

Heads Up

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The DP, which is not a FASB proposal or preliminary views, identifies aspects of the notes to the financial statements that need improvement and explores possible ways to improve them.

All the Right Disclosures

FASB Issues Discussion Paper on the Disclosure Framework

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On July 12, 2012, the FASB issued a [discussion paper](#)¹ (DP) to obtain feedback from stakeholders on its project to develop a framework to make financial statement disclosures "more effective, coordinated, and less redundant." The DP, which is not a FASB proposal or preliminary views, identifies aspects of the notes to the financial statements that need improvement and explores possible ways to improve them. If implemented, some of the ideas in the DP could significantly change the Board's process for creating disclosure requirements in future standards and could potentially alter those in existing standards. Comments on the DP are due by November 16, 2012.

The Disclosure Framework

The DP is organized into chapters that contain questions for respondents. The questions are reprinted from the DP and discussed below.

Scope and Introduction (Chapter 1)

The DP's scope is limited to the notes to the financial statements of public and nonpublic² entities. Those of not-for-profit entities are likely to be covered in a supplemental disclosure framework specific to donor needs. When the Board added the disclosure framework project to its agenda in 2009, one of its original objectives was to improve the integration of a company's public reporting package (e.g., financial statements, MD&A, and other sections). To explore additional ways to accomplish this objective, the FASB plans to work with the SEC and other regulators after completing the project.

Question for Respondents

Question 1: The details of this Invitation to Comment do not focus on the informational needs of donors to not-for-profit organizations. How, if at all, should the Board's decision process (see Chapter 2) be supplemented to consider the needs of donors? How, if at all, should not-for-profit reporting entities modify their decision-making process (see Chapter 4) for the needs of donors when deciding which disclosures to include in notes to financial statements?

¹ FASB Discussion Paper *Invitation to Comment: Disclosure Framework*.

² The FASB and the Private Company Council are developing a separate decision-making framework for identifying suitable criteria for determining whether and, if so, when exceptions or modifications to U.S. GAAP are warranted for private companies. Because that framework is in the development stage, it may have an impact on the disclosure framework described in the DP.

Chapter 2 contains 27 “decision questions” that the Board would potentially use in future standard-setting projects as part of its conceptual framework.

The Board’s Decision Process (Chapter 2)

In addition to questions for respondents, the DP’s second chapter contains 27 “decision questions” that the Board would potentially use in future standard-setting projects as part of its conceptual framework. (See the [Appendix](#) for a list of the 27 questions.) The decision questions broadly cover (1) “general information about the reporting entity as a whole,” (2) “information about line items” in the financial statements, and (3) “information about other events and conditions that can affect an entity’s prospects for future cash flows.” According to the DP:

[The decision questions] are intended to limit note disclosure to information with any of the following characteristics:

- a. It is unique to an entity or its industry.
- b. It is not already apparent from financial statements or readily available from public sources to which users could be expected to have access.
- c. It could make a material difference in future cash flow prospects.

The DP also explores the possibility of replacing specific disclosure requirements in the *FASB Accounting Standards Codification* (ASC or “Codification”) with this decision process and establishing a broad disclosure standard that reporting entities would use to determine the relevant footnote disclosures in their financial statements. However, the Board recognizes that such an approach could create significant problems in the U.S. legal and regulatory environment, including inconsistencies in application that could affect the comparability of information in the notes to the financial statements.

Making Disclosure Requirements Flexible (Chapter 3)

The Board notes that a main cause of unnecessary volume in the notes to the financial statements is that entities tend to provide each piece of information in a disclosure required by an ASC topic when they have a balance or transaction related to that topic. The DP includes an example of disclosures about a defined benefit pension plan that has been curtailed and about which an entity would probably include all the disclosures required by ASC 715-20³ in the notes to its financial statements regardless of the potential impact on future cash flows of the plan.

The Board identified disclosure selectivity as a possible solution, stating that it “may be the single best way to reduce volume” and increase a user’s ability to find the relevant information needed in the notes to the financial statements. To help achieve disclosure selectivity, the Board could potentially consider:

- Developing disclosure guidance that would vary depending on an entity’s characteristics (e.g., size, type of business, asset mixes, and key financial ratios).
- Eliminating specific disclosure requirements and instead requiring reporting entities to apply the decision process described in Chapter 2 of the DP (discussed [above](#)) to determine their appropriate disclosures.

