Federal Accounting Standards Advisory Board

June 13, 2019

MEMBER ACTIONS REQUESTED:

- Please provide responses to the questions starting on page 11 before June 21.

Memorandum

To: Members of the Board

From: Grace Wu, Assistant Director

Monica R. Valentine

Through: Monica R. Valentine, Executive Director

Subject: Note Disclosure – **Tab J**

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

The briefing material includes this memo and two appendices. The memo includes the updated NODI principles which are meant to align with sections I and II of the NODI principles outline.

- Appendix A: NODI Principles Outline
- Appendix B: Financial Accounting Standards Board's (FASB) Statement of Financial Accounting Concepts (SFAC), No.8 *Notes to Financial Statements*, Appendix A *Decision Questions to Be Considered in Establishing Disclosure Requirements* (FASB Appendix A)

Appendix A and Appendix B are for reference purposes. Questions for the Board are included on page 11 to solicit feedback from members.

BACKGROUND

During the February Board meeting, the Board approved and provided suggestions on the NODI partial draft principles. Based on input from the Board and research on FASAB and other standards-setters' literature, staff updated the partial draft. The draft principles were updated to include the section on *Decision Questions to Be Considered in Establishing Disclosure Requirements* and this completes section II of the NODI outline. FASB Appendix A is included in this document as Appendix B. The decision questions section was adapted from FASB's Appendix A.

The draft NODI principles included in paragraphs 1 – 17 have been revised to reflect comments from the February Board meeting. Those revisions are shown in tracked changes. In addition, one member's comment received after the meeting about Par. 14 was added and highlighted in italic for discussion. The updated draft principles include the following revisions:

Footnote #11 was added to explain how the term "service" is used broadly to describe government activities in SFFAC 1 *Objectives of Federal Financial Reporting*. The term "service" is also used in SFFAC 8 *Federal Financial Reporting* in a similar context. SFFAC 8 par. 24 states: "Although a variety of projections may be used in preparing financial statements, long-term projections may be used to inform users on the sustainability of services." As such, we are using the term "service" in the current principle to be consistent with existing Concepts.

- Wording in the relevance and materiality section (par.14) was modified further for the federal environment.
- User's awareness and accessibility of other information was added in par.17 as another cost benefit consideration item.
- Paragraphs 15 and 16 of the disclosure objectives section were modified to remove redundant language in the prior draft.
- The new section discussing the decision questions to be considered in establishing disclosure requirements begins on paragraph 18.

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 identify information that should be required in federal 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.

2. Statement of Federal Financial Accounting Concepts (SFFAC) 1, *Objectives of Federal Financial Reporting*, indicates that the objectives of federal financial reporting are to provide information useful for assessing accountability and making decisions. In particular, paragraph 71 states:

[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.

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 which 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 an entity's financial position, condition and performance. Nothing material should be omitted from the information necessary to represent the underlying events and conditions, nor should anything be included that would likely cause the information to be misleading to the user.

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[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 defines RSI as~~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~~introduces "high relevance" concept, it 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 draft Materiality ~~exposure draft~~Statement states: "A reasonable financial report user has appropriate knowledge of the federal government's activities and is willing to diligently review and analyze the information."

5. Accountability and decision usefulness[8] comprise the two fundamental values of ~~governmental~~ federal 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, basic information makes a contribution toward fulfilling accountability and decision usefulness goals. "Basic information provides a meaningful representation of ~~a reporting entity's~~ 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 entities."[9] Basic information can be used to help users make resource[10] allocations and other decisions. ~~and~~ Basic information can also be used to hold the entity accountable for its deployment and use of resources. Such decisions may include assessment of the efficiency of services [11]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 *Entity and Display* considerations.[12] 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. Notes provide information that complements and provides context to the financial statements and helps users better understand the financial statements. Notes, combined with financial statements, should provide information that is necessary for a reasonable financial report user to understand the impact of significant 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 entities. Notes are an integral part of the financial statements and have the same importance as

