

Board Meeting Handout Disclosure Framework June 19, 2013

Purpose of This Meeting

1. This meeting will facilitate a continuation of the Board discussions on forward-looking information, the decision questions in Chapter 2 of the FASB Invitation to Comment, *Disclosure Framework*, and a discussion of the suggested revisions to the technical plan. Appendix A of this handout includes the decision questions from the Invitation to Comment related to General Information about the Reporting Entity as a Whole and Information about Other Events and Conditions That Can Affect an Entity's Prospects for Future Cash Flows.

Expectations and Assumptions about the Future

- 2. The staff recommends that the following items are appropriate for the Board's consideration in assessing disclosure requirements that relate to the future:
 - a. Information about existing conditions that have implications for the future is eligible in establishing disclosure requirements. Examples of that information include the following:
 - Projections based on historical trends and/or existing factors (for example, useful lives of assets)
 - 2. Information about how existing assets or liabilities would change as a result of specified future changes, as opposed to changes in conditions based on management's predictions
 - 3. Future performance required by existing contractual terms (for example, analyses of contractual maturities).

The staff prepares Board meeting handouts to facilitate the audience's understanding of the issues to be addressed at the Board meeting. This material is presented for discussion purposes only; it is not intended to reflect the views of the FASB or its staff. Official positions of the FASB are determined only after extensive due process and deliberations.

- b. Management's plans (for example, a plan to refinance debt); however, predictions about the outcome of future actions that are not based on facts presently known would not be eligible.
- 3. Disclosure of expectations and assumptions about the future are appropriate if they explain the inputs to a measurement presented or disclosed in current period financial statements. The following types of disclosures do not explain inputs to a presented or disclosed measurement and, therefore, are not appropriate:
 - a. Expectations and assumptions used as inputs to an impairment test that does not result in recognition of an impairment loss (those are not inputs to a measurement in financial statements or notes)
 - b. Expectations and assumptions that are inputs to a measurement if they are being used for some purpose other than explaining that measurement
 - c. Expectations and assumptions that are implied by an observable market price, but that are not actually used by the entity as inputs (for example, future cash flows assumed by market participants in establishing a price used in a Level 1 or a Level 2 fair value measurement).

Questions for the Board

Question 1: Does the Board agree that information about existing conditions that have implications for the future is eligible for consideration in establishing disclosure requirements as detailed in paragraph 2 of this handout?

Question 2: Does the Board agree that disclosure of expectations and assumptions about the future are appropriate if they explain the inputs to a measurement presented or disclosed in current period financial statements?

Question 3: Does the Board agree that the disclosures listed in paragraphs 3(a)–(c) of this handout would not be appropriate for consideration by the Board?

Decision Questions

- 4. The decision questions in Chapter 2 of the Invitation to Comment are organized into the following three categories: information about the reporting entity in general (Questions G1–G4), additional information about line items in financial statements (Questions L1–L16), and information about events and conditions, the effects of which are not recognized (or not yet recognized) in financial statements, but that do affect the entity's potential cash inflows or outflows (Questions O1–O7).
- 5. The L questions will be separately addressed at another meeting. See Appendix A of this handout for the G and O decision questions and disclosures from the Invitation to Comment.

Staff Recommendations

6. The staff recommends that the following "Information to Be Considered for Disclosure" in Question G2(c) be replaced:

Consolidation policies and procedures, including the reasons for consolidating entities, and the elimination of intercompany balances if any.

7. The staff recommends the addition of the following disclosure in place of the one in paragraph 6: Judgments and assumptions made by an entity when determining whether to consolidate an entity.

Question for the Board

Question 4: Does the Board agree that the following "Information to Be Considered for Disclosure" should be removed?

Consolidation policies and procedures, including the reasons for consolidating entities, and the elimination of intercompany balances, if any.

Does the Board agree that the following "Information to Be Considered for Disclosure" should be added?

Judgments and assumptions made by an entity when determining whether to consolidate an entity.

