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December 19, 2012

Susan M. Cospers, CPA
Technical Director
FASB
401 Merritt 7
PO Box 5116
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Re: July 12, 2012 FASB Invitation to Comment: *Disclosure Framework* [File Reference No. 2012-220]

Dear Ms. Cospers:

One of the objectives that the Council of the American Institute of Certified Public Accountants (AICPA) established for the PCPS Executive Committee is to represent the views of local and regional firms on professional issues in keeping with the public interest, primarily through the Technical Issues Committee (TIC). This communication is in accordance with that objective. These comments, however, do not necessarily reflect the positions of the AICPA.

TIC appreciated the opportunity to discuss its comments on this ITC with the Board and staff at the FASB/TIC Liaison Meeting on September 25, 2012. TIC has re-examined the ITC and is providing the following comments for your consideration.

GENERAL COMMENTS

The July 12, 2012 FASB in Focus article on the Disclosure Framework project emphasizes that the Board's objective and primary focus of this project is as follows:

To improve the effectiveness of disclosures in notes to financial statements by clearly communicating the information that is most important to users of each organization's financial statements.

TIC agrees with the overall objective of the Disclosure Framework project and that clear communication of information that is most important to financial statement users will improve the effectiveness of disclosures in notes to the financial statements. TIC welcomes the Board's endeavors to achieve these objectives.

TIC recognizes, however, that the Board is facing some significant challenges in meeting its objective. Stakeholders have expressed concerns about lack of relevance and the sheer

volume of current disclosures while, at the same time, expressing concern about missing information.

TIC believes that the Framework, as currently drafted, will not achieve the desired objectives. Its scope is too broad and it lacks definitive disclosure boundaries. It also fails to achieve a proper balance between user needs and auditability considerations or cost/benefit constraints. The framework seems to create many more new disclosure requirements which would have the effect of increasing disclosure volume rather than reducing it.

TIC recommends that the Board make some definitive decisions about the purpose of the notes, how the conflicting needs of stakeholders can be balanced, and the boundaries of financial statement disclosures, keeping in mind that disclosures cannot be all things to all stakeholders. TIC believes such decisions are necessary before specific decision questions can be finalized. TIC also believes that disclosure objectives for each individual standard in the FASB *Accounting Standards Codification*TM (ASC) will be necessary.

Once the framework is revised, TIC recommends extended testing of the proposed Framework against current ASC Topics, with an emphasis on Topics that are considered contentious, or that are currently considered (based on feedback from users) to include too much or too little information.

In addition, consistent with the Board's commitment to working with all parties concerned to improve effectiveness, reduce overlap, and otherwise streamline the entire reporting package, TIC encourages the Board to seek the active participation of the SEC, the IASB and others in the development of the Framework.

TIC's observations regarding each of the chapters and how the framework would relate to the Private Company Decision-Making Framework are presented below.

SPECIFIC COMMENTS ON THE QUESTIONS FOR RESPONDENTS

Chapter 1 – Scope and Introduction

Scope Considerations

TIC evaluated the ITC with the following assumptions in mind:

- The stated scope of the Disclosure Framework ITC is generally all nongovernmental entities: public companies, private companies and not-for-profit organizations. For purposes of this response, TIC is taking a broad-based view and is not focusing on the unique needs of private companies.
- The suggested framework under consideration in this ITC is designed to meet the needs of diverse user groups: investors, lenders and other creditors. (The needs of

donors or others that provide resources to not-for-profit organizations are not specifically addressed in this version of the Framework.)

As TIC deliberated the various issues in the ITC, TIC reviewed paragraph OB8 from SFAC No. 8, *Conceptual Framework for Financial Reporting: Chapter 1, The Objective of General Purpose Financial Reporting*:

Individual primary users have different, and possibly conflicting, information needs and desires. The Board, in developing financial reporting standards, will seek to provide the information set that will meet the needs of the maximum number of primary users. However, focusing on common information needs does not prevent the reporting entity from including additional information that is most useful to a particular subset of primary users.