Questions for Repondents

Question 2: Do the decision questions in this chapter and the related indicated disclosures encompass all of the information appropriate for notes to financial statements that is necessary to assess entities’ prospects for future cash flows?

Question 3: Do any of the decision questions or the related indicated disclosures identify information that is not appropriate for notes to financial statements or not necessary to assess entities’ prospects for future cash flows?

Question 4: Would these decision questions be better applied by reporting entities instead of the Board? In other words, should the Board change its practice of establishing detailed requirements in each project and, instead, establish a single overall requirement similar to the questions in this chapter?

Question 5: Do you think that this decision process would be successful in helping the Board to set more effective disclosure requirements? If not, what would be a better approach?

Questions for Repondents

Question 6: Would any of the possibilities in this chapter (see paragraphs 3.8 and 3.11) be a practical and effective way to establish flexible disclosure requirements?

Question 7: If more than one approach would be practical and effective, which would work best?

Question 8: Are there other possibilities that would work better than any of the ones discussed in this chapter?

³ For titles of ASC references, see Deloitte’s “[Titles of Topics and Subtopics in the FASB Accounting Standards Codification](#).”

- Allowing flexibility in compliance with disclosure requirements by providing less prescriptive guidance; reporting entities would instead use judgment regarding whether and how to provide a disclosure.
- Providing a set of potential disclosure requirements for each ASC topic and allowing reporting entities to determine the relevance of the requirements to their financial statements.
- Establishing a scale of minimum and expanded disclosure guidelines and allowing reporting entities to use judgment in determining the amount of information to disclose within that scale.
- Creating tiers of information items or a graduated scale of requirements in each ASC topic and permitting reporting entities to determine the appropriate level of disclosure that applies to them.

Editor’s Note: As accounting standard setting continues to result in guidance that is more “principles based,” entities must generally increase their use of judgment in applying such guidance. As a result, they may need to add disclosures about their judgments and how the judgments might affect comparability to other entities.

The Board identified selectivity as a possible way to reduce unnecessary disclosure volume.

Reporting Entities’ Decisions About Disclosure Relevance (Chapter 4)

If the Board adopts an approach that offers flexibility in complying with disclosure requirements, reporting entities will need additional guidance to help them determine what information is relevant. Although the DP discusses materiality, it “does not add anything new to existing literature or practice for deciding whether an amount is material.” However, the DP explores an approach under which a disclosure would be relevant “if it would be expected to change users’ assessments of prospects for future cash flows by a material amount.” A reporting entity would consider a list of disclosures for an ASC topic and decide whether to include some, all, or none of the disclosures depending on what it determines to be relevant or material. The DP also acknowledges that assessing materiality of disclosures could be more complex than assessing materiality of information on the face of the financial statements because the impact of a disclosure on a user’s cash flow prospectus of a company is not a “precise arithmetic computation.”

Questions for Repondents

Question 9: This chapter attempts to provide a benchmark for judgments about disclosure relevance by clarifying the objective for the judgments. Is the description of the approach clear enough to be understandable? If not, what points are unclear?

Question 10: Can this approach (or any approach that involves describing the objective for the judgments) help identify relevant disclosures? If so, what can be done to improve it? If not, is there a better alternative? What obstacles do you see, if any, to the approach described?

Question 11: Reporting entities would need to document the reasons for their decisions about which disclosures to provide. How would reporting entities document the reasons for their disclosure decisions and how would auditors audit those decisions?

Editor’s Note: The DP uses the term “materiality” as it is described in Concepts Statement 8.⁴ The Board acknowledges that the U.S. Supreme Court has interpreted materiality in at least two decisions and that reporting entities must comply with that interpretation. Further, in those decisions, the Supreme Court used the terms “substantial likelihood” and “would” where the Concept Statement 8 used the term “could.” Accordingly, the Board recognizes that it may need to change its description of materiality. However, the Board believes that reconsideration of the term is beyond the scope of the DP.

The use of tools such as tables, headings, cross-referencing, and highlighting could potentially enhance a user's ability to understand the information in the notes to financial statements.

Format and Organization (Chapter 5)

The Board has received criticism about the formatting and organization of the notes to the financial statements, including comments such as the following:

- a. Disclosures are boilerplate and do not provide relevant information.
- b. Information about particular events or transactions is hard to piece together.
- c. The relationships between disclosures and financial statements are difficult to understand.
- d. The most relevant information is difficult to identify.

