



OFFICE OF THE UNDER SECRETARY OF DEFENSE

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WASHINGTON, DC 20301-1100

COMPTROLLER

September 9, 2024

MEMORANDUM FOR ASSISTANT SECRETARIES OF THE MILITARY DEPARTMENTS
(FINANCIAL OPERATIONS)
CHIEF FINANCIAL EXECUTIVES OF THE DEFENSE AGENCIES
AND DOD FIELD ACTIVITIES

SUBJECT: Implementation of Statement of Federal Financial Accounting Standards 56,
“Classified Activities” (FPM24-09)

Reference: Statement of Federal Financial Accounting Standards 56 (SFFAS 56), “Classified
Activities,” October 4, 2018

This memorandum establishes financial reporting policy and guidance for applicable Department of Defense (DoD) Components regarding the implementation of SFFAS 56, “Classified Activities.” This policy applies to DoD Components that issue unclassified Agency Financial Reports (AFRs), including the DoD consolidated AFR, in accordance with generally accepted accounting principles. This policy does not relieve DoD Components from their requirements and responsibilities to comply with other accounting standards in the appropriate classified environment. This policy is effective immediately.

The reference permits modifications to unclassified financial reporting presentations and disclosures to prevent the disclosure of classified national security information or activities under certain conditions. Given classified information is prohibited from public release, DoD Components must review the relevant Federal Accounting Standards Advisory Board’s accounting standards and conclusions from their respective Original Classification Authority (OCA) or apply derivative classification, to determine whether there are instances where compliance with these standards could result in the unauthorized public release of classified information in unclassified financial statements and/or systems unless otherwise modified.

Classified activities present unique challenges in financial reporting due to their sensitive nature and the need to balance transparency with national security concerns. Accordingly, this memorandum provides policy and implementation guidance for reporting modifications consistent with the reference, paragraphs 9, 10, and 11, that prevents the release of classified information in financial statements, required disclosures, and financial systems unclassified environments. DoD Components have the discretion to apply the allowable SFFAS 56 modifications at the program or transaction level.

Key considerations for the implementation of SFFAS 56 include:

- **Classification Criteria:** Establish clear criteria for determining which activities qualify as classified within the DoD Component.
- **Financial Reporting Framework:** Establish a framework for integrating classified activities into the DoD Component’s financial reporting processes while

maintaining the necessary level of confidentiality. This may involve implementing specialized accounting procedures and controls to ensure compliance with classification requirements.

- **Disclosure Requirements:** Determine the scope of classified information that would be revealed in unclassified financial reporting environments if unmodified. This information should be supported by the required security justification outlined in the reference.
- **Internal Controls:** Strengthen internal controls to safeguard classified financial information and prevent unauthorized access or disclosure.
- **Coordination with OCA:** Establish close coordination with OCA officials to ensure alignment between financial reporting requirements and classification protocols. Collaborate on developing procedures for handling classified financial information in accordance with applicable laws and regulations.
- **Monitoring and Compliance:** Implement mechanisms for monitoring and ensuring compliance with the reference. Conduct regular reviews and assessments to identify gaps or deficiencies in implementation and take corrective actions as needed.
- **Supporting Documentation:** DoD Components must maintain adequate supporting documentation on the application of the reference and demonstrate compliance with relevant accounting standards in the appropriate classified environment.

DoD Components must inform the Office of the Deputy Chief Financial Officer, Financial Management Policy and Reporting Directorate, if provisions of SFFAS 56 will be applied.

The attachment to this memo provides an overview of the SFFAS 56 framework and required disclosure requirements, but is not a substitute for a thorough review of SFFAS 56. This new policy and relevant provisions of SFFAS 56 will be incorporated in future updates of the DoD Financial Management Regulation, Volume 6A. My staff point of contact for this policy and the Interpretation 8 (FPM24-12) memoranda is Ms. Rebecca Evertsz, rebecca.z.evertsz.civ@mail.mil.

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Tina M. Pierce
Deputy Chief Financial Officer

Attachment:
As stated

Implementation of SFFAS 56, Classified Activities
Overview of SFFAS 56 Framework and Required Disclosure Requirements
September 9, 2024

This document provides an overview of the Statement of Federal Financial Accounting Standards 56 (SFFAS 56 or Statement) framework to include scope; background; application principles; permitted modifications and disclosure; and presentation and disclosure modifications.

