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NYSSCPA
certified public accountants

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December 17, 2012

Ms. Susan M. Cosper
Technical Director
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

By e-mail: director@fasb.org

Re: FASB Discussion Paper – Invitation to Comment, Disclosure Framework
(File Reference No. 2012-220)

Dear Ms. Cosper:

The New York State Society of Certified Public Accountants (NYSSCPA), representing more than 28,000 CPAs in public practice, industry, government and education, welcomes the opportunity to comment on the above captioned discussion paper.

The NYSSCPA's Financial Accounting Standards Committee deliberated the discussion paper and prepared the attached comments. If you would like additional discussion with us, please contact J. Roger Donohue, Chair of the Financial Accounting Standards Committee at (917) 887-7809, or Ernest J. Markezin, NYSSCPA staff, at (212) 719-8303.

Sincerely,

Gail M. Kinsella
President

Attachment

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NEW YORK STATE SOCIETY OF

CERTIFIED PUBLIC ACCOUNTANTS

COMMENTS ON

FASB DISCUSSION PAPER – INVITATION TO COMMENT, DISCLOSURE FRAMEWORK (FILE REFERENCE NO. 2012-220)

December 17, 2012

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Comments on

FASB Discussion Paper – Invitation to Comment, Disclosure Framework
(File Reference No. 2012-220)

General Comments

On July 12, 2012, the Financial Accounting Standards Board (the "Board") issued an Invitation to Comment, *Disclosure Framework* ("ITC"), with the stated intent to improve the effectiveness of the disclosures provided in the notes to financial statements. The Board expressed its concern in paragraph 1.15 that "excessive disclosure is burdensome to reporting entities and can overwhelm users or lead them to overlook important information." Accordingly, the ITC proposes a framework that would limit required note disclosure to information that is relevant to an entity or its industry. We are concerned that in the Board's desire to limit burdensome and non-relevant disclosure it might err too much in limiting disclosure.

While it is appropriate to reconsider the construction of financial statements, we believe that, rather than starting with the notes to financial statements, a preferable approach would be to start with defining the purpose of financial reporting and who the users of financial statements are. We recommend that the Board consider issuing a proposed Concepts Statement addressing these issues. After a foundation is built regarding the overarching purpose of, and intended users of, financial statements, then the individual components would be addressed.

With respect to the framework proposed in the ITC, we are concerned that the criteria suggested regarding disclosures might have the opposite effect of what was intended, *i.e.*, that disclosures might actually become more voluminous than those from current standards. We believe that the Board should consider emphasizing that the use of "plain English" is desirable and that the goal of disclosures should be conciseness, brevity, and relevance. Adding to disclosures with insignificant and immaterial verbiage is not in either preparers or users best interests.

The ITC primarily addresses the needs of investors and analysts that are a subset of users of financial statements of for-profit entities (see our response to Question 1 below). A global consideration of the purpose of financial reporting and its intended users is preferable to a piecemeal approach given the significance of the proposed changes to Generally Accepted Accounting Principles ("GAAP"). Paragraph 1.9 correctly asserts that consideration of the contents of notes to financial statements begins with the purpose of such disclosures, which is derived from the purpose of financial reporting.

Private Company Framework and Financial Statement Users

The Concepts Statement that we have proposed above should give consideration to the discussion currently in the Invitation to Comment, *Private Company Decision-Making Framework* ("Private Company Framework"), to define the purpose of financial reporting of

both public and private companies. The Private Company Framework only addresses the needs of users of private company financial statements (see Appendix A of the Private Company Framework); however, such needs are similar in certain respects to the needs of users of public companies. While we agree that investors and analysts are primarily interested in public companies, there are also lenders focusing on cash and debt covenant calculations, and regulators who are also users of financial statements issued by both private and public companies.

The ITC indicates in paragraph 1.2 that the Private Company Decision-Making Framework was not considered because the latter was not available at the time the ITC was issued. We believe it should be considered in the final version of the ITC.

Reliability

We believe it is important to address reliability in the decision making process. The ITC appears to assume that relevant information is also reliable, but it is not addressed specifically. Relevance and reliability are discussed in FASB Statement of Financial Concepts ("CON") No. 2, *Qualitative Characteristics of Accounting Information*, paragraph 58:

> "That information should be reliable as well as relevant is a notion that is central to accounting. It is, therefore, important to be clear about the nature of the claim that is being made for an accounting number that is described as reliable."

