Federal Accounting Standards Advisory Board

February 5, 2019

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**

MEMBER ACTIONS REQUESTED:

- Please provide responses to the questions starting on page 8 before February 22.

MEMO OBJECTIVE

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

BRIEFING MATERIAL

This memorandum includes the updated 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 December 2018 Board meeting, the Board approved and provided suggestions on the NODI partial draft principles. Based on input from the Board and detailed research on FASAB and other standards-setters' literature, staff updated the partial draft. Because a majority of the working group members were on furlough during the partial government shutdown, the NODI working group was not able to review and provide input on the partial draft as planned. The working group's research on the NODI topics was also delayed.

This updated partial draft addresses the comments from the last Board meeting and adds additional language to help the Board apply the principles. These changes include the following:

- Emphasizing that the report is for reasonable users, so the Board can set up disclosure requirements around these users.
- Adding user consideration when defining the term "essential" to address one member's comment from the last meeting.

- Adding a reference to the Statement of Federal Financial Accounting Concepts (SFFAC) 2's table related to factors to consider in distinguishing basic information from required supplementary information (RSI).
- Adding that the report is designed to meet the common needs of diverse users to address one Board member's comment from last meeting.
- Clarifying further the notes' purpose, especially related to how the principle in development will affect the land project in progress. Reference and key quotes from SFFAC 5 and SFFAC 7 were added. Topics like the definitions of elements, the recognition and measurement concepts, and measurement attributes are discussed to help distinguish the information presented on the face of the financial statement and in the notes.
- Explaining further the three types of information by adding discussions on the purpose for the types. This will help the Board evaluate the types when setting up disclosure requirements.
- Adding usefulness in the materiality discussion to be in line with the reporting objectives. The following sentence was discussed at the last meeting: "Sometimes, information may not be material to a reporting entity but could be relevant when it is combined or consolidated with other related information." This idea was further explained by a newly added paragraph.
- Providing a separate disclosure objective section to address comments from last meeting. The benefits of the disclosure objective for the Board and preparer were also added.
- Some of the December's approved writings were moved around to place or group with similar contents.

Below is the updated draft to date. The tracking changes are the areas where updates were made. Appendix A: NODI Principles Outline is kept for reference purposes.

Updated Note Disclosure Principles Based on Comments

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

Introduction[1]

1. This Statement discusses concepts to assist the Federal Accounting Standards Advisory Board (FASAB or "the Board") in developing disclosure requirements. . In developing this Statement, the Board considered concepts important to identifying information that should be required in financial reports and where that information should be presented. As a result, some existing FASAB concepts such as those discussed in Statement of Federal Financial Accounting Concepts (SFFAC) 1, *Objectives of Federal Financial Reporting*, are summarized to aid in understanding the concepts regarding disclosure requirements.

[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. 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.*

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

4. Required information consists of basic information and required supplementary information (RSI).[4] Basic information is information that is essential for the financial statements and notes to be presented in conformity with generally accepted accounting principles (GAAP).[5] Information is essential if it has a high relevance[6] to the reporting objectives and is necessary for a reasonable financial report user[7] to understand the impact of particular transactions, other events and conditions on the entity's financial position, condition and performance. Nothing

[2] See SFFAC 1, par.13–17, for a detailed discussion of the four federal financial reporting objectives.
[3] SFFAC 2 *Entity and Display,* par.73A.
[4] SFFAC 2, par.73C states: "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."
[5] SFFAC 2, par.73B.
[6] SFFAC 2, par 73E states:" 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."
[7] Par.1 of the Materiality exposure draft states: "A reasonable financial report user has knowledge of the reporting entity's activities and is willing to study the information with due diligence."

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 user.

5. Accountability and decision usefulness[8] comprise the two fundamental values of governmental accounting and financial reporting. Not all decision useful information can be provided in a general purpose federal financial report (GPFFR). The information presented should meet the common needs of diverse users. Within GPFFRs, ~~B~~basic information makes a contribution toward fulfilling accountability and decision usefulness goals. Basic information provides a meaningful representation of a reporting entity's financial ~~-~~ results of operations, financial position, financial condition, and operating performance of the federal government and its component reporting entities, including the status of budgetary resources provided to component reporting~~position, condition and performance~~.[9] ~~Interested~~ U~~u~~sers could use basic information to help them make resource[10] allocation and other decisions and hold the entity accountable for its deployment and use of resources. Such decisions may include assessment of the efficiency of services provided, as well as the government's financial ability to provide services in the future.