[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 1, par.14 discusses the importance of service evaluation in the federal report, it states: "Federal financial reporting should assist report users in evaluating the service efforts, costs, and accomplishments of the reporting entity."
[12] SFFAC 2, table 1 *Factors to Consider in Distinguishing Basic Information from RSI* ~~lists15~~ lists several factors including relevance for the Board to consider in distinguishing basic information from RSI.

information in the body of financial statements.[13] Notes may be used to explain information or add information not recognized in the financial statements.[14]

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

Section 2 Notes Content

9. Notes provide information at the level of detail appropriate to the entity's financial statements. Notes help users understand the financial statements by providing information that disaggregates, reconciles, or describes the items recognized in the financial statements. Notes also help users assess the risks and uncertainties that could affect the entity's 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 by the financial report user. Notes should have a clear and demonstrated relationship to

[13] 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.

[14] The role of the notes is also stated in SFFAC 5, par. 21: "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 further 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 discusses recognition and measurement, it 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 discusses measurement attributes as: "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."

the financial statements. Notes also should be written as simply as possible, without excluding essential information.

11. There are three major types of explanatory information in the notes: ~~These types are:~~

    a. Supporting information for items presented on the face of the statements (for example, disaggregation and reconciliations of items, descriptions of the nature, terms, or quality of the items, nature of a gain or loss, and methods and assumptions used). Users may be able to understand 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. Context or background information about the reporting entity, such as an entity's nature, activities, and any special restrictions or privileges that apply to it. This information could help users assess the potential effect of financial statement line items on an entity's future financial position, condition and performance. ~~because~~ For instance, an identical asset or liability held by two different entities can have very different implications.

    ~~a.~~c. ~~Information about o~~Past events, current conditions, and circumstances that have not been recognized ~~that~~ but 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[18] (for example, existing or potential litigation or 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 characteristics of financial reporting including understandability, reliability, relevance, timeliness, consistency, and comparability.[19] Also, in establishing note requirements, the Board considers cost-benefit constraints.

Relevance and Materiality

13. SFFAC 1 paragraph 161, states, "A note is relevant if it is capable of making a difference in a user's assessment of a problem, condition, or event."~~[20]~~ Relevance is a broader concept than materiality. ~~Considerations to establish d~~Disclosure requirements should generally be based generally upon relevance rather than entity-specific judgments about materiality. Sometimes, information on a stand-a-

[18] See SFFAC 5, par.5 for a detailed discussion of basic recognition criteria.~~.~~

[19] See SFFAC 1, par. 156–164 for a detailed discussion of qualitative characteristics.

~~[20] SFFAC 1, par.161.~~

lone basis may not be material to a reporting entity but could be relevant when combined or consolidated with other related information.

14. Notes ~~should~~ have the potential to apply to ~~a broad range of~~ component reporting entities ~~(or to a broad range of entities within~~ that may have sub-component entities. When establishing disclosure requirements, the Board should consider the broad aspects of relevance. For example, when considering the overall impact to the consolidated financial statements of the United States government, the Board may require individual reporting ~~entities~~ entities ~~may need~~ to disclose some information that may not be material to those ~~reporting~~ entities~~y~~. ~~When establishing disclosure requirements, the Board should consider the broad aspects of relevance.~~ In applying the individual note requirements, materiality decisions should be made by each individual component reporting entity. As such, the Board should not establish disclosure requirements that are so prescriptive that they would preclude reporting entities from making materiality judgments.

One member stated:

1. I believe the first sentence should be deleted. This is adapted from FASB concepts, but it seems out of place here. It refers to a range of entities and subset of entities. I believe this language reflects FASB's mandate to set standards for three different types of organizations: business enterprises, not-for-profit organizations, and employee benefit plans. I believe the entities subject to our standards are more homogeneous than FASBs' constituency, so this sentence seems out of place in our concepts.

2. I believe the second sentence should be deleted. I don't see how one executes what's written here. Who is considering the overall impact to the consolidated federal financial statements? As written, the sentence suggests individual reporting entities should do so. Staff has responded to my comments that this is intended as guidance for the Board and based on last meeting, OMB and Treasury would like discuss the impact to the consolidated federal financial statements. Again, I think this sentence should be deleted, but if the staff's interpretation of what the Board wanted is correct, then please see item 3 below...

