FASAB

Federal Accounting Standards Advisory Board

April 10, 2018

MEMBER ACTIONS REQUESTED:
• Please provide responses to the questions starting on page 9 before April 20.

Memorandum

To: Members of the Board

From: Grace Wu, Assistant Director

Wendy M. Payne /s/

Through: Wendy M. Payne, Executive Director

Subject: Note Disclosure Project Scope – **Tab C**

MEMO OBJECTIVE

The objective of this memorandum is to seek the Board's input and approval on the note disclosure (NODI) project's scope and input regarding potential principles.

BRIEFING MATERIAL

This memorandum includes some initial research discussion on the NODI project. Questions for the Board are included in the discussion section and at the end to solicit feedback from members.

BACKGROUND

During the October 2017 meeting, the Board approved the note disclosure's two phased project plan and agreed that the primary objectives of the NODI project are to improve the relevance, clarity, consistency, and comparability of note disclosures among the federal entities. Currently, the project is in the first phase. The goal of phase one is to identify and develop principles for disclosure to be used by the Board and preparers to reduce repetition and improve relevance and consistency in NODI.

To accomplish this task, the NODI working group resumed its tasks after the year-end busy season in December 2017. The working group researched other regulatory bodies and boards' publication and activities, and did a data analysis by comparing note disclosures on the Summary of Significant Accounting Policies and Fund Balance with Treasury across the 24 Chief Financial Officer and 2016 Certificate of Excellence in Accountability Reporting review awardee agencies. The research is on-going. Below are some initial thoughts on the disclosure project's scope and some potential principles. Staff would like direction from the Board on topics for further research.

Discussion Topics

1. Disclosure Objective and Development Method

Developing centralized disclosure objectives has been brought up by both the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) as a way to improve disclosures. The FASB stated "objectives are intended to provide insight into why the disclosures were deemed by the Board to be relevant and may assist preparers in exercising discretion when complying with the disclosure requirements."[1] An example of a disclosure objective is:

> *330-10-50-1B The objective of the following disclosures is to provide users of financial statements with information that is useful in assessing the following:*
> *a. How different types of inventory may affect prospects for future cash flows*
> *b. How inventory recorded using different measurement methods may affect the decision usefulness of information for projecting future cash flows*
> *c. How transactions, events, and circumstances outside the normal course of business affect the inventory balance.*
> *….*
> *330-10-50-7 An entity shall disclose changes in the inventory balance during the period that are from transactions, circumstances, or events outside the normal course of purchasing, manufacturing, or selling inventory for each period presented. Examples of items that meet this principle may include, but are not limited to, increases or decreases in the inventory balance for any of the following, if applicable:*
> *a. Atypical losses from the subsequent measurement of inventory or shrinkage, spoilage, or damage and a description of the facts and circumstances leading to those losses*
> *b. Balance sheet reclassifications*
> *c. Inventory obtained through a business combination*
> *d. Inventory disposed of through a divestiture*
> *e. Unrealized gains and losses for inventories recorded above cost or at selling prices.*[2]

The IASB is exploring the potential for re-organizing the disclosure requirements in order to help entities exercise judgement about what specific information to communicate to the primary users of the financial statements. Disclosure objectives for standards have not been developed or have been developed in isolation from each other leading to inconsistencies and a lack of considerations between the disclosure requirements. To fix the issue, potential development methods were discussed by IASB in its discussion paper– *Disclosure Initiative – Principles of Disclosure* (DIPD). This paper is available at http://www.ifrs.org/projects/work-plan/principles-of-disclosure/. Staff highlights key points below:

> *7.8 This subsection discusses the following actions that the Board could take to address these problems:*
> *(a) development of centralized disclosure objectives:*
> *(i) Method A—focusing on the different types of information disclosed about an entity's assets, liabilities, equity, income and expenses;*

[1] FASB, Exposure Draft, *Inventory (Topic 33)—Disclosure Framework—Changes to the Disclosures Required for Inventory*, Par. BC10, January 10, 2017.
[2] FASB – par. 330-10-50-1B and 330-10-50-7, January 2018.