This issue is further discussed in CON No. 2, paragraph 63:

> "An item and information about it should meet four fundamental recognition criteria to be recognized and should be recognized when the criteria are met, subject to a cost-benefit constraint and a materiality threshold. Those criteria are:
>
> > DEFINITIONS -- The item meets the definition of an element of financial statements.
> > MEASURABILITY -- It has a relevant attribute measurable with sufficient reliability.
> > RELEVANCE -- The information about it is capable of making a difference in user decisions.
> > RELIABILITY -- The information is representationally faithful, verifiable, and neutral."

We are concerned by the potential relationship between the reliability of information and continued allegations of misleading financial statements. Reliable information that can reasonably be verified can reduce circumstances of alleged misleading financial statements. The Board should include reliability as a consideration when determining information to be included in the financial statements. This would include consideration of whether the information can be audited with any degree of precision as the degree of estimation uncertainty affects the risks of material misstatement associated with accounting estimates.

Materiality

One of the ITC's objectives is to limit note disclosure to information that could make a material difference in assessing future cash flows. The ITC paragraph 4.2, Note 6, specifically excludes materiality from the ITC's scope despite noting that reporting entities must comply with two decisions by the U.S. Supreme Court's interpretation of materiality, and that this interpretation may require a change in Concepts Statement 8, *Conceptual Framework for Financial Reporting—Chapter 1,* The Objective of General Purpose Financial Reporting**,** *and Chapter 3,* Qualitative Characteristics of Useful Financial Information *(a replacement of FASB Concepts Statements No. 1 and No. 2*). Given its importance in disclosure decisions and as a stated objective of the ITC, the Board should define materiality in any framework on financial reporting.

Time Spent on Disclosures

Certain information to be considered for disclosure could result in a significant increase in time to obtain and audit. Examples of such information are presented in our comments on Questions G1, L1, L2, L3, L4 and L6.

Given the voluminous amount of information requested by this ITC, we are responding to selected questions to illustrate the positions outlined in our general comments.

Chapter 1—Scope and Introduction

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?

Not-for-profit entities' financial statements reflect their activities related to their not-for-profit purpose. Donors, government grantors and others providing funds or *pro bono* services either to directly or indirectly support the organization's purpose typically want to know if their contributions are being used consistently with their intent. Donor interest in their contributions is reflected in Accounting Standards Codification ("ASC") 958-205-05-03, which asserts:

> "The primary purpose of financial statements is to provide relevant information to meet the common interests of donors, members, creditors, and others who provide resources to NFPs. Those external users of financial statements have common interests in assessing both of the following:
>
> a. The services an NFP provides and its ability to continue to provide those services
>
> b. How managers discharge their stewardship responsibilities and other aspects of their performance."

Pursuant to this, ASC 958-210-45-9 requires not-for-profit entities to present, in place of an equity section, net assets reflecting donor imposed restrictions and changes thereto (either temporary or permanent).

Government grantors impose their own reporting requirements to provide assurance that grants are spent in accordance with the grantor's intent. These requirements often include provision of GAAP financial statements.

The not-for-profit entity focus on the expenditure of funds is in contrast to the financial reporting of public and private companies described in the ITC that asserts that "investment and credit decisions are based on implicit or explicit assessments of prospects for (probabilities, timing and amounts of) cash flows to the holder of those investments, loans, or other forms of credit."

Current reporting requirements are well understood by both preparers and users of financial statements issued by not-for-profit entities, and there is an emphasis on the entity's mission by management and those charged with governance.

Chapter 2—The Board's Decision Process

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?

The decision questions in this Chapter would provide sufficient information that would be helpful in determining prospects for future cash flows.

Chapter 3—Making Disclosure Requirements Flexible

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?

We agree that flexibility is a positive consideration in preparing financial statements, and the guidance in paragraphs 3.8 and 3.11 would provide guidance that is flexible with respect to disclosure requirements.

General Questions from Chapter 2

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?

Item b requires the disclosure (if possible) of a general indication of the magnitude of the effect on the difference between actual related party transactions, balances and contracts and the amounts that would have been reported for arms-length transactions, balances and contracts. Obtaining and quantifying this information would be very time consuming – even if it was possible to obtain. For example, the prices of many related party transactions reflect

noneconomic factors, such tax and estate considerations. Valuing inventory transactions would be difficult because of the variability of prices existing at any given time; related party debt often contains implicit provisions, such as security features, explicitly provided in arms length transactions and would affect the interest rate and other terms.