3. If we decide there should be guidance to the Board on potential disclosure of items that are immaterial to an individual reporting entity because of the needs of the consolidated federal financial statements, then I believe we should state this more clearly and directly, potentially along the following lines:

When considering the overall impact to the consolidated financial statements of the United States Government, the Board may require individual reporting entities to disclose some information that may not be material to those entities.

Staff Response: *Language was modified to clarify relationships such as DOD and its subsidiaries Navy and Army. In this case, the sub-component agency won't have the broader views and it is up to the Board to consider the broad aspects of the disclosure.*

This item is open for Board discussion

Disclosure Objectives

15. Disclosure objectives should be provided ~~with~~ when the Board is establishing disclosure requirements in the standards. Clearly stated disclosure objectives may make it easier to understand the purposes of the disclosure requirements and provide a basis for making disclosure decisions. ~~Objectives also may assist preparers in exercising judgment about what information is relevant and should be disclosed.~~

16. Reporting objectives, with a focus on accountability and decision usefulness, can help the Board evaluate whether the disclosure requirements are sufficient, and develop more focused disclosure objectives and requirements when setting standards. While the Board establishes disclosure objectives and 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 may assist preparers in exercising judgment on what information is relevant and should be disclosed. ~~Disclosure objectives, with a focus on accountability and decision usefulness should be included in the standards. Doing so, will help the preparer to identify additional disclosure information beyond what is prescribed by a specific Statement.~~

17. Notes to financial statements are subject to the same cost-benefit consideration[21] that applies to other aspects of financial reporting. For example, the cost to provide note disclosures will change over time with the advancement of technology's ability to process data. In addition, user's awareness and accessibility of other information such as OMB and Treasury literature should also be considered. Therefore, the Board's analysis of disclosure costs should change over time as technology and environment changes.

Decision Questions to Be Considered in Establishing Disclosure Requirements[22]

18. Information disclosed in the notes is necessary to a user's understanding of the financial statements. It provides information that presents the financial statements in the context of the entity and its operating environment. It generally will have a clear and demonstrable relationship to information displayed on the face of the financial statements to which it pertains. The level of detail provided in the financial statements is a matter of professional judgment. A decision on the level of detail would balance the need to meet the identified financial statement objectives with the need for understandable financial statements for its users.

[21] See SFFAC 1 *Chapter 5: Balancing Costs and Benefits in Recommending Standards* for detail discussion on cost-benefit consideration when setting up standards.
[22] Adapted from the Financial Accounting Standards Board's (FASAB) Statement of Financial Accounting Concepts (SFAC) No.8, Notes to Financial Statements.

When setting new accounting standards or updating existing accounting standards, the Board should consider the purpose and content of the note disclosure. Therefore, it is not necessary to include all the information that might fit the descriptions of the three types of disclosure information discussed in paragraph 11.

19. The nature and volume of additional relevant information in the notes depends on what the line item represents and many other factors. For example, assets may be physical, contractual, statutory or intangible. Similarly, liabilities may result from contacts or statutes. While some assets and liabilities are easy to understand, understanding complex issues like credit program and social insurance may require more explanation and elaboration. Ultimately, each line item should be explained in enough detail for a user to understand the nature of the underlying phenomenon and significant uncertainties. This understanding includes ownership, obligation, or matters that the entity considered in determining whether to recognize an element.

20. To help the Board identify the relevant disclosures and the level of detail required during the standard setting process, Section III Appendix *[to be developed]* provides a series of decision questions that considers the nature of information that should be provided in the notes. The Board can use these decision questions as a tool to identify possible considerations for setting standards for disclosure. A positive answer to the question indicates that the Board should consider a disclosure, but not automatically require a disclosure. Board judgments will be necessary in each circumstance.

21. To best apply consistent decisions on recognition, measurement, and presentation of financial statement elements, the Board should consider the objectives of general purpose financial reporting, qualitative characteristics of useful financial information, differences in activities among entities, and stakeholder feedback. Therefore, not all decision questions in Section III Appendix *[to be developed]* should be used for every disclosure consideration. Furthermore, additional information that is not derived directly from the decision question may be considered by the Board.