In principle, TIC supports a financial reporting objective that is premised upon developing standards that would meet the needs of the maximum number of primary users. However, this is a lofty goal, and attaining it may be contributing to today's concerns about disclosure effectiveness. Disclosure requirements have been added in recent years, either to respond to lapses in the disclosure practices of public companies or to meet the needs of public company analysts. These disclosures have been additive for all reporting entities whether they were relevant to shared user needs or not. When the Board subscribes to a framework that focuses on the needs of the maximum number of users, it's an "all or nothing" proposition, which automatically makes disclosure effectiveness for all more difficult.

One of TIC's primary concerns is the relationship between the Disclosure Framework and the Private Company Decision-Making Framework (the PCDMF). The PCDMF, as currently drafted, is an exception framework, which would apply whenever exceptions or modifications to GAAP (such as omitting or adjusting disclosures) are to be considered for private companies. If the PCDMF is the exception framework, then, by implication, the Disclosure Framework would be more expansive in scope. The question is how to define its scope. Whether the scope is stated in terms of one or more requirements (or series of requirements) or just guidelines, TIC believes the PCDMF will be an important supplementary framework to help preparers assess the relevance of the Disclosure Framework for private company financial statements. TIC suggests that the process used to develop the PCDMF may be useful in developing portions of the Disclosure Framework and encourages the Board to ensure that the next version of the Disclosure Framework will integrate well with the PCDMF.

TIC believes the scope of the Disclosure Framework should include criteria to ensure that financial statements remain comparable for the benefit of financial statement users, but disclosure selectivity/flexibility should be permitted. (See also TIC's response to Chapter 3.)

As the Board re-deliberates the scope of the framework, TIC believes the Board's efforts should be re-focused on disclosures that are universally relevant (i.e., the shared or

common needs) among a diverse group of users. TIC is not suggesting that these would be minimum disclosures. TIC believes “minimum disclosures” cannot be specified on an overall basis, since the answer to what is “minimum disclosure” will be an entity-specific determination. Rather, TIC believes the Board needs to develop a set of disclosures that would be decision-useful for the majority of financial statement users that rely on general purpose financial statements, without significantly prioritizing the needs of one group of users over another.

For the suggested scope to be operational, the Board would need to identify the important considerations that are common to investors and creditors, without trying to satisfy the disclosure needs of all investors and all creditors. As discussed further under TIC’s response to Question 3, the Board could offer extended disclosures to accommodate the most demanding of user needs (so-called “maximum disclosures”), but they should not be viewed as the norm.

TIC also believes the Board needs to specify tighter boundaries around note disclosures. Once financial reporting objectives are identified, the Board may discover that disclosure boundaries are easier to establish. The ITC states that it does not attempt to define a boundary for disclosures but that it expects the decision questions in Chapter 2 to limit the information required for notes. However, TIC believes that the decision questions in Chapter 2 are not sufficiently limiting to improve the effectiveness of note disclosures.

The July 2012 discussion paper published by the European Financial Reporting Advisory Group (EFRAG), et al., entitled *Towards a Disclosure Framework for the Notes* (the European paper), includes an entire chapter on the purpose of the notes to financial statements, which begins with the following concept:

The purpose of the notes is to provide a relevant description of the items presented in the primary financial statements and of unrecognised arrangements, claims against and rights of the entity that exist at the reporting date.

TIC believes that this proposed definition more appropriately captures the objectives of the notes to the financial statements, is clear and concise, and will be more readily and easily understood. TIC believes that grounding financial statement disclosures on matters that exist as of the balance sheet/reporting date and through the date the financial statements are available to be issued for certain events or conditions is fundamental to the establishment of criteria for inclusion or exclusion of information from the financial statements. TIC recommends using similar language in the objectives of the FASB Disclosure Framework, although TIC would provide an additional boundary that places the focus on material items, transactions and arrangements.

