Federal Accounting Standards Advisory Board

December 4, 2018

MEMBER ACTIONS REQUESTED:

- Please provide responses to the questions starting on page 5 before December 14.

Memorandum

To: Members of the Board

From: Grace Wu, Assistant Director

Wendy M. Payne /s/

Through: Wendy M. Payne, Executive Director

Subject: Note Disclosure Principles – **Tab B**

MEMO OBJECTIVE

The objective of this memorandum is to seek the Board's input on a partial draft of the note disclosure (NODI) principles.

BRIEFING MATERIAL

This memorandum includes draft NODI principles sections 1 and 2 (partial). Questions for the Board are included at the end to solicit feedback from members.

BACKGROUND

During the October 2018 Board meeting, the Board discussed and approved the NODI principles outline. Based on input from the Board and detailed research on the FASAB and other standard Boards' literature, staff drafted the first part of the NODI principles. This draft covers the NODI principles outline's introduction, section 1 *Disclosure Purpose,* and the majority of section 2 *Disclosure Content* including topic 1 *What information identified as required information should be disclosed*, and the majority discussion in the topic 2 *How to judge relevance.*

The Introduction section discusses existing reporting objectives and how existing objectives are used to identify required information (including notes). The Introduction section summarizes but does not change existing concepts to aid the reader in understanding the new NODI concepts. It also differentiates basic information (including notes) from RSI. In addition, it explains the term "essential" to address the question from the October 2018 meeting about no clear definition for the term "essential" in the current literature.

The Note Purpose section covers another discussion from the October 2018 meeting about emphasizing users and clarifies the relationship between the basic information, financial statements and the notes. Finally, it addresses the purpose of the note (see paragraph 5).

The Note Content section discusses the NODI contents. It would guide what kind of content belongs to NODI. Examples are included as well.

The last Relevance section points out that relevance is more important in identifying standards for the NODI content rather than materiality. It also states that developing a clear disclosure objective for disclosure requirements will help relevance.

Below is the draft to date. This is the beginning section of the proposed principle writing, it doesn't cover all the topics that intend to cover for NODI principles. See appendix A NODI Principles Outline for a complete set of the intended cover topics, and Appendix B Referenced Current NODI Related FASAB Concepts for some heavily quoted existing concept references.

Note Disclosure Principles

Section 1 Purpose of the Notes to Financial Statements (Notes)

Introduction[1]

1. Statement of Federal Financial Accounting Concepts (SFFAC) 1, *Objectives of Federal Financial Reporting*, indicates that the objectives of financial reporting are to provide information useful for assessing accountability and making decisions. The information helps external users to assess the operating performance of the reporting entity and internal users to plan, execute, and monitor programs. In particular, paragraph 71 states:

   71. It may be said that "accountability" and its corollary, "decision usefulness," comprise the two fundamental values of governmental accounting and financial reporting. They provide the foundation for the objectives of federal financial reporting. Because a democratic government should be accountable for its integrity, performance, and stewardship, it follows that the government must provide information useful to assess that accountability. Similarly, because a democratic government is accountable for operating economically, efficiently, and effectively, for the purposes intended by citizens and their elected officials, certain other conclusions logically follow. Specifically, those who formulate, select, and implement government policies and programs need information useful for planning, controlling, and conducting government functions.

2. Required information provides users access to information needed to meet the financial reporting objectives in the areas of Budgetary Integrity, Operating Performance, Stewardship, and Systems and Control.[2] An item of information is a candidate for required information if it is consistent with the objectives of

[1] The introduction section summarizes existing concepts relevant to note disclosure concepts. It is intended to facilitate understanding of the proposed note disclosure concepts and is not intended to replace existing concepts.
[2] See SFFAC 1, par.13–17, for a detailed discussion of the four federal financial reporting objectives.

federal financial reporting and meets certain qualitative characteristics and cost-benefit considerations.[3]

3. Required information consists of basic information and required supplementary information (RSI). Basic information is information that is essential for the financial statements and notes to be presented in conformity with GAAP.[4] Information is essential if it is highly relevant to the reporting objectives and supports fair presentation of an entity's financial position and periodic financial performance. Nothing material should be omitted from the information necessary to represent faithfully the underlying events and conditions, nor should anything be included that would likely cause the information to be misleading to the intended report user.[5]

Notes Purpose

4. Basic information provides a meaningful representation of a reporting entity's financial performance and position. Interested users could use basic information to help them make resource allocation and other decisions and hold the entity accountable for its deployment and use of resources. Such decisions may include assessment of the efficiency and effectiveness of services provided, as well as the government's financial ability to provide services in the future.