22. Section III Appendix *[to be developed]* covers the three major types of note disclosures discussed in paragraph 11 in two areas -- information about line items; and information about other past events and current conditions and circumstances that can affect an entity’s resource. Information disclosed in the notes may include entity-related factors, the basis for what is displayed, disaggregation of amounts displayed on the face of the statements, items that do not meet the definition of an element or the recognition criteria, but are important to an understanding of the entity’s funding and ability to deliver services, and information may explaining the underlying trends affecting displayed totals. The following are examples of information that the Board may find useful when

establishing disclosure requirements of standards and applying the Section III Appendix *[to be developed]*:

a. An entity's general information is unknown to users but could impair their ability to make informed resources allocation decisions. For example, information about the nature, quality, location, and other factors affecting the utility of an asset; how the asset can or will generate future resources; how the asset relates to other line items; and any significant contractual, statutory, regulatory, or judicial restrictions on the asset's use or disposition.

b. Whether the nature of an entity's primary activities is unknown or well-known, those activities could be complex or unusually and not readily apparent to readers. If those activities would have a potentially significant effect on resource allocation decisions, they are candidates for disclosure.

c. An entity may be subject to restrictions or have special privileges; others may have significant contractual, statutory, or judicial restrictions or advantages. Information about any of those current or future matters including contractual or legal terms, conditions and risks that have had, will have, or can have significant effects on resource allocation decisions is a candidate for disclosure.

d. An entity may have "consolidation entities and disclosure entities administratively assigned to it."[23] In addition, it "may have significant relationships with other parties."[24] Information on the nature of the relationship and their significant effects on conditions, circumstances, transactions, events including the potential effect of the counterparty's or the entity's inability to pay or perform; or the future exposures to risks and rewards; and potential change about the assets or liabilities resulting from those situation, if not apparently to the users, are candidates for disclosure.

e. Disclosure of accounting methods is important if (a) alternatives are permitted, (b) the methods are not otherwise apparent, or (c) the methods have changed. Disclosure of the details of frequently used mathematical models is seldom if ever important. However, certain key assumptions such as estimation methods, ranges of possibilities, or most positive outcomes or most negative outcomes within those models may be important to disclose.

f. There are types of events, conditions, and circumstances including existing or potential litigation, violation, commitments, dependency or volatility, that can affect the amounts or timings of an entity's future resource allocation but that have not yet affected a line item. For example, existing litigation against the entity or by the entity against another entity and the outcome is still uncertain. In this kind of situation, the Board should consider requiring information about such events, conditions, and

[23] SFFAS 47 *Reporting Entity*, Summary.
[24] SFFAS 47 *Reporting Entity*, Summary

circumstances subject to the cost constraint and other limitations on information to be provided in notes.

NEXT STEPS

Members are requested to provide input on the updated draft principles. Members' suggestions will be compiled for discussion at the June 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 Ms. Valentine at valentinem@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 draft NODI principles?

Appendix A NODI Principles Outline

Below outline was approved by the Board at the October 2018 Board meeting. Crosswalk from the draft to this outline is provided below

Section I Disclosure Purposes

- Disclosure is "reporting information in notes or narrative regarded as an integral part of the basic financial statement." (par.7)

o 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. 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) (Par2, 3, 4, 5, 6)

o 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) (par.8)

Section II Disclosure Content

Topic 1: What information identified as required information should be disclosed? (par. 9,10,11,12)

o 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

o 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 (par. 13)

o Relevance is a broader concept than materiality (materiality is entity specific while relevance is assessed broadly) (par. 14)

o A list of questions will be developed to aid the Board in assessing relevance as it considers new disclosure requirements (par.18, 19, 20, 21, 22, 23)

o Providing disclosure objectives in each Statement would help the preparer judge what information to include in disclosures (par. 15, 16, 17)