(ii) Method B—focusing on information about an entity's activities to better reflect the way users of financial statements assess prospects for future cash inflows and assess management stewardship;

(iii) a hybrid of Methods A and B (paragraphs 7.34–7.37); and

(b) the possibility of having a single Standard, or a set of Standards, that covers all disclosures

Method A would provide context for many of the existing disclosure objectives and requirements in the standards; therefore, fundamental changes to the current standards would not be necessary. Method A would allow an entity to use each grouping of information about each type of asset, liability, equity, income and expense as a disclosure 'building block' to organize the disclosures in its notes in the way that provides for the most effective communication. It would not provide the more fundamental changes to the way the Board develops disclosure objectives and requirements that might be necessary to encourage behavioral changes in all parties.

Method B would develop centralized disclosure objectives to address information about the operating, investing, and financing activities of an entity with the aim of providing information that helps users of financial statements assess both prospects for future net cash inflows and management's stewardship. Method B focuses first on identifying activities and then considers useful information about those activities, rather than first considering what types of information to disclose about assets, liabilities, equity, income and expenses. In this way, method B might lead to the development of more holistic disclosure objectives and requirements than method A, because method B focuses on activities on an integrated basis. This would constitute a fundamental change in how to develop disclosure objectives and requirements. Method B aligns the way in which many entities think about their activities, and the preference of many users of financial statements for information disclosed by activity. However, it would be a significant change to the current approach to developing disclosure requirements.

It would be possible to combine methods A and B into a hybrid method when developing centralized disclosure objectives. In fact, method B already incorporates a hybrid element because information about the basis of preparation of the financial statements is identified as a type of information in method A. A hybrid method would provide a Board more flexibility and it would benefit from some of the advantages of both methods, while reducing the disadvantages. A disadvantage of a hybrid method is a lack of consistency in how a Board develops disclosure objectives and requirements. It could make it difficult to determine the location for disclosure objectives and requirements in the standards.

An approach similar to method A is currently adopted by most of the standard setting boards. For example, the FASB's Proposed Statement of Financial Accounting Concepts *Conceptual Framework for Financial Reporting Chapter 8: Notes to Financial Statements* instead of proposing a fundamental change to its disclosure structure, it suggested an appendix section: *Decision Questions to Be considered in Establishing Disclosure Requirements* to assist the Board assessing the disclosure objectives and requirements when developing disclosure requirements for each standard.

Question: Staff's view is that most current SFFASs do not have disclosure objectives; it is important to set up disclosure objectives for each statement to help preparer stay focused and potentially use their judgment to remove unnecessary disclosure.

Method B suggested by the IASB could be costly for entities to implement changes to their internal systems or processes, and for regulatory bodies' to change their implementation guides to provide information based on activities. An approach like method A, combined with what FASB proposed, by going through a set of standard questions when setting the disclosure standards, would improve the consistency among the standards yet not require substantial change to the current structure and standards.

Does the Board agree with the idea of setting up a disclosure objective in the standards? Which project development method does the Board prefer?

2. Role/Content of Note Disclosure

Clarifying the role of the NODI would assist the Board and preparers to determining what type of information that should be included in the NODI. Below are the current FASAB concepts related to the role of the note disclosure in SFFAC 2, *Entity and Display:*

> *Par.* 68 *Financial information is also conveyed with accompanying footnotes, which are an integral part of the financial statements.* ***Footnotes typically provide additional disclosures that are necessary to make the financial statements more informative and not misleading.*** *[Emphasis added.]*

SFFAC 6 *Distinguishing Basic Information, Required Supplementary Information, and Other Accompanying Information* amended SFAFC 2 by adding explanations regarding the Board's process for deciding whether an item of information should be required and, if required, whether it should be presented in basic information or RSI.