The approach taken by the European paper (Chapter 2, paragraph 14) provides objective guidelines that would not only improve disclosure effectiveness but also are attainable. Both papers prioritize the need for the notes to supplement the information provided in the primary financial statements, but the European paper suggests that:

The disclosures in the notes should provide information which amplifies and explains the primary financial statements. [Emphasis added]

The underlined words above imply a need for clarity in the disclosures that TIC believes is very important to disclosure effectiveness. TIC believes it's not enough to provide more information to users through note disclosures. It's also important to provide explanations that add to the user's understanding of the information.

One of the more important boundaries set by the European paper relates to the disclosure of forward-looking information, which is defined as information about the future that is related to past transactions and other events existing at the reporting date. Further discussions are needed to properly link this objective with the need to provide users with information to assess the entity's prospects for future cash flows. TIC believes there are limits to the extent such information can and should be provided in notes to historical financial statements.

As disclosures become more predictive in nature, they also tend to include more management bias and the possibility of material error. More thought should be given to the auditability of proposed disclosure requirements, as well as the cost involved to adequately verify predictive information. The framework should exclude disclosures that would not be adequately verifiable to confirm that they are free from material error or bias. Otherwise, disclosures will be more misleading than useful.

The European paper and the ITC appropriately focus on the need for note disclosures to be entity-specific. As acknowledged in both papers, decisions about entity-specific disclosures are tied to the materiality of the item. Appropriate materiality guidelines from both papers should be carried forward to the final framework. Of course, materiality decisions are highly judgmental, but broad guidelines already articulated in the papers are useful.

Placement of Disclosure Framework in FASB Concepts Statements

TIC supports the Board's suggestion to include the Disclosure Framework as an additional chapter in FASB Concepts Statement No. 8. However, TIC believes the decision questions (when finalized) also should be incorporated into an Accounting Standards Update (ASU) for inclusion in the FASB ASC. The ASU should have appropriate cross-references to the Concepts Statement.

Modifying the decision process for not-for-profit organizations to accommodate the needs of donors

Paragraph 1.3 of the ITC indicates that a supplement to the Disclosure Framework will be added to address the special circumstances underlying the decision process for not-for-profit organizations. TIC has not discussed specific modifications that may be needed to the decision process for not-for-profit organizations, but TIC believes that the concepts discussed in FASB Statement of Financial Accounting Concepts (SFAC) No. 4, *Objectives of*

Financial Reporting by Nonbusiness Organizations, provide a suitable starting point for modifying the general decision process for not-for-profit disclosures. SFAC No. 4 discusses certain key differences between the objectives of nonbusiness v. business organizations that are certain to affect the disclosure objectives and decision process for not-for-profit organizations. TIC believes these considerations should be separately addressed in the planned supplement:

- Donors and other contributors to not-for-profit organizations, unlike the owners of business enterprises, expect little or no economic benefit in return for their contributions. Although they are not expecting personal returns on the donated resources, they would expect the not-for-profit organization to use their money wisely (stewardship).
- Certain contributors may restrict their donations to certain time or purpose restrictions. Such restrictions impose compliance responsibilities on management and limit the amount of funds available for the general purposes of the organization. Full disclosure of the restrictions is important to current and potential future donors. Current donors want to know that their contributions have been used in accordance with their wishes. Potential future donors will want to know what resources will be available to the organization in future years and the purposes for which the donations will be used.
- Budgets play a greater role in not-for-profit organizations than in business organizations. Planned expenditures by the not-for-profit organization (such as a religious organization) can help a potential donor decide whether to contribute at all and, if so, how much and to what purposes. This consideration could affect the nature and extent of forward-looking disclosures for such entities.

TIC believes the general Disclosure Framework should be applicable across industries and looks forward to having an opportunity to review a separate supplement for not-for-profit organizations.