5. Financial statements present basic information in the form of line items and notes. Notes are an integral part of the financial statements.[6] Notes have the same significance as information set forth in the body of financial statements. Although financial statements and notes may present different information, they together provide useful information for a particular kind of assessment or decision.

6. The purpose of the notes is to provide information necessary to make the financial statements more informative and not misleading. Conveying the substance of financial statement line items requires narrative and more detailed information about amounts. Notes may be used to explain information or add information not recognized in the financial statement, but cannot be used as a substitute for the proper recognition and/or measurement of an element.[7]

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[3] SFFAC 2, par.73A.
[4] SFFAC 2, par.73B.
[5] SFFAC 1, par.160.
[6] Statements of Federal Financial Accounting Standards establish disclosure requirements. Disclosures may be provided in narrative on the face of the financial statements or in notes. However, it is more common for disclosures to be presented in notes. The principles established in this Statement are applicable to all disclosures—those logically presented on the face of the financial statements as well as those presented in the notes.
[7] SFFAC 5, par. 2 defines *elements* as "broad classes of items, such as assets and liabilities, that comprise the building blocks of financial statements."

Section 2 Notes Content

7. Notes are entity specific with information at the level of detail appropriate to the entity's financial statements. Notes provide further explanation of information necessary to disaggregate, reconcile, and describe the items recognized in the financial statements. Notes help users assess the risks and uncertainties that could affect the entity's results of operations or financial position. Notes should also provide additional information necessary to meet the reporting objectives.

8. Examples of explanatory information in the notes include:
    a. Supporting information for items presented on the face of the statements (for example, disaggregation and reconciliations of items, descriptions of the nature of the items, and methods and assumptions used)
    b. Relevant information about the reporting entity that satisfies the objectives of the financial statements (for example, an entity's nature, activities, and any special restrictions or privileges that apply to it, and its advantages and disadvantages relative to other entities)
    c. Information about other past events, current conditions, and circumstances that can affect an entity's resources. The effects of these conditions and circumstances may not be recognized because they do not meet the basic recognition criteria[8] (for example, unrecognized potential settlement of a legal suit or an entity's exposure to a risk of loss)

Relevance

9. Notes should have the basic qualitative characteristics of financial reporting including relevance.[9] A note is relevant if it is capable of making a difference in a user's assessment of a problem, condition, or event.[10] Judgments about whether to establish disclosure requirements are based on broad general consideration of relevance rather than on entity-specific judgments about materiality. Relevance generally is a broader concept than materiality. Sometimes, information may not be material to an entity but could be relevant when it is consolidated with other entities' information.

10. Notes should include information not conveyed by the line item but relevant to an understanding of the line item and otherwise not available to the user in a cost effective manner. Notes also should be expressed as simply as possible without excluding essential information that can be made available to users in a cost effective manner.

11. A lack of disclosure objectives for the notes makes it difficult for entities and users to understand the purposes of some of the disclosure requirements in the standards and, therefore, to exercise judgment in deciding what information

[8] SFFAC 5, par.5.
[9] See SFFAC 1, par. 156–164 for a detailed discussion of qualitative characteristics.
[10] SFFAC 1, par.161.

should be disclosed. High level disclosure objectives should be provided for relevant disclosure requirements in the standards.

NEXT STEPS

Members are requested to provide input on the draft principles. Members' suggestions will be compiled for discussion at the December meeting.

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 draft principles? If not, do members have any suggestions?

2) Does the Board wish to discuss any other matters not identified by staff in the proposed sections?

Appendix A NODI Principles Outline

Below outline was approved by the Board at the October 2018 Board meeting.

Section I Disclosure Purposes

- Disclosure is "reporting information in notes or narrative regarded as an integral part of the basic financial statement."

  - An item of information is a candidate for required information[1] if it is consistent with the objectives of federal financial reporting and meets certain qualitative characteristics and cost-benefit considerations. Basic information is information which is essential for the financial statements and notes to be presented in conformity with GAAP. (SFFAC 2, par. 73A-B)
  - Disclosures: are an integral part of the financial statements and make the financial statements more informative and not misleading. Disclosure is not a substitute for recognition. However, unrecognized elements are candidates for disclosure. (SFFAC 2, par. 68)

Section II Disclosure Content

Topic 1: What information identified as required information should be disclosed?