> *73A.Selecting a category for communicating information may involve a process that begins with determining what information should be required. Required information is information that consists of basic information and RSI.* ***An item of information is a candidate for required information if it is consistent with the objectives of federal financial reporting and meets certain qualitative characteristics and cost-benefit considerations.*** *The Board developed these factors earlier in the conceptual framework. SFFAC 1 identifies the reporting objectives (paragraphs 112 to 150) and the qualitative characteristics (paragraphs 157 to 164). It also discusses cost versus benefit considerations (paragraphs 151 to 155).*
>
> *73B.Information that meets the criteria for required information is a candidate for basic information or RSI.* ***Basic information is information which is essential for the financial statements and notes to be presented in conformity with GAAP.*** *The FASAB standards are the core[12.1-[omitted]] of GAAP and auditors may be engaged to express an opinion as to whether basic financial statements and notes are presented in conformity with those criteria.*
>
> *73c. [Omitted – describes RSI]*
>
> *73D.The Board specifies what information should be presented as basic information and what information should be presented as RSI.* ***Assessing whether required information is a candidate for basic information or RSI may involve the Board's consideration of a range of factors which are listed in Table 1: Factors to Consider in Distinguishing Basic Information from RSI on page 107.*** *The factors are not listed in a particular order and some may convey similar ideas. In addition, different Board members may assign different weight to each factor. Thus, the factors provide a general framework for each Board member's judgment and are not considered to present a decision tree, hierarchy, or precise algorithm for classifying items. [Emphasis added.]*

Paragraph 73E provides examples of how the factors may influence classification between basic information and RSI. These examples draw from Table 1 (see below) but do not explicitly discuss factors considered in determining what information should be presented in notes.

Table 1: Factors to Consider in Distinguishing Basic Information from RSI*

	FACTORS TO CONSIDER IN DISTINGUISHING BASIC INFORMATION FROM RSI	
Low (implies RSI)	**Factor**	**High (implies Basic)**
	<Relevance to fair presentation>	
	<Connection with elements of financial reporting>	
	<Use of various types of financial data or financial transaction data>	
	<Level of importance the Board wishes to be communicated in the financial report>	
	<Significance, relevance, or importance of the item in light of *Objectives*>	
	< Level of importance the Board wishes to be communicated in the auditor's report>	
	<Relevance to measuring financial condition or changes in financial condition>	
	<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>	
	<Benefit/cost ratio of using resources to compile the information as well as ensure accuracy>	
	<Connection with basic financial statements>	
	<Reliability and/or precision possible>	
	<Reliability and/or precision needed>	

*As noted in paragraph 73D, the factors are not listed in a particular order and do not represent a hierarchy of factors.

While these paragraphs describe the general process for identifying what information to include in basic information, there is no detailed elaboration in the concepts or standards in terms of how to accomplish the objective stated in Par. 68; rather the guidance in SFFAC 2 goes on to discuss specific potential note disclosures, such as:

> *Par. 95 Organizational and program management costs are necessary costs of operating an organization and programs. ….The costs for managing the organization and/or program can therefore be displayed on the face of the financial statements or in accompanying footnotes, particularly when it would assist in evaluating operating performance and is cost-effective. Disclosure of what the support costs entail would be appropriate.*

> *Par.103 Organizations that collect custodial revenues that are incidental to their primary mission do not need to report the collections and disposition of these revenues in a separate statement. The disclosure of the sources and amounts of the collections and the amounts distributed to others could be disclosed in accompanying footnotes.*

In contrast, IASB discussion paper DIPD discussed the role and content of the notes in detail. Its Board's preliminary view is documented below:

> *The role of the notes is to:*

(a) provide further information necessary to disaggregate, reconcile and explain the items recognized in the primary financial statements; and
(b) supplement the primary financial statements with other information that is necessary to meet the objective of financial statements.

