greater weight to some factors than to others Specific decisions on each of the three types of stewardship responsibility information are discussed in the remainder of this Appendix

Risk Assumed

21 The Board agreed that information about risk assumed should be RSI rather than an integral part of the basic financial statements, because the amounts are not sufficiently reliable and measurement methods are still experimental This information is potentially valuable, but it is not yet a suitable basis for recognition or disclosure [6] The Office of Management and Budget, the General Accounting Office, and the Congressional Budget Office (CBO) have considered the use of risk assumed information as a basis for budgeting for insurance programs These agencies have concluded that more experience is needed before the measurements can be regarded as sufficiently reliable for budgeting Similar considerations lead the FASAB to conclude that information about risk assumed should be included in financial reports as RSI, at least until agencies and auditors have more experience with this information

22 The Board believes that analogies with insurance offered by private insurers, (where, for example, an expected premium deficiency on long-duration contracts such as life insurance is recognized), may be misleading due to differences in the length of the policy coverage, nature of insured risk, or other relevant variables The Board believes that additional guidance from FASAB on definition and measurement of "risk assumed" would be necessary before it would be feasible to require recognition or disclosure of this information as an integral part of the basic financial statements Developing and promulgating such guidance would require a separate project Before the Board undertakes such a project, it is desirable to encourage continued improvement in agencies' data systems and

[6] FASAB uses the term "disclosure" to refer to information that is regarded as an integral part of the basic financial statements, essential for fair presentation in conformity with generally accepted accounting principles (GAAP) Normally such disclosures are presented in footnotes, but federal accounting standards published by FASAB do not currently prescribe the format for presentation of such disclosures Nothing in GAAP prohibits formatting or combining pieces of information in appropriate ways to direct the reader's attention, provided that the results are not misleading

modeling capabilities to support reporting risk assumed The RSI requirement has the effect of providing this encouragement in an appropriate, cost-beneficial manner The Board notes that the "state of the art" for such projections is constantly evolving Should the Board in the future decide that it would be desirable to develop more specific criteria for reporting risk assumed, the Board will be able to learn from this ongoing experience

Current Services Assessment (CSA)

23 The CSA provides receipt and outlay data on the basis of the President's projections of future activities pursuant to current law It is relevant for assessing the sustainability of programs established by current law, that is, relevant for assessing the sufficiency of future resources to sustain public services and to meet obligations as they come due The CSA focuses on the totality of government operations rather than on individual programs It provides an analytical perspective on the Government because it shows the short- and long-term direction of current programs

24 The Board concluded that RSI treatment is appropriate because the CSA is important but not essential to fair presentation, and because the information provides supplemental information that supports related objectives for federal financial reporting

25 Furthermore, auditing the information would add little value if the auditor merely verifies that the information is summarized and reprinted properly from the President's Budget The procedures specified at AU 558 will lead the auditor to do that much, if the CSA is classified as RSI On the other hand, if the auditor were asked independently to assess the methodology and assumptions that underlie the CSA and to provide positive assurance on the resulting projections, the auditor could become involved in a contentious and subjective arena, and would probably not add value beyond that provided by alternative projections available from other sources such as the Congressional Budget Office The benefit/cost ratio of such an endeavor appears low The Board notes that, as RSI, the CSA could be presented in management's discussion and analysis of the financial report, if the preparer wanted to do so

26 Because the Board expects that within a few years the CFR will be published before the President's Budget is available, the requirement to include the CSA in the CFR will expire in FY 2004 (i e , the CSA will not be required in the CFR after FY 2003) SFFAS 8 defines the CSA by reference to what is published in the President's Budget The Board did not foresee the possibility that the CFR would be published before the Budget In order to continue to require something comparable to the CSA as part of the CFR when the CFR is published before the Budget, federal accounting standards would need to define the CSA in some way other than by reference to the Budget Developing the criteria for such a projection is beyond the scope of this project The Board notes that OMB, CBO, and others regularly publish similar projections, therefore, similar information will continue to be available, regardless of whether it is required to be part of the CFR The Board also notes that the "state of the art" for such projections is constantly evolving Should the Board in the future decide that it would be desirable to develop criteria for such a projection as a part of federal financial reporting, the Board will be able to learn from this ongoing experience