Chapter 2 – The Board’s Decision Process

This chapter identifies how to identify information that should be disclosed in the notes. Decision questions for various categories of disclosures were developed in order to describe the information that the Board would consider requiring:

- Information about the reporting entity in general
- Additional information about line items in the financial statements
- Information about events and conditions that are not yet recognized in financial statements but that affect the entity’s potential cash inflows and outflows.

TIC believes the decision questions in this chapter (when finalized) should be applied by the Board to use in its decision process, rather than by preparers. The Board, as the standard setter, should continue to establish disclosure requirements, supplemented by disclosure objectives and illustrations. If all decisions are applied by reporting entities, comparability may be lost.

However, some of the decision questions in this section are too broad-based or too forward-looking. They try to anticipate every need of every potential user instead of designing requirements around a user base representing a common denominator. As noted above, the scope of the framework tries to be all things to all users. The result is a disclosure framework that lacks boundaries. Without boundaries, the number of disclosure requirements will likely increase, rather than decrease. TIC sees evidence of this trend in certain decision questions in this chapter. Below are the specific areas where TIC identified concerns:

Information about the reporting entity in general

Question G1 addresses related parties and includes a disclosure requirement, if possible, of a general indication of the magnitude and effect of financial statement differences between the actual related party transactions, balances and contracts, and the amounts that would have been negotiated at arm's length. Disclosure of arm's-length prices for related party transactions would be an impossible and unrealistic task for many preparers and would present significant auditing challenges. In addition, the ITC does not justify why this information would be important. TIC does not believe that the typical financial statement user would actually aggregate the differences to determine the opportunity cost to the company of engaging in related party transactions v. third-party transactions.

TIC believes some of the information considered for disclosure under Question G3 may be too forward-looking to include in the financial statements. TIC understands that the Board believes that all financial statements include some form of forward-looking information and that the Board has struggled with defining the boundaries for including this information in general purpose financial statements. However, this is one of the most significant boundary issues in the ITC and one that must be resolved.

As stated in SFAC No. 8, paragraph QC28:

It may not be possible to verify some explanations and forward-looking financial information until a future period, if at all. To help users decide whether they want to use that information, it normally would be necessary to disclose the underlying assumptions, the methods of compiling the information, and other factors and circumstances that support the information.

The extra disclosures referred to in the last sentence of paragraph QC28 always involve extra cost for preparers and can affect the timely preparation of financial statements. An increase in the volume of disclosures on forward-looking information will also create more auditability problems. Careful analysis is needed to determine when such disclosures are relevant, especially since adding requirements for the inclusion of forward-looking information in the notes will automatically increase disclosure volume.

That question cannot be answered until the Board reaches a decision on other boundary issues, such as the true purpose of the notes and the scope of the Framework. Estimates that must be calculated from specific GAAP-driven measurement criteria seem to be less troublesome than vague requirements to disclose anticipated effects on future financial statements.

Information about line items

Some of the suggested disclosures under Question L2 also seem too forward-looking and are not readily auditable. For example, item L2(b) would require disclosure:

If the item [e.g., financial instrument] is an asset, the likelihood of the risk of counterparty nonperformance (credit risk or failure to deliver other assets or services) at the date of the financial statements.

The suggested requirement to determine the likelihood of nonperformance is much too speculative since the requirement requires knowledge that would be unattainable in many circumstances and has no stated upper boundary. Assessing likelihood for a financial statement user implies disclosure of a range of outcomes that may bear no relationship to future reality, which can change in an instant based on a number of unforeseeable factors. Attempting such precise disclosure is likely to mislead financial statement users rather than provide them with decision-useful information.

Questions L5 and L6 also cross the forward-looking boundary. Question L5 is asking for disclosure of factors that management may not have the knowledge to assess. Also, disclosing the past effectiveness of policies, practices and strategies that mitigated the effects of changes in conditions or market factors may be misleading since past effectiveness may not be an indication of how effective such practices would be in the future.

