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Heads Up

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Disclose This?

FASB Proposes Decision Process for Determining Disclosures to Require in Notes to Financial Statements

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On March 4, 2014, the FASB released for public comment an exposure draft[1] (ED) that proposes a decision process to be used by the Board and its staff for determining what disclosures should be required in notes to financial statements. In issuing the proposal, the FASB aims to improve the effectiveness of such disclosures by ensuring that reporting entities clearly communicate the information that is most important to users of financial statements.

If adopted, the proposed guidance would constitute a new chapter in the FASB's *Conceptual Framework for Financial Reporting* (the "conceptual framework"). However, it would not be part of the *FASB Accounting Standards Codification* (the "Codification") and therefore would not override authoritative U.S. GAAP. Rather, it outlines principles that the FASB and its staff would consider when formulating disclosure requirements related to notes to financial statements. If implemented, the guidance in the ED could significantly change the Board's process for creating disclosure requirements in future standards and could result in changes to disclosure requirements in existing standards.

Editor's Note: The Board did not specifically indicate that an objective of this new chapter of the conceptual framework is to narrow or eliminate current or future disclosure requirements. However, the ED notes that the chapter would be used to "identify, by design, a broad range of possibilities for the Board to consider when deciding on the disclosures related to a particular topic." The Board would then narrow that "intentionally broad set" of disclosures and, in many cases, make it "far more narrow." The narrowing of the broad set of disclosures identified by this new chapter is not outlined in the ED but would be accomplished during the standard-setting process for each individual topic.

The ED incorporates certain key concepts proposed in the FASB's July 2012 discussion paper[2] and addresses some of the concerns expressed by constituents in response to that paper's proposals. The Board is currently seeking feedback on the proposals in the ED, including (1) the concepts in the proposed new chapter of the conceptual framework and (2) the "decision questions." For a list of the ED's questions for respondents, see Appendix A of this *Heads Up*. Comments on the ED are due by July 14, 2014.

[1] FASB Exposure Draft, *Conceptual Framework for Financial Reporting — Chapter 8: Notes to Financial Statements.*
[2] FASB Discussion Paper, *Invitation to Comment: Disclosure Framework.*

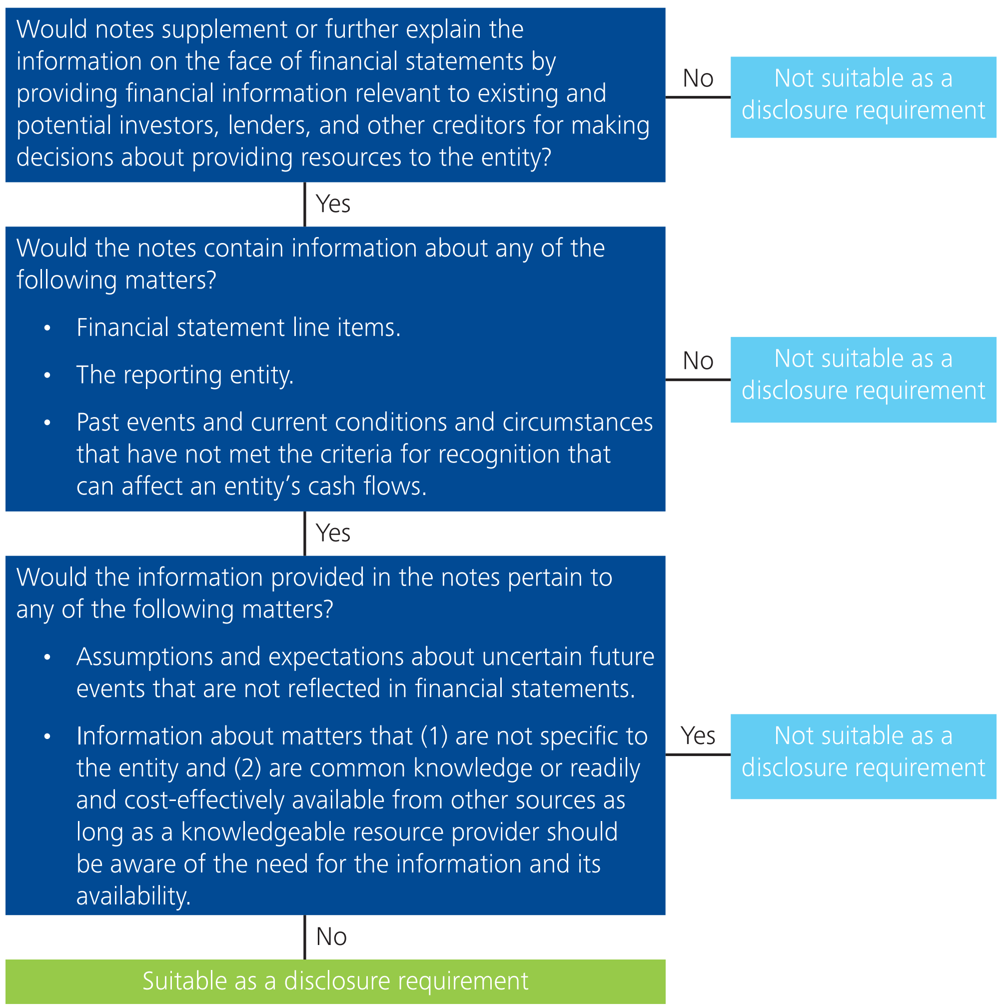
Editor's Note: In June 2013, the FASB decided to distinguish between the "entity's decision process" and the "Board's decision process" for evaluating disclosure requirements and indicated that it would consider the entity's decision process in a separate project. The entity's decision process will be the subject of a proposed Accounting Standards Update that addresses the decision process to be used by preparers when evaluating their entity's financial statement disclosures.