Social Insurance

27 The Board believes that social insurance information should be treated as an integral part of the basic financial statements because it is important to achieve the objectives of federal financial reporting and is essential to fair presentation The related stewardship objectives include helping users to assess the impact on the country of the Government's activities, determine whether the Government's financial position improved or deteriorated over the period, and predict whether future budgetary resources will likely be sufficient to sustain public services and meet obligations as they come due In that regard, the multi-trillion dollar obligations associated with social insurance over the next 75 years could dwarf the largest liabilities recognized in the U S Government Balance Sheet

28 The Board acknowledges that there is great uncertainty inherent in long term projections, but believes that if the uncertainty is suitably disclosed--as is required by SFFAS 17--it need not preclude designating the information as an integral part of the basic financial statements, essential for fair presentation in conformity with GAAP The Board rejects the idea that information based on projections cannot be an integral part of the basic financial statements that are presented in conformity with GAAP FASAB has not limited federal financial statements to historical information

29 Even within the context of historical financial reporting, the Board notes that accrual-basis "historical" financial statements include many measurements that involve assumptions about the future The distinction between reporting on the financial effects of events that have occurred and the effects of future events depends, obviously, upon the definition of the event The information required by SFFAS 17 reports on the financial effects of existing law and demographic conditions, just as the pension obligation at a point in time is based on existing conditions In that sense, social insurance information can be viewed as reflecting events that have occurred and, therefore, as "historical"

30 Measuring the future effects of existing law and conditions for social insurance involves projections of economic and demographic trends, just as measuring the pension benefit obligation at a point in time involves assumptions about future salary progression It is true that SFFAS 5 specifies a different measurement method for pensions and retiree healthcare than the method SFFAS 17 specifies for social insurance It is also true that social insurance measurements are based on projections for longer periods than are customarily needed for measuring obligations for pensions and retiree healthcare, and are far more sensitive to assumptions about the "out years" of the projection period Nevertheless, the Board believes that it is appropriate to report social insurance information as an integral part of the basic financial statements, essential for fair presentation in conformity with GAAP

31 Classifying social insurance information as an integral part of the basic financial statements will mean that auditors will consider a modification of their opinion if this information is materially misstated A modification would send a clear and appropriate signal to users in such a circumstance The Board understands that some added audit expense will be incurred as a result of this change in status for social insurance information, and added demands may be made on the accounting and actuarial staff of agencies that report social insurance information The Board believes that the benefits in this case outweigh the expense The social insurance information is useful, important to those who would understand the Government's financial condition and its impact on the financial condition of individual citizens, interesting to the public, and essential to fair presentation

32 The impact of this change in audit status should be mitigated by the fact that preparers and users have experience with similar information Also, much of the actuarial and audit work can be done before the end of the fiscal year, if the preparer and auditor prefer SFFAS 17 provides for considerable flexibility in selecting the measurement date Paragraph 26 of SFFAS 17 states

> All projections and estimates required in these standards should be made as of a date (the valuation date) as close to the end of the fiscal year being reported upon ("current year") as possible and no more than one year prior to the end of the current year This valuation date should be consistently followed from year to year

Effective Date

33 The proposed standard would not change the definition, presentation guidelines, or audit status for the CSA and for risk assumed information (RSSI is currently treated as RSI for audit purposes, pursuant to instructions in OMB's *Audit Bulletin*) No delay is needed as a result of the change in status for these two items Audit status for social insurance information would change, however, as noted above, the information is not new Most of the relevant agencies have produced similar information for several years, and analysts and public officials have routinely used this information Also, impact of the audit requirement on the auditor and preparer should be reduced by the flexibility SFFAS 17 provides in selecting a measurement date for social insurance Accordingly, the Board agreed that this statement should be effective for reporting periods that begin after September 30, 2002

Appendix B: Questions for Respondents

1 This exposure draft proposes that information about risk assumed, required by SFFAS 5 and currently designated required supplementary stewardship information (RSSI), shall be designated required supplementary information (RSI) Do you agree with this decision? If not, please explain your reasons, and the alternative you would prefer

2 This exposure draft proposes that information about the Current Services Assessment (CSA), required by SFFAS 8 and currently designated RSSI, shall be designated RSI Do you agree with this decision? If not, please explain your reasons, and the alternative you would prefer

3 This exposure draft proposes that the requirement to present the CSA shall be eliminated for FY 2004 and following years Do you agree with this decision? If not, please explain your reasons, and the alternatives you would prefer

4 This exposure draft proposes that information about social insurance, required by SFFAS 17 and currently designated RSSI, shall be designated an integral part of the basic financial statements, essential to fair presentation in conformance with GAAP Do you agree with this decision? If not, please explain your reasons, and the alternative you would prefer Agencies that prepare this information and their auditors are encouraged to provide information on the expected cost of compliance with the proposed standard

5 This exposure draft proposes an effective date for periods beginning after September 30, 2002 Do you agree with this effective date? If not, what date would be preferable, and why?