Questions L10, L13 and L16 address disclosures for alternative accounting policies, new accounting pronouncements or alternative measurements. These additional requirements would also go beyond current GAAP requirements and increase the volume of disclosures rather than reduce them. The suggested disclosures for Questions L10 and L16 may be appropriate for analysts, but are far beyond what other financial statement users would require. TIC believes it is inappropriate for general purpose financial statements to have such disclosure requirements if the framework is not designating analysts as the primary financial statement users. TIC does not believe that users are in a position to second-guess management's policy decisions at this granular level.

The proforma disclosure suggested by Question L13 defeats the purpose of having transition periods for new standards. It would force the entity to go through the cost of adopting a new standard prior to the end of the transition period. Entities need this time to understand and work through the effects of accounting principle changes and should not be forced to effectively adopt early.

Information about other events and conditions that can affect an entity's prospects for future cash flows

Paragraph 2.19 states that all of the decision questions in this section relate to matters that can affect prospects for future cash flows and for which there is no information on the face of the financial statements. TIC believes all of these disclosures would be better suited to the Management's Discussion & Analysis section of a public company's financial statements since they exceed the boundary of what belongs in the notes. They are exceedingly predictive in nature and would be difficult, if not impossible, to audit.

For example, Question O1 requires disclosure of potential litigation against the entity and possible violations of laws and regulations if those conditions create a possibility that net cash flows that the entity would otherwise have experienced would be significantly different (lower or higher). The terms "potential" and "possible" by definition are speculative and not appropriate to disclosure decisions. The auditor's ability to corroborate management's assertions would be highly unlikely due to the limited responses that the entity's lawyers would be able or willing to give. The determination of whether potential litigation meets the threshold of possibly having a significant effect on net cash flows is highly judgmental and will introduce significant complexity and risk into the process of preparing disclosures. Such disclosure could also be viewed as prejudicial to the entity.

If the FASB does not address the boundary issue for forward-looking information, TIC is pessimistic that the proposed framework will help the Board set more effective disclosure requirements.

Chapter 3 – Making Disclosure Requirements Flexible

TIC supports the concept of disclosure selectivity (i.e., flexible disclosure requirements that could be applied differently by different entities). No two entities are exactly the same and should have some flexibility to customize disclosures within a topic to tailor them to user needs. TIC acknowledges that the two possible extremes presented in paragraph 3.10 are indeed extremes.

However, TIC could not agree on one specific approach for disclosure flexibility. Some members believe that some disclosures should be requirements and that other extended disclosures should be left to management judgment based on relevance and other factors (similar to paragraph 3.11c). Others favor a more flexible approach similar to paragraph 3.11b. TIC discovered that it was very difficult to reach a consensus on disclosure selectivity without more specific disclosure objectives, a more refined scope and proper boundaries for note disclosure.

Paragraph 3.21 introduces a list of minimum disclosure requirements for stock-based compensation. Paragraph 3.19 states that these disclosures seem basic to understanding the overall effect of stock-based compensation on an entity's financial statements. However, TIC did not understand the concept behind the minimum disclosures selected.

The next version of the Disclosure Framework should provide more guidance around the concept of basic disclosures, since this concept would apply to every section of the ASC.

Allowing preparers to have a role in the disclosure decision-making process raises a related concern as to documentation. Question 11 within Chapter 4 states that:

Reporting entities would need to document the reasons for their decisions about which disclosures to provide.

TIC disagrees with the suggested documentation requirement. Permitting flexibility in the information that is considered for disclosure should not lead to a requirement for management to document why omitted disclosures were appropriately omitted. Excessive documentation requirements will also discourage preparers from making decision-useful judgments and attempting to reduce irrelevant disclosures to avoid being second-guessed.