- 8. The staff thinks that the O questions in the Invitation to Comment would result in consideration of disclosures that are consistent with the types of future-oriented disclosure permitted by the parameters suggested in paragraphs 2–3 of this handout.
- 9. Based on the staff recommendations in paragraphs 2–3 of this handout, the staff recommends the following changes to the "Information to be Considered for Disclosure" in Questions O1(d) and O2(e) of the Invitation to Comment:
 - O1(d). The entity's judgment about the magnitude of the possible effect on future cash flows as a point estimate of the most likely outcome, as a probability-weighted outcome, or as a range of possible outcomes
 - O2(e). The entity's judgment about the magnitude of the possible effect on future cash flows as a point estimate of the most likely outcome, as a probability-weighted outcome, or as a range of possible outcomes
- 10. The staff is split on whether the "Information to be Considered for Disclosure" in Question O3(b), which states, that "a judgement of the prospects for losing the customers or suppliers" constitutes a prediction, expectation, or assumption about the future that should not be considered.

Questions for the Board

Question 5: Does the Board agree that the O questions result in consideration of disclosures that are consistent with the types of future-oriented disclosure permitted by the parameters suggested in paragraphs 2–3 of this handout?

Question 6: Does the Board agree that the "Information to Be Considered for Disclosure" from Questions O1(d) and O2(e) should be modified as detailed in paragraph 9 of this handout?

Question 7: Should the "Information to Be Considered for Disclosure" from Question O3(b) be eliminated?

- 11. The staff would incorporate the following wording before Questions O3–O7:
 - a. Questions O3–O7 were designed to be general enough to result in the Board establishing a one-time disclosure requirement about any inputs and outputs or

other external factors that may have an effect on line items in the future but that are not currently recognized. However, there may be additional inputs, outputs, or external factors not specifically identified within these questions. Therefore, the Board may want to consider these questions on an ongoing basis in addition to establishing one-time disclosure requirements about input and output markets and other external factors.

Question for the Board

Question 8: Does the Board agree that the wording in paragraph 11 of this handout should be incorporated into the framework?

Technical Plan

- 12. The staff would separate the components of the project as follows:
 - a. Through a field study with preparers and auditors (and to the extent possible, peer reviewers and regulators), explore the ability of an entity to exercise discretion in applying disclosure requirements and continue to develop the entity's decision process based on the results.
 - b. Address comments on the Board's decision process and work toward an Exposure Draft of a new chapter to 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.
 - c. Develop any other aspects of the Invitation to Comment that the Board may decide to pursue. The staff would not reflect this in the technical plan until work commences on those other aspects.
- 13. The staff thinks that the Board can address those issues and issue an Exposure Draft of a new chapter to Concepts Statement 8 in the fourth quarter of 2013.
- 14. The staff is currently conducting a field study on an entity's decision process and expects to present a report on the field study's findings in the first quarter of 2014.

15. The staff thinks that constituents would like the framework for the Board's decision process to also consider decision making about disclosure in interim reports.

Questions for the Board

Question 9: Does the Board agree with the staff's suggestion to officially separate an entity's decision process and the Board's decision process as major components of the Disclosure Framework project on the Board's current technical plan?

Question 10: Does the Board want to (a) include work on a decision process for the Board when considering interim disclosure requirements with the broader decision process or (b) address disclosures in interim reporting separately?

Appendix A

General Information about the Reporting Entity as a Whole

2.16. The following group of questions relates to information about a reporting entity in general that can affect prospects for future cash flows.

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?

Information to Be Considered for Disclosure

The information to be considered would include the following:

- a. Nature of the transaction(s), balance(s), or contract(s)
- b. If possible, a general indication of the magnitude of the effect on the financial statements of the difference between the actual transactions, balances, and contracts, and the amounts that would have been reported for arm's-length transactions, balances, and contracts in the aggregate
- c. Any unique or highly unusual aspects of the transaction(s), balance(s), or contract(s) that would affect an assessment of the entity's prospects for future cash flows.

Why the Information Could Be Important

Without disclosure of related party transactions, reasonable users would be entitled to assume all transactions to be at arm's length and would assess prospects for future cash flows on that basis. Transactions with related parties may not be at arm's length and, even if they are, similar future transactions may not be. The prices may be different, the payment requirements or other terms may be different, or the transactions may not have occurred at all with unrelated parties. Any of that information has the potential to influence users' assessments of prospects for future cash flows.

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

Information to Be Considered for Disclosure

The information to be considered would include the following:

a. General or specific information about the entities included in the consolidated financial statements

- Comparison to the group of entities in the previous years' consolidated financial statements, if there are any changes in the consolidated members in the current reporting period
- c. Consolidation policies and procedures, including the reasons for consolidating entities, and elimination of intercompany transactions and balances, if any.