Appendix C: Distinguishing RSI from the Basic Financial Statements and Associated Notes

34 This appendix discusses some practical and conceptual factors that affected the Board's decision whether to designate an item as RSI or as an integral part of the basic financial statements The basic financial statements include the principal financial statements and associated notes on which the auditor expresses an opinion as to whether the information is presented in conformity with GAAP [7] This appendix does not present any proposed accounting standards It is included to help respondents understand the Board's deliberations and comment on this proposal

Operational Differences Between the Basic Financial Statements and RSI

35 Figure 1 (on page 16) identifies some operational differences under current auditing standards (AICPA is considering certain limited-scope proposals to revise its guidance regarding RSI) Given these operational differences between basic financial statements and RSI, the Board must determine whether it would be more appropriate for a given piece of required information to be deemed an integral part of the basic financial statements or RSI The appropriateness depends on the particular benefits (based on various federal financial reporting objectives) and the costs (preparing, auditing, user processing, other) of making it subject to audit (vs more limited procedures) and varying the potential audit opinion treatment (qualification vs mere mention in the auditor's report)

36 It should be noted that the value of information to users and the value added by auditing it are separate, though certainly related, considerations For example, some information may be valuable to some users, yet auditing it might add little value On the other hand, some information (e g , aggregated financial information for a federal agency as a whole) may not be used directly by decision makers as input to a particular "decision model," but auditing it might provide some degree of valuable assurance about other information (e g , detailed program cost or budgetary expenditure information) or objectives of interest (e g , internal accounting control and finance-related legal compliance) Auditing financial statements may also deter fraud and errors of various sorts, including inaccurate reporting in other, more timely reports In other words, in some cases, "accounting may not be useful for its expediency in providing timely valuation

[7] The terms "basic financial statements" and "principal financial statements" have been used synonymously in federal accounting

information ... but for its ability to provide a veracity check on other, unaudited sources of information."[8]

Figure 1

Comparison Dimension	Basic Financial Statements	RSI
Is the information required to be in the financial **report**? That is, it is either an integral part of the basic financial statements or it must accompany them (In some cases, RSI need not physically accompany the basic financial statements in the same document, certain GASB standards have specified reference to another publicly-available report as an option for specified RSI)	Yes	Yes
Is the information deemed essential if the financial **statements** are to "present fairly" in conformity with GAAP?	Yes	No
What audit fieldwork is required?	Audit	Limited procedures pursuant to AU 558
Auditor's report	Positive assurance regarding "fair presentation"	Silent, no explicit assurance unless engaged to audit the RSI However, a proposed AICPA Interpretation of GAAS would clarify that, if the RSI is financial information that has been subjected to audit procedures in connection with auditing the basic financial statements, the auditor may express assurance "in relation to the financial statements taken as a whole "
What audit report mention is required if the information is missing or not prepared in conformity with guidelines?	Qualified or adverse opinion	Mention in report, no qualification of opinion on the basic financial statements

[8] Pierre Jinghong Liang, "Recognition An Information Content Perspective," *Accounting Horizons*, September 2001, page 237

Footnote vs RSI Section

37 Although not required by auditing standards,[9] RSI has customarily been located in a separate section of the financial report, to aid in distinguishing it from audited information [10] This practice has continued with RSSI, evidently in part because federal preparers thought it was necessary, or at least desirable, to report "stewardship" items together It is possible that placement of information in different sections of the financial report leads some types of readers to pay more (or less) attention to the information Although the magnitude of these differences is an open question, research has shown that formatting can matter to individual users Some research, as well as intuition, suggests that the effects of different placement are less for skilled and persistent users than for less sophisticated or casual users of financial reports [11]

[9]AU 558 10 states "Ordinarily, the required supplementary information should be distinct from the audited financial statements and distinguished from other information outside the financial statements that is not required by the FASB, GASB, or FASAB However, management may choose not to place the required supplementary information outside the basic financial statements In such circumstances, the information should be clearly marked as unaudited If the information is not clearly marked as unaudited, the auditor's report on the audited financial statements should be expanded to include a disclaimer on the supplementary information "

