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FASB Proposes Disclosure Framework

The FASB recently issued a proposed Concepts Statement aimed at improving its process for evaluating future and existing disclosure requirements for the notes to financial statements.[1] Comments are due by July 14, 2014.

Key Facts

- The proposed Concepts Statement would be non-authoritative U.S. GAAP guidance.
- The proposed framework is not intended to be used by companies in their decision process; specific guidance for companies on evaluating disclosures will be issued separately as a later part of the disclosure framework project.
- The proposed guidance also addresses interim disclosure requirements.

Key Impacts

The proposed guidance is intended to provide a framework to help the FASB:

- Develop disclosure requirements that provide more useful and relevant disclosures for financial statement users; and
- Be more consistent in developing disclosure requirements in new standards and in evaluating existing disclosure requirements.

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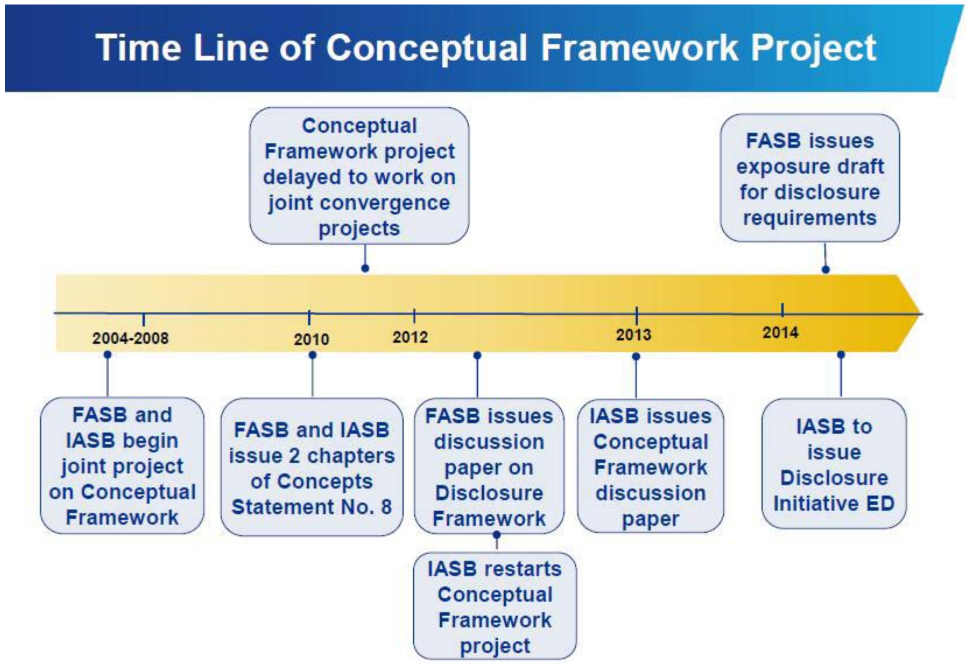
[1] FASB Proposed Statement of Financial Accounting Concepts: Conceptual Framework for Financial Reporting, Chapter 8: Notes to Financial Statements, March 4, 2014, available at www.fasb.org.

Conceptual Framework Background

The IASB and FASB began a joint project on the conceptual framework in 2004. The conceptual framework establishes the objectives and qualitative characteristics of financial reporting and defines the elements of financial statements that follow from those objectives.

As part of that project, in 2010 the Boards issued two chapters. (The FASB chapters are included in Concepts Statement No. 8).[2]

- Chapter 1, The Objective of General Purpose Financial Reporting; and
- Chapter 3, Qualitative Characteristics of Useful Financial Information.



However, the joint conceptual framework project was temporarily delayed and ultimately removed from the Boards' joint projects so the Boards could focus on their joint convergence projects on revenue, leases, and financial instruments. The FASB added the disclosure framework project in July 2009. The initial objective is to create a framework to produce more effective and useful disclosures in the financial statements.

In July 2012, the FASB issued a discussion paper soliciting public comments.[3] The discussion paper discussed the FASB's decision process when it evaluates disclosure requirements. The FASB chose to not revamp all the existing accounting disclosure requirements but instead to improve the existing concepts so that the results would be realized more quickly in upcoming standards.

[2] FASB Statement of Financial Accounting Concepts No. 8, Conceptual Framework for Financial Reporting, Chapter 1, The Objective of General Purpose Financial Reporting, and Chapter 3, Qualitative Characteristics of Useful Financial Information, available at www.fasb.org.

[3] FASB Discussion Paper, Disclosure Framework, July 2012, available at www.fasb.org.