Why the Information Could Be Important

The nature and composition of a reporting entity can make a difference in its ability to generate cash flows and move cash from one part of the business or the other, which can affect cash flow prospects. More important, however, is the fact that changes in the composition of the entity could significantly affect year-to-year comparisons.

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?

Information to Be Considered for Disclosure

The Board should consider requiring disclosure of the following:

- a. Description of restrictions on the uses of assets
- b. The amount of cash and other liquid assets available to meet anticipated cash requirements
- c. Description of plans or strategies to deal with any concerns about shortfalls
- d. Descriptions of commitments made or planned uses for a cash balance.

Why the Information Could Be Important

Restrictions affect the ability to realize a return on assets, to meet liquidity needs, and to pay dividends, among other things. All of those can affect an assessment of prospects for future cash flows.

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

Information to Be Considered for Disclosure

The Board should consider requiring disclosure of the following:

- a. Description of the entity's segments
- b. The markets or geographic locations in which the entity operates.

Why the Information Could Be Important

Different businesses and different geographic areas contribute to different rates of growth and return as well as different levels of risks and uncertainties. Any of those can significantly affect users' assessments of prospects for future cash flows.

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

- 2.18. The following group of questions relate to information about other events and conditions (the effects of which have not yet been reflected in financial statements) that can affect prospects for future cash flows.
- 2.19. The heading titled "Why the Information Could Be Important" has been omitted for the questions in this section because the explanation is the same in each case. All of the questions in this section relate to matters for which there is no information on the face of the financial statements, and all relate to matters that can affect 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?

Information to Be Considered for Disclosure

The information to be considered would be the following:

- a. The existence and description of the event or condition
- 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 cash flows
- c. Whether the event or condition itself is unique or infrequent or is routine or frequent
- d. The entity's judgment about the magnitude of the possible effect on future cash flows as a point estimate of the most likely outcome, as a probability-weighted outcome, or as a range of possible outcomes

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

If the entity has plans that it believes may minimize decreases or maximize increases in net cash inflows, it may describe those actions and should explain whether the amounts disclosed as possible effects on future cash flows assume that the planned actions will be effective. In other words, if the disclosure assumes that the entity will be able to minimize a probable loss or maximize a probable gain, disclose that fact. Unless the entity has prior experience in successfully minimizing that type of loss or maximizing that type of gain, the more pessimistic amount also should be disclosed (assuming the minimizing or maximizing plans fail).

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).)

Information to Be Considered for Disclosure

The information to be considered would be the following:

- a. The existence and description of the event or condition
- b. Uncertainties that were assessed in deciding not to recognize an asset or liability and gain or 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. The entity's judgment about the magnitude of the possible effect on future cash flows as a point estimate of the most likely outcome, as a probability-weighted outcome, or as a range of possible outcomes
- f. The entity's judgment of the probability that the event or condition will affect future cash flow prospects.

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?

Information to Be Considered for Disclosure

The information to be considered would be the following:

a. The fact that the entity is dependent on one or a few customers or suppliers and an indication of the degree of dependence

- b. A judgment of the prospects for losing the customers or suppliers
- c. An explanation of actions the entity has taken to mitigate potential effects from the deterioration of a relationship with a supplier.

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?

Information to Be Considered for Disclosure

The information to be considered would be the following:

- a. Possible cause of the volatility or other uncertainty in inputs or outputs markets
- b. The worst-case effect on the financial statements of volatility in inputs and outputs markets.

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)?

Information to Be Considered for Disclosure

The information to be considered would be the following:

- a. The existence and possible causes and effects of the uncertainty about restrictions in access to inputs and outputs markets
- b. The potential effects on the financial statements of significant access restrictions to inputs and outputs markets
- c. How the entity plans to mitigate adverse financial statement effects arising from restrictions to its access to inputs and outputs markets.

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)?

Information to Be Considered for Disclosure

The information to be considered would be the following:

- a. The existence and causes of the significant uncertainty to maintain a qualified work force and suitable physical facilities
- b. The potential effects of that uncertainty on financial statements

c. How the entity plans to mitigate adverse financial statement effects arising from the significant uncertainty about maintaining a qualified work force or suitable physical facilities.

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?

Information to Be Considered for Disclosure

The information to be considered would be the following:

- a. An explanation of the macroeconomic factor(s) that affect particular assets, liabilities, or equity instruments
- b. The potential effects of changes in the macroeconomic factors on the assets, liabilities, and equity instruments and on net income and other comprehensive income.