Topic 3: List of items to consider on disclosure

o General information if it can be obtained easily somewhere else

o 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)

o Differentiate the RSI vs. note disclosure

o Consideration of sensitive disclosure including adverse consequences

o Information for which the cost of disclosure exceeds the benefits

Topic 4: Disclosure style

o 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.
- 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 FASB SFAC No.8 *Notes to Financial Statements*, Appendix A *Decision Questions to Be Considered in Establishing Disclosure Requirements*

Introduction

DQ1. The Board and stakeholders that use this appendix will be guided and aided by the concepts in this chapter, but judgments based on the particular circumstances of each case will continue to play a major role in improving disclosure. The questions in this appendix are developed as educational guidance for the Board to be used as a tool to identify possible considerations for setting standards for disclosures in Topics in the Codification. Consistent with decisions about recognition, measurement, and presentation, the consideration by the Board should include a robust consideration of the objective of general purpose financial reporting, relevance of the information, cost constraints, and differences in activities among entities. Therefore, not all questions in this appendix will be utilized for each Topic of the Codification. Furthermore, disclosure requirements not derived directly from the decision questions may be considered relevant in advancing the objective of general purpose financial reporting at a standards level.

DQ2. A “yes” answer to a question indicates that the Board should consider requiring that information in notes. However, a “yes” answer does not necessarily mean that the Board should require note disclosure. It also does not indicate the extent of disclosure that would be necessary. Those decisions can be reached only by considering the particular Topic and are subject to all of the constraints listed in paragraphs D22–D40.

DQ3. When the decision questions reference cash flows, and because the decision questions will be used by the Board and staff as a tool in standard-setting projects, the cash flows being referred to relate to the cash flows of the entity from the particular line item, transaction, phenomenon, event, circumstance, or condition being addressed. Ultimately, the prospects of cash flows to the entity can affect the cash flows to the resource providers.

Information about Line Items

DQ4. The following group of questions relates to information about line items in financial statements that can affect a user’s decisions.

Question L1

Is there information about the nature or quality of the phenomenon or phenomena represented by the line item (for example, the underlying rights, obligations, or transactions) that can affect assessments of cash flow prospects and that is not adequately conveyed by the line item's description?

Information to Be Considered for Disclosure

a. Enough information (normally qualitative instead of quantitative) about the phenomenon or phenomena so that a user may access reference materials or other sources of information to understand the phenomenon or phenomena

b. If a user could not reasonably be expected to find adequate information from other sources, an explanation of the nature of the phenomenon or phenomena in enough detail to provide an understanding of how the item might affect prospects for cash flows.

Question L2

Does the line item represent any of the following:

a. Financial instruments issued or held by the entity

b. Other contracts or legally binding documents

c. Other binding arrangements?

Information to Be Considered for Disclosure

a. Terms (obligations and rights) needed for assessing prospects for cash flows. Some examples are amounts and timing of payments and receipts, interest rates, and the nature and timing of other required performance, call or put options, and penalty or bonus clauses.

b. If the item is an asset, the risk of counterparty nonperformance (credit risk or failure to deliver other assets or services) at the date of the financial statements.

c. The potential effect on the financial statements of the reporting entity of counterparty nonperformance.

d. The potential effect on the financial statements of the reporting entity of the entity's nonperformance.

e. The estimated amounts and timing of future cash flows that are contractually required, but whose amounts and/or timing are not contractually specified.

f. The estimated amounts and timing of future cash flows that are not contractually specified but that are anticipated or otherwise probable (for example, on the basis of past history or economic incentives).

g. Terms needed for assessing prospects for cash flows of claims against the entity related to equity instruments issued by the entity. Some examples are the number of shares outstanding, the number of share options outstanding, dividend and liquidation preferences, conversion or exercise prices, participation rights, and unusual voting rights.

h. For claims against the entity, information about the priority of those claims.

Question L3

Could the existence or ownership of the rights and obligations underlying the line item be uncertain?

This question is different from the uncertainty question related to measurement (see Question L12) in that it does not relate to uncertainty about measurement, but to uncertainty about whether an asset or liability exists or is owned or owed by the entity.