The DP suggests that the use of tools such as tables, headings, cross-referencing, and highlighting could potentially enhance a user's ability to understand the information in the notes to financial statements and the relationship of such information to the financial statements. Other potential alternatives for improving the format and organization of the notes to the financial statements include specifying a standard order for the notes and using a topic-based approach to group related information. Any new requirements related to format or organization would most likely be added to existing guidance on financial statement presentation (rather than becoming part of the disclosure framework).

Disclosures for Interim Financial Statements (Chapter 6)

The issues and potential solutions explored in Chapter 6 of the DP apply only to entities that issue interim financial statements under SEC Form 10-Q. The Board has received conflicting feedback on the current reporting requirements for the notes to interim financial statements. Primarily, constituents have noted that:

- Interim financial statements do not include enough information to meet the needs of users.
- Accelerated reporting deadlines limit the ability of preparers to provide increased disclosures.

The DP outlines various possible solutions to the problems identified in the feedback, including the development of a unique set of decision questions for use in establishing the interim reporting disclosure requirements. By establishing a separate decision process for disclosures within interim financial statements, the Board (or preparers) could make more consistent decisions about developing (or applying) interim disclosure guidelines.

Questions for Repondents

Question 12: Would any of the suggestions for format improve the effectiveness of disclosures in notes? If so, which ones? If not, why not?

Question 13: What other possibilities should be considered?

Question 14: Do any of the suggested methods of organizing notes to financial statements improve the effectiveness of disclosure?

Question 15: Are there different ways in which information should be organized in notes to financial statements?

Questions for Repondents

Question 16: Do you think that any of the possibilities in this chapter would improve the effectiveness of disclosures for interim financial statements?

Question 17: If you think that a framework for the Board's use in deciding on disclosure requirements for interim financial statements would improve the effectiveness of interim reporting, what factors should the Board consider when setting disclosure requirements for interim financial statements?

Question 18: If you think that a framework for reporting entities' use in deciding on disclosures for interim financial statements would improve the effectiveness of interim reporting, what factors should reporting entities consider when providing disclosures for interim financial statements?

Question 19: What impediments do you see regarding the development of a framework for the Board, reporting entities, or both that addresses disclosures for interim financial statements?

⁴ FASB Concepts Statement 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*.

Other Matters for Discussion, Including Costs and Consequences of Disclosure Requirements (Chapter 7)

The DP notes that the summary of accounting policies potentially contributes to unnecessary volume in the notes to financial statements. This disclosure often includes irrelevant information that users understand or can easily find elsewhere, stays the same from period to period, or addresses immaterial items. Potential solutions to reduce the unnecessary volume include:

- Moving accounting policy information to a location outside of the financial statements (e.g., a reporting entity's Web site).
- Limiting accounting policy disclosures to instances when various acceptable accounting alternatives exist or when the accounting for a certain transaction or event is not specifically addressed by an ASC topic (resulting in the disclosure of the nature of the transaction or event and accounting method applied).

Questions for Respondents

Question 20: Would the change to the requirements described in paragraph 7.8 for disclosure of the summary of accounting policies improve the effectiveness of disclosure?

Question 21: Should the summary of accounting policies include information about industry-specific accounting policies?

Question 22: Are there other required disclosures that could be modified or eliminated in the short term that would result in a significant reduction in the volume of notes to financial statements?

The DP notes that the summary of accounting policies potentially contributes to unnecessary volume in the notes to financial statements.

Finally, the DP explores the costs and consequences of developing and implementing a disclosure framework. The DP explains that the cost burden to issuers of financial statements should be at least partially offset by the cost savings to users of the financial statements as a result of their improved ability to evaluate and analyze the disclosures. The DP explores how the Board evaluates costs and consequences of projects and notes that “[n]et positive consequences to the capital market as a whole are benefits of reporting standards even if the results are negative to some entities.”

Comparison of the FASB’s DP and the European Project Team’s DP

In developing the DP, the FASB staff worked with a team consisting of the European Financial Reporting Advisory Group (EFRAG), the Autorité des Normes Comptables (French standard setter), and the UK Financial Reporting Council Accounting Committee (UK standard setter). The European project team released a [discussion paper](#) of its own concurrently with the FASB’s DP.