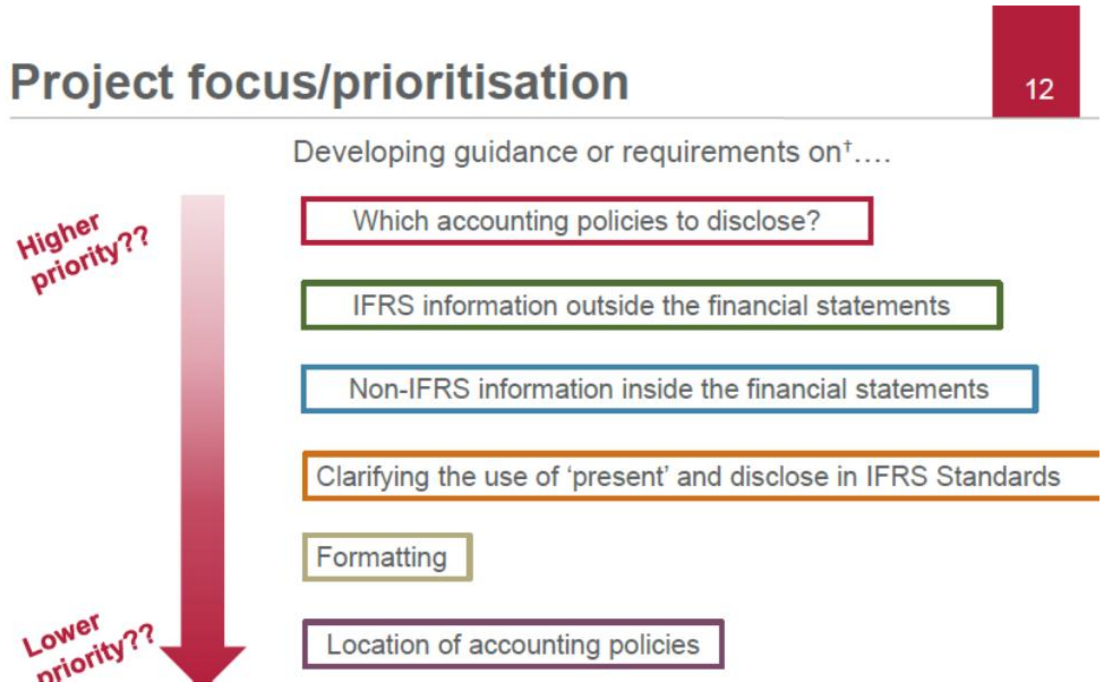
FASB Exposure Draft chapter 8 *Notes to Financial Statements* has a similar discussion regarding the role /content of note disclosures*:*

D12. Consequently, notes to financial statements provide types of relevant information that cannot be or is not provided on the face of the financial statements. The resulting disclosures can be categorized as information about financial statement line items, the reporting entity, and past events and current conditions and circumstances that have not met the criteria for recognition that can affect an entity's cash flows.
D13. First, notes provide information about specific line items either to amplify or to explain information on the face of the financial statements.
D14. Second, notes provide general information about the nature of the entity, its activities, any special restrictions or privileges that apply to it, and other advantages and disadvantages relative to other entities.
D15. Third, notes provide information about other past events and current circumstances and conditions that will or may affect an entity's future cash flows but that have not affected a line item.

Question: Staff's view is that role and content principles, like what are proposed by the IASB and FASB, would help the Board and the preparers stay focused when setting up or applying standards. Does the Board agree that FASAB should now clarify the role and content for the note disclosure?

3. Project Research Topics/Focus

In its March 2018 meeting, IASB's note disclosure project staff presented feedback on the project focus/prioritization based on the discussion paper DIPD published in March 2017. Many of the respondents think that IASB needs to be better focus the project – ie identify and prioritize the things that are most important. IASB staff suggested the project focus based on the discussion paper topics as listed in the below table.