Information to Be Considered for Disclosure

a. A description of the uncertainty or uncertainties about the existence and ownership of the item

b. An explanation of how future cash flows would change if the uncertainty is resolved in a manner that is different from what the entity expects.

Question L4

Does the line item include components of different natures that could affect prospects for net cash flows differently?

There are many examples of line items that contain different components, and some of those components may affect prospects for cash flows in a different manner. Some examples include the following:

a. A portfolio of financial instruments of different types

b. Inventories of different types of products or raw materials, work in process, or finished goods

c. Revenues from different products or services whose sales are not correlated

d. Real estate that includes apartment buildings, malls, and office buildings

e. Revenue related to a business acquired through a business combination

f. Property, plant, and equipment acquired in exchange for debt.

The following are examples of indications that components affect prospects for cash flows differently:

a. Different frequency or timing of occurrence

b. Different probabilities of repeating

c. Responses to different variables or different responses to the same variables
d. Different rates of return expected.

Information to Be Considered for Disclosure
a. The amounts and natures of the different components of the line item
b. Unusual or infrequent items.

Question L5

Are the causes of the changes in an entity's line item of an asset, liability, or equity instrument not readily assessable because there are numerous causes or because the line item is subject to nonroutine changes?

Information to Be Considered for Disclosure

a. A detailed rollforward, major inflows and outflows, or particular changes in a line item.

It may be important to separate routine changes from nonroutine changes and changes in reported amounts caused by changes in accounting, changes in economic conditions, changes in the composition of the entity, and changes in contractual obligations or rights.

Question L6

Could the quality or utility of a nonfinancial asset have changed?

That disclosure is related to measurement but is not strictly a measurement issue. Some productive assets are carried at amounts that are not closely related to their current values, and they do not change in relation to those values. For example, a building with a carrying amount that is being depreciated may actually be appreciating in value, and its cash-flow generating potential may be increasing.

Information to Be Considered for Disclosure

a. A description of the nature of the change and how that change could affect prospects for cash flows of the entity. The objective of this disclosure would be to provide information not signaled or indicated by accounting and reporting. For example, the carrying amounts of depreciable assets may systematically decline in a way that masks a change in utility or value. The asset may have been depreciated at a rate that exceeds the rate at which its economic value has declined. Therefore, a technological change that causes it to become significantly less valuable in a single year may not require an impairment write-down. That change in economic value is the kind of information to be provided by this disclosure.

Question L7

Does the line item include individual items (or groups) that are measured differently?

Information to Be Considered for Disclosure

a. Descriptions, carrying amounts, and measurement methods of the items or groups that are measured differently. a. The accounting policy or method applied

b. The magnitude of the effect if the accounting method is unusual, if results produced are counter to what a reader might otherwise expect (for example, last-in, first-out [LIFO] inventory costing), or if the method otherwise dramatically affects the financial statements (full cost versus successful efforts).

Question L8

Are there acceptable alternative accounting policies or methods provided under GAAP that might have been applied to this line item?

Information to Be Considered for Disclosure

Question L9

Has the accounting policy or method used for this line item changed because of adoption of or transition to newly issued guidance or because the previous method was determined to no longer be proper?

Information to Be Considered for Disclosure

a. The fact that a change has occurred

b. The reason(s) for the change

c. How the change would have affected previous years or, if that is not feasible, how the previous method would have produced different information this year.

Question L10

Will this line item be affected in future years by transition to an accounting standard that has been issued but that is not yet effective or not fully effective?

Information to Be Considered for Disclosure

a. When the transition will occur

b. A description of the anticipated effect on future financial statements[13]

c. If readily available, the pro forma effect on current-year financial statements.

[13]If the data are available without undue effort.

Question L11

Is the method for determining the amount of the line item uncommon, not apparent from the description, or otherwise hard to discern?

Information to Be Considered for Disclosure

a. An explanation of how the amount of the line item was determined (for example, an option pricing model, a matrix pricing technique, or an internally developed technique). However, if the computation is unique or unusual but prescribed in an accounting standard (such as the way of determining deferred taxes or uncertain tax positions), disclosure might be unnecessary if the line-item description is adequate to indicate the accounting requirement that is applied.

