Federal Accounting Standards Advisory Board

MEMBER ACTIONS REQUESTED:

Please review the materials and answer the question on page 4 by **February 21, 2020**

February 14, 2020

Memorandum

To: Members of the Board

From: Ross Simms and Robin Gilliam, Assistant Directors

Through: Monica R. Valentine, Executive Director

Subject: Reporting Model – Note Disclosures – **TAB D**[1]

MEETING OBJECTIVE

The meeting objective is to review and approve plans for improving note disclosures.

PHASE

The project is currently in the research phase.

BRIEFING MATERIALS

The briefing materials include this memorandum and the following attachments:

- **Attachment 1**: Examples of Current Note Disclosure Concepts provides an overview of those note disclosures concepts the Board expressed while developing Statements and other guidance
- **Attachment 2**: Note Disclosures Technical Plan presents the proposed plan for the note disclosure project

[1] The staff prepares Board meeting materials to facilitate discussion of issues at the Board meeting. This material is presented for discussion purposes only; it is not intended to reflect authoritative views of the FASAB or its staff. Official positions of the FASAB are determined only after extensive due process and deliberations.

You may electronically access the briefing material at https://fasab.gov/board-activities/briefing-materials/

BACKGROUND

During the December 17, 2019 meeting, the Board agreed to continue conducting the reporting model phase II (budgetary information), note disclosure, and MD&A projects concurrently. Members determined that more progress could be made using this approach.

PLAN FOR IMPROVING NOTE DISCLOSURES

The Board developed certain note disclosure concepts in the early 1990s,[2] and subsequently noted additional concepts as part of various Statements and other guidance. For instance, Statement of Federal Financial Accounting Concepts (SFFAC) 2, *Entity and Display* discusses that the Board may follow a process that begins with determining what information should be basic information (financial statements and note disclosures) and RSI. The information may be presented in financial statements and disclosures or RSI if it is consistent with the objectives of federal financial reporting and meets certain qualitative characteristics and cost-benefit considerations. SFFAC 1 identifies the reporting objectives (paragraphs 112 to 150), qualitative characteristics (paragraphs 157 to164), and cost versus benefit considerations (paragraphs 151 to 155).

In SFFAC 2, the Board also developed concepts to help distinguish basic information (financial statements and note disclosures) from RSI.[3] SFFAC 2 also distinguishes the financial information conveyed on the face of financial statements from the information conveyed in financial statement note disclosures.

> Financial information is also conveyed with **accompanying footnotes**, which are an integral part of the financial statements. Footnotes typically provide additional disclosures that are necessary to make the financial statements more informative and not misleading.[4]

In addition, in SFFAC 5, *Definitions of Elements and Basic Recognition Criteria for Accrual-Basis Financial Statements*, the Board discussed that note disclosures may present information that may not be measurable or material or, because of uncertainty, the information does not meet basic recognition criteria.[5] Also, the basis for conclusions

[2] For example, see Statement of Federal Financial Accounting Concepts 2, *Entity and Display*, paragraph 68.
[3] SFFAC 2, paragraph 73E.
[4] SFFAC 2, paragraph 68.
[5] SFFAC 5, paragraphs 9 and 57.

in Statement of Federal Financial Accounting Standards (SFFAS) 32, *Consolidated Financial Report of the United States Government requirements: Implementing Statement of Federal Financial Accounting Concepts 4 "Intended Audience and Qualitative Characteristics for the Consolidated Financial Report of the United Statement Government*", indicates that a distinction should be made between component entity disclosure requirements and disclosure requirements for the consolidated financial report of the U.S. government (CFR).[6] As such, the concepts discussed in SFFAC 4, *Intended Audience and Qualitative Characteristics for the Consolidated Financial Report of the United States Government*, should be considered when developing note disclosure requirements for the CFR. SFFAC 4 reiterates two of the qualitative characteristics from SFFAC 1 – understandability and timeliness.

SFFAS 32 also requires note disclosures to provide information on significant accounting principles applied and the inflow and outflow of resources, financial position, and financial condition of the entity.