Chapter 4 – Reporting Entities’ Decisions about Disclosure Relevance

The Framework’s discussion of disclosure relevance needs further development as it lacks structure and is difficult to follow. Materiality concepts, quantitative and qualitative, have long existed to guide preparers in determining disclosure relevance. In theory, the baseline approach outlined in the Framework is a good foundation for relevance determinations. However, it is unlikely that a well-informed financial statement user, if users can be so defined, can develop reasonable expectations of future cash flows based on information on the face of the financial statements. In practice, it is likely that baseline assessments across users will vary greatly, and, consequently, so, too, will the inclusion or exclusion of disclosures. TIC recommends that the Framework include more robust discussion of materiality assessments and the application of quantitative and qualitative considerations in the determination of disclosures.

Chapter 5 – Format and Organization

TIC supports the Board’s assumption that benefits would likely be realized from the consistent organization and formatting of financial statements. However, TIC’s response below is based on the view that format and organization are of secondary importance to the development of appropriate content that is important to users.

The ITC included a number of suggestions to improve format and organization of the notes to the financial statements, such as:

- Disclosures should be entity-specific and not include boilerplate language drawn from the ASC.
- They should have common points of reference.
- Enhance understandability by using tables, headings, cross referencing and highlighting.

- Organize notes in a specific order or in groups or another basis.

TIC is supportive of many of the suggestions. However, TIC believes one of the suggested methods of highlighting information will not be operational; namely, to begin the notes with a summary of the most noteworthy events or transactions that occurred during the year with a cross reference to the related detailed footnote. TIC objects to this idea because of the judgments required to identify these events and transactions. TIC believes it would not be possible to anticipate the common elements that a diverse group of users would consider as “noteworthy” and would subject the preparer to unnecessary second-guessing. Users would be better served if the notes are presented in a manner that facilitates the identification of important disclosures. Many of the other suggestions in this section could accomplish that.

Chapter 6 – Disclosures for Interim Financial Statements

Notwithstanding that interim financial statements are less prevalent in the private company arena, TIC believes that disclosures in interim financial statements should be an update to previous annual financial statements. TIC does not support the development of a separate decision framework for interim financial statements.

Chapter 7 – Other Matters for Discussion – Summary of Accounting Policies

Paragraph 7.6 of the ITC suggests the possibility of moving the summary of accounting policies outside the financial statements (such as a company’s web site) as an effective, short-term solution to the problem of voluminous note disclosures. TIC does not support this proposal. TIC believes the financial statements should stand alone, such that all of the information that is required to be included therein is “packaged” together in the same location.

All financial statement users need to have equal access to financial information. Directing financial statement users to a web site or other source for any information that is meant to be read in conjunction with the financial statements sends a message that implies the information is unnecessary and irrelevant and not an integral part of the financial statements. Although much of the information may remain the same from year-to-year, the summary effectively provides information on the GAAP principles that are pertinent to a particular entity and provides context for the rest of the disclosures.

Currently, the summary of accounting policies can vary considerably from entity to entity in terms of the specific items included and the amount of information presented for each topic. Without additional rules that would specify the boundaries of content and length, there is a risk that some entities may move too much information outside the financial statements to the detriment of financial statement users.

TIC therefore believes that this recommendation is very premature and inappropriate at this point in the process. Moving the summary of accounting policies outside the financial

statements would be contrary to the objective of more effective communication of relevant financial information.

To the extent that the summary of accounting policies tends to include immaterial items, as mentioned in paragraph 7.3 of the ITC, TIC suggests that a more effective short-term remedy for voluminous disclosure would be to encourage entities to focus disclosure on what is material or significant. This would reduce volume and improve relevance without sacrificing user's access to information or comparability among entities.

TIC appreciates the opportunity to present these comments on behalf of PCPS member firms. We would be pleased to discuss our comments with you at your convenience.

Sincerely,

A handwritten signature in cursive script that reads "Karen Kerber".

Karen Kerber, Chair
PCPS Technical Issues Committee

cc: PCPS Executive and Technical Issues Committees