6. Further, the Board may identify information that is related to the basic information, but does not meet the criteria for basic information. For example, the information may be a candidate for RSI reporting, based on SFFAC 2 considerations.[11] Also, the Board may determine that the basic information should identify where additional information about a subject may be obtained outside of the GPFFR.

Notes Purpose

~~7. Financial statements present basic information in the form of line items and notes. Notes are an integral part of the financial statements.[12] Notes have the same importance 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.~~

[8] See SFFAC 1, chapter 3 for a detailed discussion of accountability and users' information needs in the federal environment.
[9] SFFAC 8, par.20.
[10] SFFAC 5 *Definitions of Elements and Basic Recognition Criteria for Accrual-Basis Financial Statements*, par. 21. The term resource means "a useful or valuable possession or quality of a country, organization or person" or a "means of supplying a want."
[11] SFFAC 2, table 1 *Factors to Consider in Distinguishing Basic Information from RSI* lists15 factors including relevance for the Board to consider in distinguishing basic information from RSI.
~~[12] 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.~~

~~8.~~7. ~~The purpose of the~~ N~~n~~otes ~~is to~~ provide information that complements and provides context to the financial statements and is necessary to a user's understanding of financial statements~~to make the financial statements more informative and relevant~~. Notes, combined with financial statements, should provide information that is necessary for a reasonable financial report user to understand the impact of particular transactions, other events, and conditions on the financial results of operations, financial position, financial condition, and operating performance of the federal government and its component reporting entities,~~-~~including the status of budgetary resources provided to component reporting. Notes are an integral part of the financial statements and have the same importance as information set forth in the body of financial statements.[13] ~~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 statements~~, but they cannot be used as a substitute for the proper recognition and/or measurement of an element~~.[14]

~~9.~~8. The distinction between information presented on the face of a financial statement and in the notes is determined by the definitions of elements,[15] the recognition and measurement concepts discussed in SFFAC 5, *Definitions of Elements and Basic Recognition Criteria for Accrual-Basis Financial Statements*,[16] measurement attributes discussed in SFFAC 7,[17] *Measurement of the Elements of Accrual-Basis Financial Statements in Periods After Initial Recording*, and the financial reporting objectives discussed in SFFAC 1.

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[14] SFFAC 5, par. 21 states:~~"~~ "Notes to financial statements generally are considered an integral part of financial statements, but they are not elements. They serve different functions, including amplifying or complementing information about items reported in the body of financial statements."

[15] SFFAC 5, par. 2 defines elements as "broad classes of items, such as assets and liabilities that comprise the building blocks of financial statements." SFFAC 5, par. 9 states: "An item that meets the appropriate definition of an element is an asset, liability, revenue, or expense, even if it is not recognized in the accrual-basis financial statements because, for example, it is not measurable or its amount is not material. Unrecognized elements are candidates for disclosure in the notes to financial statements or as supplementary information."

[16] SFFAC 5, par. 5 states: "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."

[17] SFFAC 7, par. 7b states:" The measurement attribute (or measurement basis) [footnote omitted] is a measurable characteristic of an asset or liability, such as its fair value or settlement amount [footnote omitted]. Major questions are: Which attributes result in more useful information for decision making, and what factors and circumstances may contribute to that result, such as the class of asset or liability, the type of transaction, and variations in users' decision-making needs? Also, the selection of a measurement attribute often entails the selection of a measurement method…Different measurement attributes and methods may be used for different assets and liabilities, and the selections made can affect the usefulness of reported information for decision making."

Section 2 Notes Content

~~10.~~9. Notes are entity-specific, providing information at the level of detail appropriate to the entity's financial statements. ~~Notes provide additional information necessary to meet the reporting objectives.~~ Notes help users understand the financial statements by providinge ~~further explanation of~~ information ~~necessary to~~that disaggregates, reconciles, ~~and~~ or describes the items recognized in the financial statements. Notes also help users assess the risks and uncertainties that could affect the entity's ~~results of operations or~~ financial position and condition.