However, FASAB's initial concepts as well as subsequent concepts expressed in Statements and other FASAB literature have not been codified into a cohesive framework explicitly for note disclosures. A note disclosure framework could help the Board

- reexamine the existing financial reporting standards for note disclosures, and
- establish financial reporting standards for note disclosures in the future.

In October 2017, the Board agreed to conduct a note disclosure project in two phases. The first phase would involve developing a conceptual framework for note disclosures and the second phase would involve using the conceptual framework to evaluate existing note disclosure requirements.[7] Attachment 2: Note Disclosures Technical Plan, accordingly addresses the concepts development phase. The plan for evaluating existing standards would be developed upon completion of the conceptual framework phase.

The plan for note disclosures phase I would address the following:

1. State the purpose of note disclosures and their relationship to basic financial statements

2. Codify existing note disclosure concepts into a cohesive framework explicitly for note disclosures [8]

[6] SFFAS 32, paragraph 32.
[7] FASAB Meeting Minutes, October 2017.
[8] Please see Attachment 1: Example of Current Note Disclosure Concepts

3. Identify the types of information appropriate for note disclosures, such as descriptions of accounting polices underlying the amounts recognized in the financial statements and additional information about inflows and outflows of resources that do not meet basic recognition criteria

Staff plans to propose the note disclosure conceptual framework during the April 2020 meeting and issue an exposure draft concepts statement in December 2020. This approach builds on the preliminary determinations the Board made during the October 2019 meeting. During the meeting, the Board reviewed a draft outline of note disclosure concepts and determined that only a few core concepts are needed and that the concepts should not be tied to any one topic. Also, the concepts should consider the relationship between basic financial statements and note disclosures.

A concern is that, because some conceptual guidance has been developed, the Board may need to amend the current concepts to accommodate a note disclosure framework. For instance, the Board may determine the need to revisit references to note disclosures in the SFFAC 5 basic recognition criteria for accrual basis financial statements.

BOARD QUESTION

1. Does the Board agree with the proposed technical plan?

NEXT STEPS

The next steps depend on Board member feedback and answers to the staff questions.

MEMBER FEEDBACK

If you have any questions or comments, please email Mr. Simms at simmsr@fasab.gov and Ms. Gilliam gilliamr@fasab.gov, with a cc to Ms. Valentine at valentinem@fasab.gov, by February 21, 2020.

Examples of Current Note Disclosure Concepts

As FASAB developed accounting and financial reporting Statements and other guidance, the Board also developed concepts regarding note disclosures. The following discussion presents some of the note disclosure concepts the Board has expressed or implied in that guidance. The Board may consider these in determining the extent of additional note disclosure concepts.

Federal Financial Reporting Objectives

Statement of Federal Financial Accounting Concepts (SFFAC) 1, *Objectives of Federal Financial Reporting*, discusses the budgetary integrity, operating performance, systems and control, and stewardship reporting objectives and provide a basis for determining the information that should be presented in financial statements and note disclosures. The federal financial reporting objectives consider the information needs of both internal and external users and are designed to assist the federal government in demonstrating accountability, providing useful information, and helping users improve the management of the federal government.[1] The objectives, however, are broad and can be attained by sources other than financial statements because they relate to the entirety of federal management and financial reporting systems.[2]

Information that should be presented in Financial Reports

In determining the information that should be presented in financial reports to achieve the reporting objectives, the Board considers the qualitative characteristics of the information. SFFAC 1 discusses the following qualitative characteristics.

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.

[1] SFFAC 1, paragraph 3.

[2] SFFAC 1, paragraph 5.

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.

Distinguishing Financial Statements and Note Disclosures from Required Supplementary Information (RSI)

The Board has developed criteria to help distinguish financial statements and note disclosures from RSI. SFFAC 2, *Entity and Display*, discusses the criteria and notes the following with respect to RSI

> … [RSI] 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.[3]

In addition, SFFAC 2 discusses factors the Board could consider when determining whether information should be basic information (financial statements and note disclosures) or RSI. The following provides examples of the factors.

> 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…[4]
>
> 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

[3] SFFAC 2, paragraph 73C.

[4] SFFAC 2, paragraph 73E.