The IASB also reactivated its own conceptual framework project in 2012 and added the disclosure framework as one of the discussion items. In March 2014 the IASB announced that it would issue *Exposure Draft: Disclosure Initiative (Proposed amendments to IAS 1)* for public comment.

Disclosure Framework Addressed by Other Publications

Financial statement disclosures have received considerable attention by users, preparers, and accounting standard setters in recent years.

- Organizations such as the European Financial Reporting Advisory Group (EFRAG) and the Financial Executives Research Foundation (FERF) of the Financial Executives International (FEI) have issued publications on the topic;[4]
- CFA Institute and the SEC issued papers and reports in 2013 discussing disclosures.[5]

Overview of Proposed Framework

The proposed Concepts Statement would become chapter 8 within the FASB's *Conceptual Framework for Financial Reporting*. It would set guidelines to be used when establishing disclosure requirements for the notes to financial statements. The proposal includes limits on what should be included and presents questions for the FASB to consider when determining disclosure requirements. However, when the FASB finalizes a new standard, it will still have the discretion to adjust the specific disclosure requirements.

The scope of this proposed Concepts Statement addresses the notes to financial statements and would not apply to other information contained in financial reports such as management's discussion and analysis. Additionally, the current proposal is not intended to be a guide for preparers' assessment of what to disclose in the notes. The Board expects to address preparers' assessment in a later phase of the project.

The guidance in the proposed Concepts Statement is structured around discussions of:

- Types of information in the notes to the financial statements;
- Limitations of information in the notes to the financial statements;
- Interim reporting considerations;
- Other entities including not-for-profit entities and employee benefit plans; and

Decision questions and considerations utilized in evaluating the concepts discussed in the proposed Concepts Statement.

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[4] EFRAG, Discussion Paper – Towards a Disclosure Framework for the Notes, December 7, 2012, available at www.efrag.org; Financial Executives Research Foundation, Disclosure Overload and Complexity: Hidden in Plain Sight, 2011; and Disclosure in the Balance: Investors' Perspective on Information Streamlining, January 2014; both available at www.financialexecutives.org.

[5] CFA Institute, Financial Reporting Disclosures: Investor Perspectives on Transparency, Trust, and Volume, July 2013, available at www.cfainstitute.org; and SEC Staff Report on Review of Disclosure Requirements in Regulation S-K, December 2013, available at www.sec.gov.

Notes to Financial Statements

The information included in the notes to the financial statements should be relevant to capital providers and assist them when assessing cash flows of a reporting entity. The notes should contain information to assist decisions made by users about:

- Financial statement line items;
- The reporting entity; and
- Past events and current circumstances that have not met the criteria for recognition that could affect an entity's future cash flows.

The FASB provided a list of questions and considerations to use when establishing disclosure requirements surrounding line items and past events and current conditions (see the Appendix).

Financial Statement Line Items

Line items alone may not give financial statement users enough information to adequately understand what is embedded within the line items without additional information in the note disclosures. The level of additional information needed will vary based on the level of complexity of the transactions underlying the line item's balance. For example, some balances could consist of routine transactions while others could consist of multiple transactions or estimates. Preparers of financial statements are expected to use judgment in determining what additional disclosures would be needed so users would be able to understand the nature of transactions on which the line item is based.

Some examples of information to be included in disclosures related to line items are:

- Nature of what comprises the line item (quality, location, and other factors affecting cash flows);
- Contractual terms, if any, that underlie the balances;
- Measurement methods and uncertainties of cash flows embedded in the line item;
- Impacts of changes in economic, political, and other forces; and
- Further breakdown of line items that may have multiple levels of characteristics and transactions.

Information about the Reporting Entity

The information that reporting entities should provide in the notes to the financial statements can vary greatly depending on their activities, and information available from other sources. The proposed Concepts Statement makes the following points:

- ***Information about the Reporting Entity and Its Activities.*** The information that is readily known about the reporting entity's activities, including whether they are routine and recurring, will determine the extent of disclosures that will be required.

- ***Restrictions, Privileges, and Advantages.*** Whether a reporting entity has unique and significant contractual, statutory, or judicial restrictions or, for example, relies heavily on government subsidies or on very few customers will influence what disclosures would be required.
- ***Information about Related-Party Activity.*** The extent to which related-party activities vary from what informed observers would have expected should be disclosed.
- ***Disaggregation of Legal Entities.*** A reporting entity could provide wide ranging services or products and operate in numerous locations, which could affect user assessments about future cash flow prospects.