This *Heads Up* gives an overview of the FASB's proposed decision process for assessing what disclosures to require in notes to financial statements. In particular, it discusses (1) the scope of the proposal, (2) information to be provided in notes to financial statements, (3) limitations on the information to be provided, and (4) considerations related to financial statements for interim periods.

Proposed Decision Process at a Glance

The following flowchart, whose text is adapted from the ED, outlines application of the proposed decision process that the FASB and its staff would apply in establishing future, and evaluating existing, disclosure requirements related to notes to financial statements:

In June 2013, the FASB decided to distinguish between the "entity's decision process" and the "Board's decision process" for evaluating disclosure requirements and indicated that it would consider the entity's decision process in a separate project.



Details of the Board's proposed decision process are discussed below.

Scope of the Proposed Guidance

The new chapter of the conceptual framework proposed in the ED would apply to disclosures by public and private[3] businesses and not-for-profit entities; however, it would exclude disclosures that are unique to employee benefit plans. The Board will consider employee benefit plans separately during disclosure standard setting. For not-for-profit entities, the Board's decision questions will also focus on assessing "how an entity used its resources to provide services and the entity's efficiency and effectiveness in providing those services as well as the entity's ability to continue to provide those services."

Information to Be Provided in Notes to Financial Statements

The ED focuses on the following three types of information that is included in notes to financial statements:

- *Information about specific line items* — The purpose of this type of information is to "amplify or to explain information on the face of the financial statements."
- *General information about the nature of the entity, its activities, any special restrictions or privileges that apply to it, and other advantages and disadvantages relative to other entities* — The ED explains that such information is needed to give users "appropriate context or background to assess the potential effect of financial statement line items on prospective future cash flows to and from the entity because, among other things, an identical asset held or a liability owed by two different entities can have very different implications for a resource provider's decisions."
- *Information about past events and current circumstances and conditions that will or may affect future cash flows but have not affected a line item* — Although such information does not qualify for recognition in financial statements, it should be furnished in notes to financial statements to inform users of the impact of important matters.

On the basis of the answers to the decision questions in the ED, the Board would determine the type and form of disclosures to require in future standards and evaluate disclosure requirements in existing standards.

The ED provides numerous sample disclosures of such information. The Board created the samples by applying the decision questions in the ED that it would potentially use in future standard-setting projects as part of its conceptual framework. On the basis of the answers to these decision questions, the Board would determine the type and form of disclosures to require in future standards and evaluate disclosure requirements in existing standards. See Appendix B of this *Heads Up* for a list of the decision questions proposed in the ED.

Editor's Note: The ED's proposed decision questions do not address the following disclosures that would generally be required in notes to financial statements:

- Accounting methods used by the entity that are not clearly addressed in the Codification (e.g., new transactions accounted for by analogy to other existing guidance).
- Error corrections.

Further, the ED does not propose decision questions related to additional information about the reporting entity because the Board typically does not consider such information when it sets standards about individual financial statement line items. Requirements to disclose such information are included in Codification topics.

[3] The FASB's and Private Company Council's *Private Company Decision-Making Framework: A Guide for Evaluating Financial Accounting and Reporting for Private Companies* (the "private company framework") would separately address any factors unique to private companies that affect disclosure requirements. The ED states that "[p]rocedurally, the private company framework is applied after the Board has established general applicability of disclosure requirements to all entities."

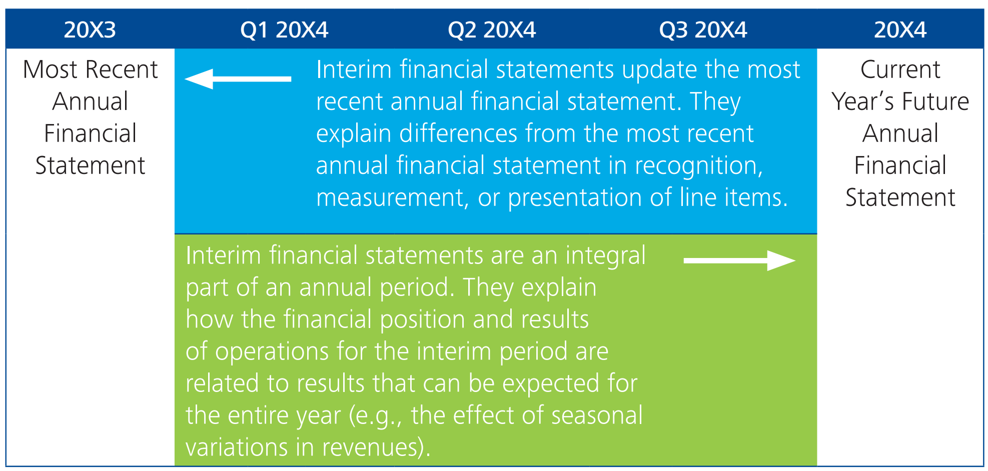
Limitations on Information in Notes to Financial Statements