[10] In practice, notes and RSI generally have not been commingled Indeed, in discussing the location of RSI it requires, FASB said, "Reporting specialized information on oil and gas producing activities in a single location within a financial report is a desired objective of this Statement so as to make the relationship among the different types of information easier to analyze " (FAS 69, par 117)

In theory, RSI might be integrated with related audited information, provided the unaudited information was suitably labeled Whether this would be feasible and desirable in practice may be debatable Concern on the part of independent CPAs about litigation risk has been among the factors that encouraged physical separation of audited information from unaudited information

Another practical consideration may be introduced by proposed guidance from AICPA regarding the auditor's ability to offer some limited assurance "in relation to the financial statements" on certain RSI This could imply a need to distinguish the RSI that was unaudited but subject to limited procedures, and for which such assurance is offered, from other types of supplementary information, both required and voluntary

Some comments regarding FASAB's *Preliminary Views on Eliminating the Category "Required Supplementary Stewardship Information"* suggested that there are conceptual as well as practical reasons to report different kinds of information separately

[11]For example, see Laureen A Maines and Linda S McDaniel, "Effects of Comprehensive-Income Characteristics on Nonprofessional Investors' Judgments The Role of Financial-Statement Presentation Format," *Accounting Review*, April 2000 Their research suggests that the format or location in a report may affect how nonprofessionals **weigh** information more than whether they **acquire** it

One recent study suggests that people are more likely to confuse or "blend" audited with unaudited data when they are presented with this information by means of hyperlinks in a web-based environment than when they are given separate paper documents to study The same study found that the tendency to "blend" information in a web-based environment can be reduced by labeling information as audited and unaudited This study did not attempt to compare the degree of blending that might be associated with alternative ways of presenting the information within a single printed document See

Audit Aspects of Basic vs RSI

38 Both footnote disclosures and required supplementary information are viewed as being sufficiently relevant to be required to accompany the basic financial statements in financial reports, though only the notes are regarded as required for fair presentation in conformity with GAAP As noted above, one major difference between the two types of information is the extent and nature of the auditor's scrutiny and responsibility for the information, another is the nature of the auditor's report and the kind of "signal" it sends Thus, the cost and value added by audit are factors to consider The main question is for what types of information, users, and objectives would the benefits of making an item an integral part of the basic financial statements instead of RSI exceed the incremental costs of audit, compared with reviewing pursuant to AU 558's limited procedures?

Factors to Consider

39 In deciding whether a given item should be classified as RSI or as an integral part of the basic financial statements, one might consider a variety of factors, such as those listed in figure 2 on the next page They are not listed in any particular order, and some "overlap" or convey similar ideas Different people assign different weight to each factor, some people may not consider some of the factors at all, and some people may consider factors that are not listed Likewise, different people may evaluate each item to be reported differently on each dimension Therefore, figure 2 is not a decision tree, hierarchy, or precise algorithm for classifying items, but a general framework for each individual's judgment

Frank D Hodge, "Hyperlinking Unaudited Information to Audited Financial Statements Effects on Investor Judgments," *The Accounting Review,* October 2001

Figure 2

-Low (implies RSI) < < < < < < < < < < < < < < > > > > > > > > > > > > > > **+High (implies basic)**

<Relevance to fair presentation>
< Connection with elements of financial reporting >
< Use of historical financial data or financial transaction data >
<Preparers' discretion in preparing and presenting the information>
< Strength of signal Board wishes to be sent in the financial report >
< Significance, relevance or importance of the item in light of *Objectives* >
< Strength of the signal the Board wishes to be sent in the auditor's report >
< Relevance to measuring financial position or changes in financial position >
<Extent to which the information interests a wide audience (rather than specialists)>
<Extent to which there are not alternative sources of reliable information>
< Agreement on criteria that permit comparable and consistent reporting >
< Experience among users, preparers, and auditors with the information >
<Extent to which the information is aggregated (lacking in detail)>
< Benefit/cost ratio of using resources to ensure accuracy >
< Connection with basic financial statements >
< Reliability and/or precision possible >
< Reliability and/or precision needed >

-Low (implies RSI) < < < < < < < < < < < < > > > > > > > > > > > > **+High (implies basic)**

40 As noted, different people will assign different importance to each factor However, a consensus did emerge during the Board's deliberations on the proper classification of social insurance information that three related factors are particularly important for that decision (1) The Board agreed that this information is "essential to fair presentation " A set of financial statements could not be said to "present fairly" when this information is missing or materially misstated For this reason, it is important (2) that this signal clearly be communicated to the reader of the financial report and (3) to the reader of the auditor's report Other factors listed also were deemed relevant, and were deemed consistent with "basic" status, for example, a wide audience is interested in this information