I. SFFAS 56 Scope:

SFFAS 56 guides preparers of financial statements at the government-wide and Department of Defense (DoD) Component consolidation entity levels in permitting certain modifications to prevent the disclosure of classified information in an unclassified General Purpose Federal Financial Report (often referred to as "Agency Financial Report" (AFR)). SFFAS 56 does not apply to the reporting of financial information within the classified environment and only applies when the information is presented in the unclassified environment, such as the publicly available DoD consolidation entities' AFRs. In addition, this Statement does not apply to classified AFRs provided to cleared personnel, including elected officials. Further, this Statement does not relieve DoD consolidation entities from their requirements and responsibilities to comply with other accounting standards in the appropriate classified environment. The provisions of this Statement need not be applied to information if the effect of applying the provision(s) is immaterial.

Classified National Security Information, also known as "classified information," is any information that has been determined pursuant to Executive Order (E.O.) 13526, as amended; or any successor orders, to require protection against unauthorized disclosure and is marked to indicate its classified status. Information may be classified at one of the following three levels:

1. **TOP SECRET:** Which is applied to information, the unauthorized disclosure of which reasonably could be expected to cause exceptionally grave damage to the national security that the original classification authority is able to identify or describe.
2. **SECRET:** Which is applied to information, the unauthorized disclosure of which reasonably could be expected to cause serious damage to the national security that the original classification authority is able to identify or describe.
3. **CONFIDENTIAL:** Which is applied to information, the unauthorized disclosure of which reasonably could be expected to cause damage to the national security that the original classification authority is able to identify or describe.

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II. Background:

As DoD commenced full-scope financial statement audits since Fiscal Year 2018, DoD identified accounting standard requirements that would conflict with its responsibility to prevent the unauthorized disclosure of information in accordance with E.O. 13526. The E.O. 13526, Section 1.4, authorizes the classification of information regarding the following types:

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

Unauthorized disclosure of classified information is prohibited by Title 18, United States Code, Section 798. Classified information is determined by an Original Classification Authority (OCA) or by applying derivative classification. The OCA and derivative classification are defined as follows:

- The OCA is an individual authorized in writing, either by the President, the Vice President or by agency heads or other officials designated by the President, to classify information in the first instance.
- Derivative Classification is incorporating, paraphrasing, restating, or generating in new form information that is already classified and marking the newly developed material consistent with the classification markings of the source of the information. Derivative Classification includes the classification of information based on classification guidance. The duplication or reproduction of existing classified information is not derivative classification.

DoD Components are responsible for safeguarding classified information related to activities identified in Interpretation 8 when presented in unclassified AFRs.

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III. Application Principles:

According to Interpretation 8 of SFFAS 56 guidance, there are four steps for determining inclusion:

1. Determine if the information is unclassified or classified: DoD Components should describe the determination as to whether the information is classified or unclassified and the basis for that determination, as determined by an OCA or by applying derivative classification (include references to Security Classification Guides when possible). If the information is unclassified, record information in unclassified AFR.
2. Determine if the information can be included in unclassified AFRs without modification: DoD Components should describe the information (e.g., financial information on classified assets) that is under consideration for presentation in the unclassified AFR or financial statements. Include a description of which financial statement line items, footnotes, and other information in the unclassified AFR would be affected.

If the information is determined to be classified, assess whether the information can be presented in the unclassified AFR without modification, while not disclosing classified information. Document the basis for this determination, including what classified information could potentially be disclosed by including in an unclassified AFR. Include classified information only if able to, without disclosing classified information following all Federal Accounting Standards Advisory Board standards except for SFFAS 56.

3. Determine if the information can be included in unclassified AFRs by applying SFFAS 56 modifications (see Section IV – “SFFAS 56 Permitted Modifications and Disclosure”). SFFAS 56 applies when an OCA concludes, or others determine by applying derivative classification, that the information is classified; and therefore, cannot be presented without modification in unclassified AFRs.