The ED further explains that to prevent "excessive disclosure" that is unhelpful to users and "burdensome to reporting entities," certain types of information should **not** be required in notes to financial statements, including the following:

- Information that is not relevant to providers of resources to a significant number of entities.
- Information whose disclosure is subject to cost constraints, such as (1) readily available information that is not specific to the entity and (2) information the necessity and availability of which users should be aware of (e.g., general economic, political, and social conditions or common accounting policies).
- Certain future-oriented information (e.g., predictions of outcomes that are outside the control of the entity), except for the following information that may be important:
    - Estimates and assumptions used as inputs to measurements.
    - Existing plans and strategies related to matters under management's control.
    - The effect of specified future changes in existing conditions on specific line items or on the entity as a whole.

Considerations Related to Financial Statements for Interim Periods

The following chart, whose text is adapted from the ED, illustrates the function of interim financial statements:



The ED describes certain types of information that should be included in notes to both the interim and annual financial statements. For example, when the fluctuation in an interim period "cannot be readily estimated or [is] otherwise not discernable" from information contained in the interim or immediately prior annual financial statements, additional disclosure should be made of the new matters (e.g., changes in fair values and contingent liabilities). Information that explains fluctuations from the previous annual period should also be disclosed in notes to the interim financial statements in certain cases (e.g., when there is no longer an observable market price for a financial instrument that was measured at fair value).

In addition, notes to interim financial statements should disclose matters that are "especially important to the assessment of cash flow prospects" (e.g., disaggregated revenue details and contract terms).

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Appendix A — Questions for Respondents

The ED's questions for respondents are listed below for reference.

Question 1: Should financial statements of employee benefit plans be excluded from the scope of this chapter of the conceptual framework?

Question 2: Do the concepts in this chapter related to not-for-profit entities address the informational needs of resource providers to those entities?

Question 3: Do the concepts in this chapter encompass the information appropriate for disclosure in notes to financial statements that would assist resource providers in their decision making? Are there concepts that should be added or removed?

Question 4: Are there additional concepts needed to identify information that is unsuitable for requirement by the Board in notes to financial statements even though that information would be consistent with the purpose of the notes?

Question 5: Do the decision questions in Appendix A identify the information appropriate for the Board to consider requiring for disclosure when setting standards related to line items and other past events and current circumstances and conditions that can assist resource providers in their decision making?

Question 6: Does the discussion in paragraphs D43–D50 identify the information appropriate for the Board to consider when setting standards related to information about the reporting entity?

Question 7: Will the concepts related to future-oriented information (paragraphs D22–D31) result in disclosures that are appropriate for the notes? If not, what types of information should be included in or excluded from consideration for disclosure in the notes?

Question 8: Do the concepts in this chapter appropriately distinguish the types of information that are appropriate for the notes from the analysis management provides in other communications?

Question 9: Are the concepts related to disclosure requirements for interim periods (paragraphs D60–D71) appropriate? If not, are there concepts that should be added or removed?

Question 10: If no disclosure guidance for a transaction, event, or line item is specified in U.S. GAAP, how will an entity consider the nonauthoritative guidance in this chapter?

Appendix B — Decision Questions to Be Considered in Establishing Disclosure Requirements

The questions below are reproduced from the ED's Appendix A. The ED notes that the Board can use such questions as a "tool" to help it "decide when to consider whether a disclosure should be required and to identify the nature of the disclosure."

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 cash flow prospects and that is not adequately conveyed by the line item's description?

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?

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

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

Question L5. 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?

Question L6. 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?

Question L7. Are the causes of the changes in an entity's line item of an asset, liability, or equity instrument not easily understood?

Question L8. Could the quality or utility of a nonfinancial asset have 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 provided under U.S. GAAP that might have been applied to this line item?

Question L11. 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?

Question L12. 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 L13. Is the method for determining the amount of the line item uncommon, not apparent from the description, or otherwise hard to discern?

Question L14. Is the carrying amount of the line item an estimate that requires assumptions, judgments, or other internal inputs that could reasonably have been different?

Question L15. Is there an alternative measure or way of applying a measurement that clearly would be useful in assessing prospects for cash flows?

Question L16. Does a line item have a direct relationship to another line item(s) in another statement that is not otherwise apparent?

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

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?

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 Questions O1(a) and O1(b))?

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?

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