> specialists, the information may accompany the basic information as RSI.[5]
>
> 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.[6]

The Board has refrained from providing prescriptive guidance for distinguishing the information that should be presented in note disclosures, financial statements, and RSI. The Board has expressed concern that prescriptive guidance could constrain the Board when developing standards and deciding among the alternatives in the future. Also, reporting entities may view the guidance as part of a compliance exercise and not present relevant information to users.

Distinguishing the Face of Financial Statements from Financial Statement Note Disclosures

The Board has developed guidance regarding the characteristics that distinguish the face of financial statements from financial statement note disclosures. SFFAC 2 states that note disclosures are a part of financial statements and provide information that makes the statements more informative. In particular, the concepts state

> Financial information is also conveyed with **accompanying footnotes**, which are an integral part of the financial statements. Footnotes typically provide additional disclosures that are necessary to make the financial statements more informative and not misleading.[7]

Also, SFFAC 5, *Definitions of Elements and Basic Recognition Criteria for Accrual-Basis Financial Statements*, discusses characteristics of items that may be disclosed in notes versus recognized on the face of financial statements. For instance, SFFAC 5 discusses that items that are not measurable or the amount not material may be disclosed in notes. Also, items that do not meet basic recognition criteria, because of uncertainty, may be disclosed in notes. Specifically, SFFAS 5 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.[8]
>
> Uncertainty about economic activities and results is pervasive. Uncertainty about whether a transaction or other event gives rise to the existence of an element means that judgment often is required as to whether the item possesses the essential characteristics of an element and therefore meets the relevant definition. Items that are judged to meet the definition of an element are candidates for recognition provided they are measurable—that is a monetary amount can be determined with reasonable

[5] SFFAC 2, paragraph 73E.c.

[6] SFFAC 2, paragraph 73E.d.

[7] SFFAC 2, paragraph 68.

[8] SFFAC 5, paragraph 9.

> certainty or is reasonably estimable. Items that, because of uncertainty, do not meet the basic recognition criteria may be candidates for disclosure.[9]

Distinguishing CFR Note Disclosures from Component Reporting Entity Note Disclosures

SFFAS 32 indicates that a distinction should be made between component entity disclosure requirements and disclosure requirements for the CFR.[10] The concepts discussed in SFFAC 4, *Intended Audience and Qualitative Characteristics for the Consolidated Financial Report of the United States Government*, should be considered when developing note disclosure requirements for the CFR.SFFAC 4 states

> SFFAC 1 also provides that information should be reliable, relevant, consistent, comparable, understandable and timely. While all of these characteristics are important for all reports and all users, it is particularly fundamental that the CFR be timely and understandable for citizens and citizen intermediaries. The content and structure of the CFR should be clear and complete to citizens and citizen intermediaries and the CFR should be available on a timely basis. For example, to be timely, the CFR should be issued not less than annually and as close to the end of the fiscal year as is possible.[11]

Types of Information in Note Disclosures

Additional FASAB guidance indicates the types of information note disclosures should present. For instance, disclosures should help users understand how management applied particular accounting principles. Statement of Federal Financial Accounting Standards (SFFAS) 32, *Consolidated Financial Report of the United States Government requirements: Implementing Statement of Federal Financial Accounting Concepts 4 "Intended Audience and Qualitative Characteristics for the Consolidated Financial Report of the United Statement Government*" requires a note disclosure of accounting principles and methods of applying those principles that management concluded are appropriate for presenting the entity's net cost of operation, changes in net position, and assets and liabilities. Specifically, the Statement states

> Describe the reporting entity and identify its major components. Summarize the accounting principles and methods of applying those principles that management has concluded are appropriate for presenting fairly the entity's assets, liabilities, net cost of operations, and changes in net position. Disclosure of accounting policies should identify and describe the accounting principles followed by the reporting entity and the methods of applying those principles. In general, the disclosure should encompass important judgments as to the valuation, recognition, and allocation of assets, liabilities, expenses, revenues and other financing sources. Disclosures of accounting policies should not duplicate details presented elsewhere as part of the notes to the financial statements.[12]
>
> In addition, the summary of significant accounting policies should disclose any significant changes in the composition of the reporting entity or significant changes in the manner in which the reporting entity aggregates information for financial reporting purposes. These

[9] SFFAC 5, paragraph 57.