. The meanings for each item in this table are summarized below:

1. Which accounting policies to disclose: An entity shall disclose its significant accounting policies and consider what to disclose.
2. IFRS information outside the financial statements: Permit entities to provide specific information required by Standards outside the financial statements by providing a link or reference.
3. Non IFRS information inside the financial statements: An entity might identify supplemental information in the financial statements as non-IFRS information, or by a similar labelling, to distinguish it from information necessary to comply with IFRS standards.
4. Clarifying the use of "present" and "disclose" in IFRS standard: Two terms should be clarified in the standard as the "present" usually describes providing information in the primary financial statements while the "disclosure" refers to notes[3]
5. Formatting: How to present information such as data vs. text.
6. Location of accounting policies: where to disclosure the accounting policies

The IASB recent survey results showed that while users are concerned about the lack of relevant information and ineffective communication in the note disclosure, the preparers believe there are too many prescriptive disclosure requirements and the regulatory and compliance environment adds more complexity. Judgment-based disclosure principles could potentially help

[3] FASAB defined "disclosure" as "Reporting information in notes or narrative regarded as an integral part of the basic financial statement." This permits the preparer to present information on the face of the financial statement or in note.

disclose relevant information, increasing the usefulness of the note to the readers and reducing the burden to preparers.

Item #2 in the table is historical IASB issue as its board allows referencing outside the financial statements for compliance items in their current standards. No such referencing exists in current FASAB standards. The technology is revolving very fast today. It is hard to predict what financial reporting would look like and where the location of accounting policies would be stored in the future. The format and place of the financial reporting presentation could be substantially changed, which makes it difficult to set up principles for some uncertain technology. In addition, each entity may alter the format of its financial reporting presentation, as long as its content meets the standard requirements.

Question: Staff suggests concentrating the note disclosure project on the disclosure principles. Staff also believes some discussion of non- FASAB information included in disclosures would be helpful. The guidance related to the formatting and location of disclosure that may be helpful to prepares, can be provided through other methods, such as implementation guidance. Staff does not suggest developing principles on them. Does the Board agree with the note disclosure project's focus? If not, does the Board have any suggestions?

4. Two Tiers of Disclosure Requirements

Two tiers of disclosure requirements were suggested by the New Zealand Accounting standards Board staff. It suggested:

> *8.12 two tiers of disclosure requirements, which would require entities to:*
>
> *(a) provide summary information, subject to a materiality judgement (tier 1 disclosures); and*
> *(b) assess whether it is necessary to provide additional information, depending on the relative importance of the item or transaction to the reporting entity and the amount of judgement involved in accounting for the item or transaction (tier 2 disclosures).*
>
> *8.13 The aim of this two-tier approach to disclosing information is to provide a balance between:*
>
> *(a) ensuring a level of consistency and comparability between entities, and a level of specificity, which directs entities when judging what information is required to satisfy the overall disclosure objective in a Standard—subject to materiality, all entities would be required to provide the summary information (tier 1 disclosures).*
>
> *(b) providing entities with some flexibility to exercise judgement about what further information is needed to meet the overall disclosure objective in a Standard (tier 2 disclosures).*

Question: The two tiers disclosure approach allows flexibility for the entity to exercise judgment regarding how much detail it would like to disclose on the subject but still keeps the consistency among the entities through required summary information. This approach would require the Board to establish minimum (Tier 1) requirements when setting up standards as well as additional (Tier 2) items to be included based on materiality of an item for the particular entity. Does the Board think there is a need to set up a two tiered disclosures requirement for the standards?

NEXT STEPS

Members are requested to approve the project plan and identify the next steps staff should consider taking.

MEMBER FEEDBACK

If you require additional information or wish to suggest another alternative not considered in the staff proposal, please contact staff as soon as possible. In most cases, staff would be able to respond to your request for information and prepare to discuss your suggestions with the Board, as needed, in advance of the meeting. If you have any questions or comments prior to the meeting, please contact me by telephone at (202) 512-7377 or by e-mail at wug@fasab.gov with a cc to paynew@fasab.gov.

QUESTIONS FOR THE BOARD

1) Does the Board agree with the idea of setting up a disclosure objective in the standards? Which project development method does the Board prefer?

2) Does the Board agree that FASAB should now clarify the role and content for the note disclosure?

3) Does the Board agree with the note disclosure project's focus? If not, does the Board have any suggestions?

4) Does the Board think there is a need to set up a two tiered disclosure requirement for the standards?

5) Does the Board wish to discuss any other matters not identified by staff?