Question L12

Is the carrying amount of the line item an estimate that requires assumptions, judgments, or other internal inputs that could reasonably have been different?

This question is not limited to fair value or other estimates of current value. At times, accumulations of costs involve uncertainties (about which costs to include, for example), and impairment allowances not based on quoted market prices are nearly always subject to significant uncertainties. Information about how changes between periods for significant estimates, assumptions, judgments, or other internal inputs that have affected a line item also could be relevant.

Information to Be Considered for Disclosure

a. Disclosure of enough detail about the significant estimates, assumptions, judgments, or other internal inputs to provide a general understanding of (1) how the carrying amount was determined, (2) the level of uncertainty inherent in the amount, and (3) how significantly the number might have changed if the inputs had been different.

Question L13

Is there an alternative measure or way of applying a measurement that clearly would be useful in assessing prospects for cash flows?

An alternative measure might be considered for an asset or a liability. One example is the fair value of a financial instrument reported at a cost-based amount. Another example is disclosing inventory using the first-in, first-out (FIFO) inventory costing method for inventory carried using the LIFO inventory costing method.

Information to Be Considered for Disclosure

a. Identification of the alternative measurement or method of application

b. An indication of the magnitude of the difference between the reported measurement and the alternative measurement (or the amount of the alternative measurement).

Question L14

Does a line item have a direct relationship not otherwise apparent to another line item or items in another statement?

Information to Be Considered for Disclosure

a. A description of the relationship(s) between line items when the relationship or relationships are otherwise not apparent

b. The effects that a change in a particular item has on another item

c. A reconciliation of the relationship(s) between line items on various statements.

Information about Other Past Events and Current Conditions and Circumstances That Can Affect an Entity's Cash Flows

DQ5. The following group of questions relates to information about other past events and current conditions and circumstances (the effects of which have not yet been reflected in financial statements) that can affect a user's decisions.

Question O1

Can any of the following events or conditions create a possibility that a user's assessment of an entity's future cash flows would be significantly different (lower or higher):

a. Potential litigation against the entity or by the entity against another entity or entities (because of specific matters instead of general business risk)

b. Existing litigation against the entity or by the entity against another entity or entities, the outcome of which is still uncertain

c. Suspected or known violations by the entity of laws, regulations, or contractual terms or violations of the entity's rights under statutes, regulations, or contracts

d. Other uncertain conditions (such as the entity's inability to continue as a going concern)?

Information to Be Considered for Disclosure

a. The existence and description of the event or condition

b. Whether the effect of the event or condition would involve the entity's routine and frequent business activities or would have an infrequent or one-time effect on the entity's cash flows

c. Whether the event or condition itself is unique or infrequent or is routine or frequent

d. A current measure of the possible effect of the event or condition on the entity's future cash flows

e. The entity's judgment about the probability that the event or condition will affect the entity's future cash flows.

Question O2

Are there other events or circumstances that are not represented by an asset or a liability and a gain or loss (or income or expense) in an entity's financial statements but for which there is uncertainty in the decision about whether it should be recognized (that would include items other than the contingencies discussed in Question O1(a) and (b))?

Information to Be Considered for Disclosure

a. The existence and description of the event or condition

b. Uncertainties that were assessed in deciding not to recognize an asset or a liability and a gain or a loss (income or expense) and the reason for that decision

c. Whether events or conditions of the same type are routine and frequent or would have an infrequent or one-time effect on cash flows

d. Whether the event or condition itself is unique or infrequent or is routine or frequent

e. A current measurement of the possible effect of the event or condition on future cash flows

f. The entity's judgment of the probability that the event or condition will affect future cash flows.

Question O3

Are there contractual rights or obligations arising from past transactions and events or current conditions and circumstances that are expected to meet the criteria for recognition by the entity in the future?

Information to Be Considered for Disclosure

a. Unrecognized obligations

b. Future payments related to unrecognized obligations

c. Potential issuances of an entity's own shares resulting from existing contractual agreements.