10. Notes include information not conveyed by the line item but relevant to an understanding of the line item and otherwise not easily accessible to the user. Notes should have a clear and demonstrated relationship to the financial statements. Notes also should be written as simply as possible without excluding essential information.

11. There are three major types ~~Examples~~ of explanatory information in the notes. These types are ~~include~~:[18]
    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 including physical condition, nature of a gain or loss, and methods and assumptions used). Sometimes, users can understand some line items with little or no explanation in the notes; nevertheless, explanation may be required to make the nature or quality of a line item apparent.
    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). Appropriate context or background information helps users to assess the potential effect of financial statement line items on an entity's financial position, condition and performance because an identical asset or liability held by two different entities can have very different implications.
    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[19] (for example, ~~unrecognized potential settlement of a legal suit~~existing or potential litigation or ~~an entity's exposure to a risk of loss~~dependency on another entity for continuing operation).

12. Information presented in the note should be useful to the user and highly relevant to the reporting objectives. To be useful, notes should have the basic qualitative

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[18] Adapted from the Financial Accounting Standards Board's (FASAB) Statement of Financial Accounting Concepts (SFAC) No.8, *Notes to Financial Statements~~.~~,*
[19] SFFAC 5, par.5.

characteristics of financial reporting including understandability, reliability, relevance, timeliness, consistency, and comparability~~including relevance~~.[20] Also, in establishing note requirements, the Board considers cost-benefit constraints.

Relevance and Materiality

13. A note is relevant if it is capable of making a difference in a user's assessment of a problem, condition, or event.[21] Relevance is a broader concept than materiality. Considerations to establish disclosure requirements should be based generally upon relevance rather than entity-specific judgments about materiality. Sometimes, information may not be material to a reporting entity but could be relevant when combined or consolidated with other related information.

~~13.~~14. Disclosures should have the potential to apply to a broad range of reporting entities (or to a broad range of entities within an identified subset of entities).[22] For example, when considering the overall impact to the consolidated financial statements of the United States government, individual reporting entities may need to disclose some information that may not be material to the particular component reporting entity. When establishing disclosure requirements, the Board should consider the broad aspects of relevance. The materiality decision should be made by each individual component reporting entity. The disclosure requirements should not be so prescriptive that they preclude reporting entities from making materiality judgments.

~~14. Notes should include information not conveyed by the line item but relevant to an understanding of the line item and otherwise not easily accessible to the user. Notes also should be expressed as simply as possible without excluding essential information.~~

~~15. Notes to financial statements are subject to the same cost-benefit consideration that applies to other aspects of financial reporting.~~

Disclosure Objectives

~~16.~~15. ~~An absence of~~Disclosure objectives for the required disclosures may make it easier for entities and users to understand the purposes of the disclosure requirements in the standards. This also may ~~make it difficult for~~assist preparers in exercising judgment about what information is relevant and should be disclosed. Hence, disclosure objectives should be provided with disclosure

[20] See SFFAC 1, par. 156–164 for a detailed discussion of qualitative characteristics.
[21] SFFAC 1, par.161.
[22] Adopted from FASB SFAC 8.

requirements in the standards. Authoritative and visible disclosure objectives could encourage all stakeholders to make disclosure decisions on the basis of disclosure objectives.

16. Reporting objectives can help the Board evaluate the sufficiency of the disclosure requirements and develop more focused disclosure requirements when setting standards. While the Board sets disclosure requirements, it is up to the preparer to consider whether there are additional disclosures necessary for the financial statements to be fairly presented. Disclosure objectives in the standards, with a focus on accountability and decision usefulness, would help the preparer to identify what additional disclosure information beyond what is prescribed by a specific Statement should be included in the disclosures to meet the disclosure objectives.

17. Notes to financial statements are subject to the same cost-benefit consideration that applies to other aspects of financial reporting. The cost to provide note disclosures will change over time with the advancement of technology's ability to handle data. Therefore, the Board's analysis of disclosure costs should change over time as technology changes.

NEXT STEPS

Members are requested to provide input on the updated draft principles. Members' suggestions will be compiled for discussion at the February 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 updated 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: List of items to consider on disclosure

○ 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 RSI 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