- Information not conveyed by the line item but relevant, such as:

a. Supporting information for items presented on the face of the statements
b. Relevant information about the reporting entity
c. Information about other past events and current conditions and circumstances that can affect an entity's resources.

Topic 2: How to judge relevance

- Disclosures should include information not conveyed by the line item but relevant to an understanding of the line item and otherwise not available to users in a cost effective manner
- Relevance is a broader concept than materiality (materiality is entity specific while relevance is assessed broadly)
- A list of questions will be developed to aid the Board in assessing relevance as it considers new disclosure requirements
- Providing disclosure objectives in each Statement would help the preparer judge what information to include in disclosures

Topic 3: What should not be disclosed?

- General information if it can be obtained easily somewhere else
- Expectations and assumptions about the future that are not inputs to current measures in financial statements or notes (note that some federal financial statements are projections)
- Differentiate the MD&A vs. note disclosure
- Consideration of sensitive disclosure including adverse consequences
- Information for which the cost of disclosure exceeds the benefits

Topic 4: Disclosure style

- Note shall be presented in a systematic manner as far as practicable by presenting disclosures associated with an entity's assets, liabilities, net position, revenue and expenses.
- Disclosures should not provide definitions for commonly used terms or terms already defined in the standards. Ideally GFFR should provide definitions in a glossary or on line.

- Board would encourage some basic communication principles

Section III Appendix

- Question list for the Board including detail examples of how to apply the list
- Others

Appendix B Referenced Current NODI Related FASAB Concepts

Below are extracted paragraphs from the current concepts that were quoted by the draft NODI principle writings.

SFFAC 1, Objectives of Federal Financial Reporting

Objectives of Federal Financial Reporting

Budgetary Integrity

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

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

Operating Performance

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

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

Stewardship

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

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

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

Systems and Controls

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

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

Chapter 3: Accountability And Users' Information Needs—the Foundation Of Governmental Financial Reporting

71.It may be said that "accountability" and its corollary, "decision usefulness," comprise the two fundamental values of governmental accounting and financial reporting. They provide the foundation for the objectives of federal financial reporting. Because a democratic government should be accountable for its integrity, performance, and stewardship, it follows that the government must provide information useful to assess that accountability. Similarly, because a democratic government is accountable for operating economically, efficiently, and effectively, for the purposes intended by citizens and their elected officials, certain other conclusions logically follow. Specifically, those who formulate, select, and implement government policies and programs need information useful for planning, controlling, and conducting government functions.

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

Chapter 6: Qualitative Characteristics Of Information In Financial Reports

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

Understandability

157. Special purpose reports are prepared to meet the needs of specified users. Understandability is rarely a problem in such cases because mutual understanding of what

information is needed can generally be assumed between report preparer and report user. Information in general purpose financial reports, however, should be expressed as simply as possible. Users of general purpose financial reports, including internal users, tend to have different levels of knowledge and sophistication about government operations, accounting, and finance.

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

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

Reliability

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

Relevance

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

Timeliness

162. In some circumstances, the mere knowledge that a report eventually will be made public can influence behavior in desirable ways, just as the knowledge that one's tax return might eventually be audited can influence the behavior of people when they report their income. In other circumstances, however, if financial reports are to be useful, they must be issued soon

enough to affect decisions. Timeliness alone does not make information useful, but the passage of time usually diminishes the usefulness that the information otherwise would have had. In some instances, timeliness may be so essential that it requires sacrificing a certain amount of precision or detail; a timely estimate may then be more useful than precise information that takes longer to produce.

Consistency

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

Comparability

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

SFFAC 2, Entity and Display

73. The fourth objective, systems and controls, is fulfilled, in part, by the act of preparing the financial statements. Other ways the fourth objective could be fulfilled through the audited financial reporting process is by a management assertion that would accompany the financial statements and/or an auditor's attestation on the financial statements. The management assertion would be an acknowledgment of its responsibility for the accuracy of the information in the financial statements, the completeness and fairness of the presentation of the information, the accuracy of the information in all material respects, and the reporting of the information in a manner designed to fairly present financial position and results of operations. The assertion could also include a statement regarding the adequacy of the entity's systems and controls, accompanied by the auditor's concurrence with the assertion.

Distinguishing Basic Information, RSI, and OAI

Determining Required Information

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).

Determining Basic Information versus RSI

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] 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.RSI is information that a body that establishes GAAP requires to accompany basic information. It may be experimental in nature to permit the communication of information that is relevant and important to the reporting objectives while more experience is gained through resolution of accounting issues. Also, the information may be expressed in other than financial measures or may not be subject to reliable estimation. As issues are resolved, the information may be considered basic at some point in the future.