Past Events and Current Conditions Impacting Cash Flows

Past events and current conditions and circumstances not recognized in the financial statements, but potentially impacting future cash flows, should be considered for disclosure. The following events and current conditions are potential candidates for such disclosure.

- Existing or potential litigation;
- Suspected or known violations by the reporting entity or against it;
- Commitments that have not been recognized;
- Uncertainty of recorded amounts or other items not recognized;
- Subsequent events;
- Concentration of customers or vendors;
- Potential volatility of sales volumes and prices;
- Access to markets to obtain inputs or sell outputs;
- Workforce concerns; and
- Sensitivity analysis (changes in future rates and prices).

Limitations of Notes to Financial Statements

While the FASB wants to improve the effectiveness and consistency of disclosures in the notes to financial statements, it realizes that excessive disclosure can lead to less focus on important issues and create an undue burden on preparers. Three limitations about what information should be disclosed in the notes are included in the proposed Concepts Statement:

- Information's relevance to capital providers;
- Cost constraint versus benefit; and
- Whether providing future-oriented information may have a negative effect on cash flow prospects.

The proposed Concepts Statement acknowledges future-oriented information such as future cash flow assumptions used in a fair value calculation may help users assess the entity's results and future cash flow prospects by comparing those assumptions to their own. The proposed Concepts Statement suggests there are risks in some circumstances of providing future information that could result in future litigation or consequences if the actual results materially differ from the guidance provided and those risks should be evaluated in setting disclosure requirements.

Interim Reporting Considerations

Financial statements for interim periods generally have a different purpose than annual financial statements and therefore have unique characteristics and limitations including:

- Interim statements should be viewed primarily as an integral part of the annual period.
- Interim disclosures provide new information or significant changes from the most recent annual report such as:
    - A change in recognition, measurement, or presentation of financial statement line items;
    - How interim results relate to the entire year; and
    - Additional disclosure for significant changes from the annual period embedded within condensed amounts in the interim financial information.
- Certain annual disclosures are not needed for interim purposes, however if there is new information about an annual disclosure that could impact a user's assessment of future cash flows, disclosure should be considered.

Not-for-Profit Entities

The proposed Concepts Statement discusses whether the framework and related decision questions should apply to not-for-profit entities. Their financial statement users also are interested in cash flow assessments and the entities' ability to provide services. However, some not-for-profit entity financial statement users such as donors may have different needs than a lender or owner in a for-profit entity. The FASB indicated that it will consider donor-specific items when addressing disclosure requirements impacting not-for-profit entities.

Employee benefit plan financial statements are not in the scope of the proposed Concepts Statement.

Appendix – FASB’s Decision Questions

The questions below are the decision questions suggested by the FASB in the proposed Concepts Statement that it will use to develop the disclosure requirements for standards. The “L” questions pertain to information in the line items and the “O” questions pertain to information about past events and current circumstances. The questions are summarized below. For the complete text of the questions along with their considerations, see the FASB’s Web site.

L.1	Is there information about the nature or quality of the phenomenon or phenomena represented by the line item (e.g., 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?
L.2	Does the line item represent any of the following: financial instruments issued or held by the entity; other contracts or legally binding documents; and other binding arrangements?
L.3	Could the existence or ownership of the rights and obligations underlying the line item be uncertain?
L.4	Does the line item include components of different natures that could affect prospects for net cash flows differently?
L.5	Are the cash flows related to the line item subject to change as a result of changes in general economic conditions or market factors? If so, are the specific conditions or factors or the nature of their effects not apparent from the description of the line item?
L.6	Are the prospects for cash flows related to the line item affected by changes in entity-specific factors or sector-specific factors, particularly those that can be expected to change frequently or significantly, and would a user not be expected to be aware of the factors or their potential effects?
L.7	Are the causes of the changes in an entity’s line item of an asset, liability, or equity instrument not easily understood?
L.8	Could the quality or utility of a nonfinancial asset have changed?
L.9	Does the line item include individual items (or groups) that are measured differently?
L.10	Are there acceptable alternative accounting policies or methods provided under U.S. GAAP that might have been applied to this line item?

L.11	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?
L.12	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?
L.13	Is the method for determining the amount of the line item uncommon, not apparent from the description, or otherwise hard to discern?
L.14	Is the carrying amount of the line item an estimate that requires assumptions, judgments, or other internal inputs that could reasonably have been different?
L.15	Is there an alternative measure or way of applying a measurement that clearly would be useful in assessing prospects for cash flows?
L.16	Does a line item have a direct relationship to another line item(s) in another statement that is not otherwise apparent?
O.1	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?
O.2	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 Questions O1(a) and O1(b))?
O.3	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?

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