41 The amount of discretion available to the preparer was deemed especially important to the decision about how to classify the CSA If there is very little discretion in preparing the information, the value of auditing may be modest An example is SFFAS 8's requirement to reprint information as it was presented in the President's Budget, without independent criteria for evaluating it On the

other hand, if there is great discretion, questions may arise about whether the resulting information would be sufficiently reliable, comparable, and consistent without auditing Another factor, relevant both to the decision initially to classify the information as RSI and to the decision eventually to terminate the requirement, is that there are other, credible sources of similar information As noted in the Basis for Conclusions, OMB and CBO routinely publish intermediate and long-term projections that are scrutinized by Congress and by analysts in the private sector

42 Because SFFAS 5 does not include detailed criteria for defining and measuring risk assumed, preparers have considerable discretion in calculating it This might seem to imply that audit would be desirable However, auditors may have concerns about expressing positive assurance on information for which specific definitions and measurement criteria have not been defined In other words, there may not be sufficient agreement on criteria that permit comparable and consistent reporting to permit classifying risk assumed as an integral part of the basic financial statements Another example where this concern has affected classification is information about condition of assets and deferred maintenance Even when auditors do provide assurance, in some cases they may wish to express special qualifications, explanations, or caveats in their report An example might be an auditor's report on an examination of prospective financial information where there is great inherent uncertainty, or an examination of other assertions by management about matters where management has great discretion

43 Concerning the "significance" factor The basic financial statements (including notes that are regarded as an integral part of the financial statements) and RSI are both important enough to be required items in financial reports With respect to the audit status of the information, it would seem that, by itself, the importance of an item need not automatically imply that the information should be audited Rather, one would also consider the extent of the information-preparer's discretion as well as the cost of auditing the information item However, it does seem that the more important the item, the more likely it should be audited, if the information preparer had a significant degree of discretion One would be willing to incur more audit costs to avoid misstatement of very important information items that could affect users' decisions Furthermore, the more important the item, the more likely it would be deemed essential to fair presentation, thus implying a need to qualify the auditor's opinion if the information were missing or misstated

44 Concerning the "reliability and/or precision" factors These factors are intertwined, and all affect the extent to which one would prefer audited information to RSI "Reliability and/or precision **needed**" asks one to evaluate the users' tolerance for imprecise measures of a relevant item Since auditing is likely to increase precision (either through inducing more precise measures by the preparer or by reducing the variance in the measures by audit procedures), the less tolerance for imprecision that users have concerning an information item, the more likely that the Board would want to make the item a required note disclosure instead of RSI

45 "Reliability and/or precision **possible**" deals with the very nature of the information item being reported Precision about measures of past events seems inherently more possible than precision about estimates of future events To the extent that there is a fundamental minimum amount of imprecision in certain information items, the cost of increasing audit effort might not be justified For some Board members, this consideration was among the factors (along with others such as cost/benefit) that imply "risk assumed" information should properly be classified as RSI at this time

46 Some other listed factors also relate to the "nature" of the information For example, some people may define the domain of accounting and/or financial reporting (or categories within that domain) in terms of the nature of information involved (e g , as limited to "historical" financial information or to certain defined "elements" of financial reporting, or to certain concepts such as "financial position") FASB has emphasized the role of "elements of financial reporting" in defining the financial statements and notes FASB and GASB also emphasize the concept of net assets or financial position in defining financial statements and notes

47 Other people may define financial reporting, and its component categories, in terms of the comparative advantage unique to reporting based on the information system for processing financial transactions SFAC 5, *Recognition and Measurement in Financial Statements of Business Enterprises,* says that the "financial statements articulate with each other and derive from the same underlying data (par 5) Some believe this idea is rooted in the basic "bookkeeping" paradigm of accounting (see SFFAC 1, *Objectives of Federal Financial Reporting,* paragraphs 166-168) Such a definition might be expected to lead to accounting standards that would define the basic financial statements in a narrow or traditional way, with other kinds of information (e g , performance indicators or management's assertions about internal control) being reported as RSI

48 Others may define the domain of financial reporting, and categories within that domain, more broadly A broader definition might, for example, be expressed in terms of the objectives of federal financial reporting, or the comparative advantage of the annual reporting+audit cycle, which assures the production and examination of information deemed essential to fair presentation by GAAP where GAAP reporting is mandated by law, contract, or market forces This kind of broader definition might be expected to lead to standards that would define more types of information (e g , performance indicators or management's assertions about internal controls) as a part of the basic financial statements