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.

73E. For example, members may consider the relevance of the information to fair presentation. If the information has a high relevance to fair presentation, it may be a candidate for basic information communicated by financial statements and notes to the financial statements.
The financial statements and notes could not be considered fairly presented if the information is missing or materially misstated. The rationales for some of the other factors that members may consider are:

a. Use of various types of financial data or financial transaction data. Members may deliberate the nature of the data used or the type of system used to process the information. Financial data used or data derived from a system for processing financial transactions, may be more likely to be considered basic information.

b. Level of importance the Board wishes to be communicated in the financial report or the auditor's report. In addition to the nature of the information, the Board may take into account the effect of categorizing an item as basic information or RSI in the financial report and what the auditor's report would communicate if the item is missing or materially misstated. By designating an item as basic information rather than RSI, the Board can have some bearing on the level of importance conveyed in the financial report and auditor's report. In other words, users may pay less attention to items categorized as "supplementary" in the financial report. Conversely, they may be more concerned with the auditor's conclusions regarding the fair presentation of the financial statements. Hence, the more important the item, the more likely it would be a part of the financial statements and notes prepared in conformity with GAAP, such that if the item is missing or materially misstated, the matter would be conveyed in the auditor's report on the fair presentation of the financial statements.

c. The extent to which the information interests a wide audience (rather than specialists). If an item of information is of great interest to users, the information may be a candidate for basic information. Conversely, if the item is primarily of interest to subject matter specialists, the information may accompany the basic information as RSI.

d. Extent to which there are not alternative sources of reliable information. If organizations routinely publish an item of information that is scrutinized by independent advisors, it may be more likely to be considered RSI than basic information.

e. Agreement on criteria that permit comparable and consistent reporting. If there is a lack of specific criteria for measuring an item, preparers may have great discretion in developing their calculations and auditors may lack criteria necessary for the expression of an opinion. The item of information may be a candidate for RSI.

f. Experience among users, preparers, and auditors with the information. The Board may consider the views of expert users, preparers, and auditors in developing measurement criteria for basic information. If the level of experience regarding an item is low, input on specific criteria may not be available. Also, when there is not sufficient experience to develop measurement criteria, auditors may have concerns about expressing an opinion on the information. They may express qualifications or include explanations in their report. Categorizing the information as RSI may encourage reporting while more experience is gained and criteria developed.

g. Benefit/cost ratio of using resources to compile the information as well as ensure accuracy. The Board may consider the benefit and cost associated with producing and auditing the item of information.

SFFAC 5, Definitions of Elements and Basic Recognition Criteria for Accrual-Basis Financial Statements

Summary

Objective of this Statement

Elements of financial statements result from an entity's transactions or other events that affect the entity. Elements are the “building blocks” of financial statements-the broad classes of items from which the statements are constructed. This Statement defines five elements of accrual basis financial statements of the federal government. Items that meet the definitions also are elements of accrual-basis financial statements of the relevant component entity. The elements are defined as follows:

An ***asset*** is a resource that embodies economic benefits or services that the federal government controls.

A ***liability*** is a present obligation of the federal government to provide assets or services to another entity at a determinable date, when a specified event occurs, or on demand.

Net position or its equivalent, net assets, is the arithmetic difference between the total assets and total liabilities recognized in the federal government's or a component entity's balance sheet. Net position may be positive (assets greater than liabilities) or negative (assets less than liabilities).

A ***revenue*** is an inflow of or other increase in assets, a decrease in liabilities, or a combination of both that results in an increase in the government's net position during the reporting period.

An ***expense*** is an outflow of or other decrease in assets, an increase in liabilities, or a combination of both that results in a decrease in the government's net position during the reporting period.

This Statement establishes two basic recognition criteria that an item must meet to be a candidate for recognition in the body of a financial statement: (1) the item must meet the definition of an element and (2) the item must be measurable, meaning a monetary amount can be determined with reasonable certainty or is reasonably estimable. An item that meets the definition of an element but is not measurable is a candidate for disclosure in the notes to financial statements or as supplementary information.

Basic Recognition Criteria

5. Basic recognition criteria are the conditions an item should meet in order to be a candidate for recognition in the financial statements. The basic recognition criteria established in this Statement are (a) the item meets the definition of an element of financial statements and (b) the item is **measurable**. As used in this Statement, the term *measurable* means that a monetary amount can be determined with reasonable certainty or is reasonably estimable.