The substance of both DPs is similar regarding the decision process for selecting relevant information to include in the notes. However, a key difference is that the European project team’s DP explains the purpose of the notes, whereas the FASB’s DP does that implicitly in the decision questions directed to the standard setter. The European project team’s DP suggests a narrower purpose for the notes, and it questions whether they should include information about the reporting entity as a whole. The DPs also differ in some jurisdiction-specific ways (e.g., the FASB’s DP addresses interim reporting and aspects of materiality that are not the same as those under IFRSs).

Appendix — Questions Related to the Board’s Decision Process Regarding Disclosures in the Notes to the Financial Statements

The questions below are reproduced from the DP’s Chapter 2, “The Board’s Decision Process.” The DP notes that such questions could be used in a “conceptual framework” or “to replace the existing detailed disclosure requirements with a single set of overall disclosure requirements based on decision questions.”

General Information About the Reporting Entity as a Whole

Question G1. Do the financial statements reflect transactions, balances, or other contractual relationships with related parties on terms that could be different from arm’s-length transactions and contracts with third parties?

Question G2. Does the reporting entity issue consolidated financial statements?

Question G3. Are there restrictions on the entity’s use of assets and potential concerns about the entity’s cash flows that are not otherwise apparent from the financial statements?

Question G4. Does the entity operate different types of businesses in different geographic areas or in other segments that are managed separately?

Information About Line Items

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 future cash flow prospects and that is not adequately conveyed by the line item’s description? [Footnote omitted]

Question L2. Does the line item represent any of the following:

- a. Financial instruments
- b. Other contracts or legally binding documents
- c. Other binding arrangements?

Question L3. Is the existence or ownership of the rights and obligations underlying the line item uncertain?

Question L4. Does the line item include components of different natures that could affect prospects for future net cash flows differently?

Question L5. Are the cash flow prospects related to the line item affected by changes in general economic conditions or market factors, *and* are the conditions, factors, or likely effects on the line item not apparent from the nature of the line item?

Question L6. Are the prospects for future 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?

Question L7. If the line item is an asset, liability, or equity instrument, could the causes of changes from the prior period be generally understood?

Question L8. If the item is a productive asset or intellectual property, has the quality or utility of the item changed?

Question L9. Does the line item include individual items (or groups) that are measured differently?

Question L10. Are there acceptable alternative accounting policies or methods that might have been applied to this line item? [Footnote omitted]

Question L11. Does the line item include balances or the effects of transactions or events that either:

- a. Are not addressed by directly applicable reporting requirements
- b. Are not clearly analogous to other transactions or events for which there is applicable guidance?

Question L12. 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 be improper?

Question L13. 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?

Question L14. Is the method for determining the amount of the line item uncommon, not apparent from the description, or otherwise hard to discern?

Question L15. Is the carrying amount of the line item an estimate that required assumptions, judgments, or other internal inputs that could reasonably have been different?

Question L16. Is there an alternative measure or way of applying a measurement that clearly would be useful in assessing prospects for future cash flows?

Information About Other Events and Conditions That Can Affect an Entity's Prospects for Future Cash Flows

Question O1. Have any of the following events or conditions created a possibility that net cash flows that the entity would otherwise have experienced will 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. Possible 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?

Question O2. Are there other events or conditions that are not represented by an asset or liability and a gain or loss (or income or expense) in the entity's financial statements but about which there was uncertainty in the decision not to recognize? (That would include items other than the contingencies discussed in Questions O1(a) and O1(b).)

Question O3. Could future loss of or deterioration in the relationship with one or a few customers or suppliers significantly affect an entity's future cash flows?

Question O4. Could the entity's future cash flows be subject to significant positive or negative changes because of volatility or other uncertainty in volumes or prices in the markets for the entity's inputs or outputs?

Question O5. Is there uncertainty in an entity's access to the markets for its inputs or outputs (whether resolution of the uncertainty would result in increased or decreased access)?

Question O6. Is there significant uncertainty about an entity's ability to maintain a qualified work force and suitable physical facilities (whether resolution of the uncertainty would result in increased or decreased ability)?

Question O7. Could an entity's possible future cash flows be subject to significant changes because of the effects of possible future changes in the following:

- a. Interest rates
- b. The entity's ability to obtain financing
- c. Foreign currency exchange rates
- d. Commodity prices (whether exchange-traded or not) or volumes
- e. Stock market prices or volumes
- f. Other financial market prices or market conditions?

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