49 More generally, the "benefit/cost ratio of using resources to assure accuracy" asks one to assess the costs of producing auditable information and auditing it versus the benefits that could be achieved by merely preparing the information as RSI and applying the procedures specified at AU 558 Other things being equal, one would avoid auditing where the cost of auditing is quite high Similarly, to the extent that alternative, credible sources of information exist, the cost of auditing the information may exceed its benefits Those who advocated RSI status for social insurance information cited their belief that costs of audit would exceed benefits Although the Board was not persuaded by this argument, it did agree to solicit more information about the potential added cost of auditing the social insurance information

Appendix D: Alternative View

50 One member believes that the Board has not yet resolved the issues raised in the Alternative Views in *Preliminary Views on Eliminating the Category "Required Supplementary Stewardship Information."* Federal accounting standards require reporting non-traditional information, and progress in developing an appropriate approach to assurance has been evolving in the three years since RSSI became a required category. This member believes that eliminating the RSSI category now may cause unnecessary audit-related problems, and therefore it is premature to proceed along the path of classifying all information either as an integral part of the basic financial statements or as RSI.

51 His conclusions in that Alternative View were reinforced by nearly all of the 36 responses (in letters and at the public hearing) to *Preliminary Views*. The respondents expressed a variety of views, a number made constructive suggestions, and progress was reported in developing appropriate assurance for non-traditional information. Their concerns about reclassification were cogently expressed by the AICPA response, signed by the chairs of AcSEC, the Non-Financial Information Task Force of the ASB, and the FASAB Liaison Task Force (March 27, 2001):

> We are concerned that the elimination of the RSSI category may lead to much of this information becoming part of the basic financial statements and notes, without sufficiently defined criteria to provide reasonably consistent estimation and measurement of the information. We therefore recommend that if FASAB decides to eliminate the RSSI category, the Board should reclassify the information as Required Supplemental Information (RSI) pending further study of the information and development of criteria for estimation and measurement. Alternatively, if the Board decides to keep RSSI as a separate category of information, the Board should rename the category to avoid confusion and issue specific guidance stating that the RSSI category of information should be treated as a subset of RSI until such time as the FASAB, working with practitioners, the AICPA, the Office of Management and Budget (OMB) and the General Accounting Office (GAO), has more time to experiment with the criteria and auditability of this information.

52 His concerns are illustrated by the proposal in this ED that the required information about social insurance should be designated an integral part of the basic financial statements. This member believes that the nature, timing, volatility, and imprecision of the information, the crucial role of assumptions in making the projections, the as-yet undefined auditing standards applicable to the information, and the cost to audit it, all indicate that social insurance information

should not be designated as an integral part of the basic financial statements at this time

53 First, as the Basis for Conclusions acknowledges, "social insurance measurements are based on projections for longer periods than are customarily needed for measuring obligations for pensions and retiree healthcare, and are far more sensitive to assumptions about the 'out years' of the projection period " One reason for sensitivity is that many social insurance projections for an "open group" generally grow rather than dwindle, with time Small changes in assumptions about the later years of the projection therefore have greater impact on open group projections Until appropriate audit procedures are developed, this makes the information better classified as RSI than as an integral part of the basic financial statements

54 Second, many social insurance projections include benefits for future participants not yet born This is unlike the projections required for pension and other retiree benefit plans Therefore, the key social insurance projections are different in kind from historical financial statements and are better classified as RSI, at least until appropriate audit procedures are developed

55 Third, while the auditing requirements are as yet undefined, the cost could be significant Testimony at FASAB's public hearing described the extensive measures now in place to provide independent oversight and verification of social insurance projections to the degree verification is feasible The extent and multi-disciplinary nature of social insurance assumptions demands that a team of experts conduct the review over a considerable period of time This type of review is now conducted by independent experts periodically It is supplemented by the extensive information about assumptions published every year in the Trustees' Reports for Social Security and Medicare, which are widely distributed to the public and available to experts and interested citizens alike Appropriate audit procedures may in the future make it cost-beneficial to classify social insurance information as an integral part of the basic financial statements, but those procedures have not been developed yet

56 For these reasons, this member would not take further steps at this time to reclassify Required Supplementary Stewardship Information – neither the social insurance and other information addressed in this ED, nor the other categories of RSSI If other members still wish to eliminate the RSSI category, this member suggests classifying all information as RSI for the time being

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