More workable disclosure possibilities might include disclosures of minimum objectively determinable differences such as exchanges of assets or instruments with level 1 fair values or the excess of the "risk-free" (i.e., in the U.S. context Treasury) interest over the rate charged. The latter would not imply that the "risk free" rate was the appropriate arms-length rate, just that that minimum difference was objectively determinable. Another possibility is the disclosure of more raw data about related party transactions, for example, the average volume of receivables and payables during the period, or the cost of inventory sold to related parties, or the cost to seller of inventory purchased from entities under common control.

Information on Line Items from Chapter 2

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?

The Board is considering requiring disclosure of enough information so that a user may access other sources of information to understand the issue. This proposal is somewhat vague, because the concept of "enough" is only understood by the user and could change over time. The preparer and auditor may not have knowledge of the users' information requirements. The considerable amount of conflicting information currently available, particularly on the Internet, could create an extensive disclosure based on speculation and written in meaningless "boilerplate" language. This result would be exacerbated by factors considered in Questions L2 through L7, as discussed below. The current presentation reflects the preparer's belief, as attested to by the auditor, of what information is relevant. Most users should be able to obtain relevant information from the Internet on their own.

This concept could also create legal exposure to the auditor by implying that the auditor and user have an agreement creating legal privity that would expose the auditor to lawsuits by all users for not meeting the vague objective of requiring the preparer to provide "enough" information.

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?

GAAP currently require the disclosure of the terms of financial instruments. In addition, GAAP require the recognition of a contingent loss when such loss is probable and can be easily estimated or be disclosed if such losses are possible. However, the recommendation goes beyond the current requirements to require the disclosure of the likelihood of counterparty non-performance. Whereas the preparer should be able to assess the possible failure to perform,

neither the preparers nor the auditors can assert with any degree of certainty that all counterparties – including those who are complying with the terms of the instrument, will perform in accordance with the contract. In the event of non-performance, auditors and preparers also may not know the extent of any recourse to affiliates of the counterparties that could be limited by the counterparties' legal structure. Thus, the proposal to assess performance of all counterparties that are beyond their control is unrealistic.

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

Uncertainties regarding rights and obligations exist in most contracts that have "escape" clauses contingent on certain events. Disclosures of uncertainties based on the mere existence of such clauses would be extensive as compared to the current requirement of accruing and/or disclosing uncertainties derived from the likelihood the specified events would occur (see ASC Topic 450).

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

We are concerned that trying to separate every component, or even material component, that has a separate nature that "could" affect the prospects for future cash flows may cause a considerable amount of effort by preparers without providing assurance that all such considerations would be identified.

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?

The instability of the current economic condition and interaction between the various economic indicators make this proposal open to a continual discussion. Disclosures a. and b. for Board consideration could be provided in a general manner and could be useful. On the other hand it could lend itself to disclosure that would be boilerplate when presented to "those who have a reasonable understanding of business and economic activities" who are the users described in Concepts Statement 1. Regarding disclosures c. and d., many reporting entities would consider their evaluation of current market conditions proprietary, and would be unwilling to disclose any meaningful information. Proprietary differences could result in similar transactions being reported in different ways.

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?

Examples provided in this question are consistent with ASC 275-10-50. The issue is the extent of new disclosures, if any. Attempting to quantify this would be difficult and the result speculative.

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?

The detailed disclosures being considered seem to make this a requirement for a reporting entity to disclose why previous disclosures of future events, based on speculation, did not "pan out." We anticipate any disclosure of this would be "boilerplate-type language" approved by the reporting entity's attorneys to avoid possible litigation. This would defeat the ITC's objective of improving the effectiveness of disclosures.

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

The example provided is based on signed leases of a tangible asset. The quality or utility of intellectual property is speculative. See the article, "Risks in Applying the New Business Combination Guidance to Intangible Assets," by Matthew Crane and Robert A. Dyson, in the January 2009, *The CPA Journal*.

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?

Fair value is deemed to be an exit price. Given the lack of observable inputs, any financial instruments classified as either Level 2 or (in particular) Level 3 would have alternative methods of measuring. Generally, reporting entities present their best estimate. Given that it is unreasonable to expect reporting entities to know users' information needs (see our response to Question L1), this would be an impossible task.

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

This entire section is a "what-if" exercise guaranteed to expand disclosures to an incomprehensible length. Asserting that the Boards will permit flexibility ignores the legal consequences of missing some event now that proves significant sometime in the future.