[10] SFFAS 32, paragraph 32.

[11] SFFAC 4, paragraph 9.

[12] SFFAS 32, paragraph 29.

changes, in effect, result in a new reporting entity, and their impact should be reported by restating the financial statements for all prior periods presented in order to show the new reporting entity for all periods presented.[13]

Also, while developing guidance to help achieve the budgetary integrity objective, the Board acknowledged that users would have difficulty understanding the budgetary terms used in financial reports. The Board, therefore, determined that note disclosures are needed to assist users in understanding terms specific to a field of knowledge not necessarily known to a general user of the financial statements.[14]

In addition, note disclosures provide additional information about inflows and outflows of resources and financial position and financial condition that do not meet the basic criterial for recognition. The following provide examples.

SFFAS 2, paragraph 128

The Board further believes that agency financial statements should include a footnote to explain the calculation of the cost of modifications and nature of gain or loss on modifications.

SFFAS 5, paragraph 67

The administrative entity should disclose the assumptions used. Administrative entities are encouraged to consult with one another to achieve the maximum consistency among assumptions used for financial reports. Smaller federal administrative entities may employ the assumptions used by any of the three primary plans where appropriate or their own assumptions. If they use assumptions that differ from all of the primary plans, a footnote should explain how and why the assumptions differ from one of those plans.

SFFAS 6, paragraph 45

The following are minimum G-PP&E disclosure requirements:

- the cost, associated accumulated depreciation, and book value by major class;
- the use and general basis of any estimates used;
- the estimated useful lives for each major class;
- the method(s) of depreciation for each major class;
- capitalization threshold(s) including any changes in threshold(s) during the period; and
- restrictions on the use or convertability of G-PP&E.

The above listed disclosure requirements are not applicable to the U.S.

[13] SFFAS 32, paragraph 30.

[14] Implementation Guide, Accounting for Revenue, paragraph 71.

Government-wide financial statements. SFFAS 32 provides for disclosure applicable to the U.S. Government-wide financial statements for these activities.

SFFAS 18, paragraph 48

… The Board believes that program subsidy data should be reported in a note to agency financial statements because they are directly related to information reported in the financial statements.

Note Disclosures

FY 2020 Technical Plan

<u>Project Description</u>: The objective of this project is to improve the effectiveness of note disclosures in general purpose federal financial reports. The project will be conducted in two phases:

- Phase I. Develop the Note Disclosures Conceptual Framework Statement from existing note disclosures concepts to guide the Board in reexamining existing standards and developing accounting and financial reporting in the future.
- Phase II. Evaluate existing note disclosures to identify opportunities for improving financial reporting. This phase will be conducted as part of the Reexamination of Existing Standards project and a technical plan for the project will be developed at that time. The project will also use the Note Disclosures Conceptual Framework developed during Phase I to coordinate with the Budget Information Improvement project to improve the usefulness of budgetary information.

<u>Accounting and Financial Reporting Issues</u>:

Specific issues to be considered during the project include:

1. What should be the purpose of note disclosures and their relationship to basic financial statements?
2. How should concepts explicitly for note disclosures be codified in the conceptual framework?
3. What types of information are appropriate for note disclosures, such as descriptions of accounting polices underlying the amounts recognized in the financial statements and additional information about inflows and outflows of resources and financial position and financial condition that do not meet the criterial for recognition?

<u>Current Developments</u>: During the December 2019 meeting, the Board discussed the project and its relationship to the Budgetary Information Improvement and Management’s Discussion and Analysis Improvement projects.

Work Plan

Board Meetings	Topics to Be Considered
April 2020 – October 2020	Discuss Note Disclosures Conceptual Framework Exposure Draft and pre-ballot/ballot
December 2020	Approve Note Disclosures Conceptual Framework Exposure Draft
January 2021 – March 2021	Comment period
April 2021 – June 2021	Redeliberate and approve final Note Disclosures Conceptual Framework Statement
August 2021	Begin Note Disclosures Phase II Project