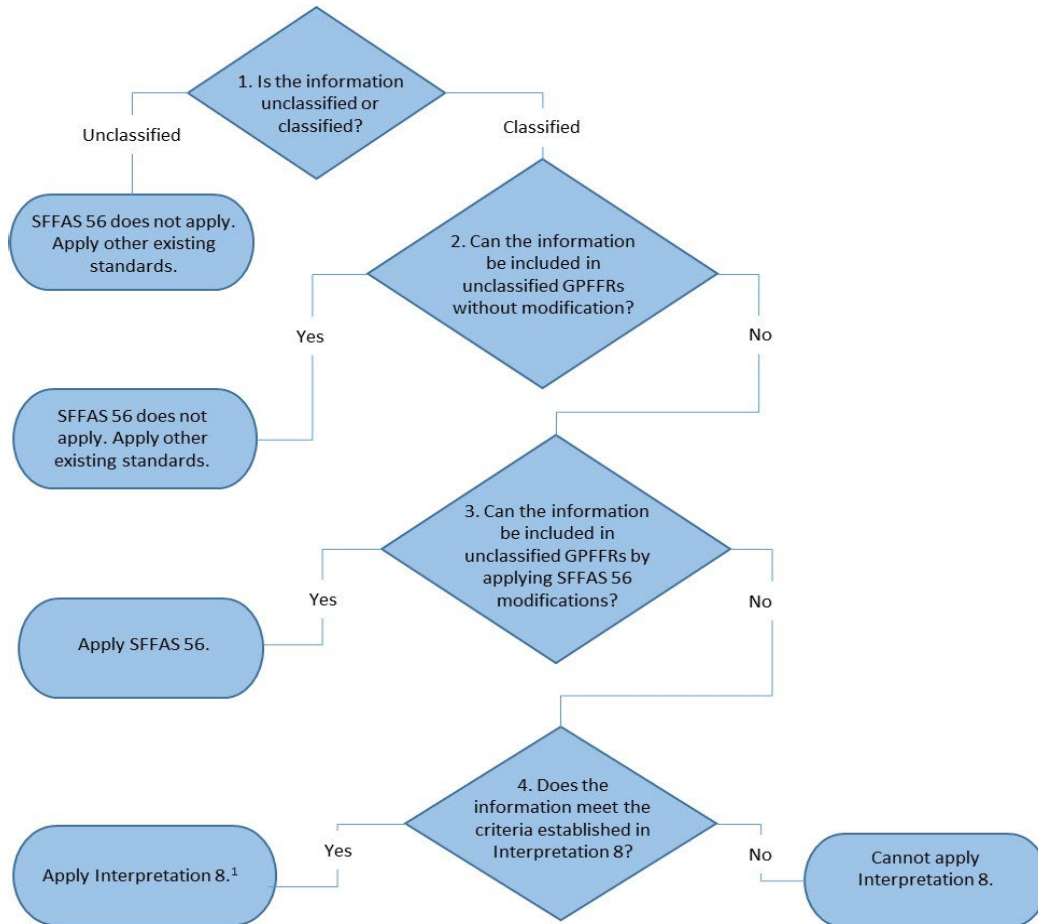
If classified information cannot be included in unclassified AFR without modification, document whether either of the following two options for modifying the unclassified AFR can be applied to include the classified information. Describe conclusions and rationale for each of the scenarios considered under each option if any option/scenario is deemed acceptable, that option must be used.

- a. Modify information required by other standards if the effect of the modification does not change the net results of operations or net positions.
 - b. DoD consolidation entity is excluded from one consolidation entity into another DoD consolidation entity. The effect of the modification may change the net results of the operations and/or net position.
4. Determine if the information meets the criteria established in Interpretation 8.

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Figure 1 depicts the application principles of Interpretation 8 of SFFAS 56 guidance.

Figure 1 – Application Decision Chart



¹ The guidance may be applied at the program or transaction level.

IV. SFFAS 56 Permitted Modifications and Disclosure:

A. Permitted Modifications:

SFFAS 56 permits the following modifications:

1. A DoD Component may modify information required by other standards if the effect of the modification does not change the net results of operations or net position.

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2. A DoD consolidation entity is allowed to be excluded from one DoD consolidation entity and consolidated into another DoD consolidation entity. The effect of the modifications may change the net results of operations and/or net position.
3. A DoD Component may apply Interpretations of this Statement that allow other modifications to information required by other standards, and the effect of the modifications may change the net results of operations and/or net position.

These modifications are only permitted after the DoD Component has made the determination that classified information exists and has a clearly documented approach to identify that information for separation from the rest of the financial data in unclassified AFRs.

B. Required Disclosure for all DoD Consolidation Entities:

All DoD consolidation entities must include the following disclosure in the summary of significant accounting policies:

“Accounting standards require all reporting entities to disclose that accounting standards allow certain presentations and disclosures to be modified, if needed, to prevent the disclosure of classified information.”

DoD consolidation entities must not disclose the application of SFFAS 56, including any Interpretations of SFFAS 56.

V. Presentation and Disclosure Modifications:

For the Department’s consolidated financial statements, DoD consolidation entities and the Office of Under Secretary of Defense (Comptroller) are responsible for modifying unclassified financial statement presentations, disclosures, required supplementary information (RSI), and required supplementary stewardship information (RSSI) required by other SFFASs to prevent the disclosure of classified information if the effect of the modification does not change the net results of operations or net position. In this context, modify means:

- a. Presenting amounts associated with one financial statement line item in another financial statement line item but not presenting a narrative explaining the modification.
- b. Omitting required disclosures, RSI, or RSSI that would otherwise reveal classified information.