MINUTES

To:	Board Members
From:	Cizek (ext. 354)
Subject:	Minutes of the March 11, 2008 Board Meeting—Disclosure of Loss Contingencies
Date:	April 3, 2008
cc:	FASB: Bielstein, Golden, MacDonald, Cosper, Roberge, Hood, Elsbree, Cizek, Posta, Bossio, Chookaszian, Lott, Gabriele, Sutay, Allen, Klimek, Intranet; IASB: Leisenring

The Board meeting minutes are provided for the information and convenience of constituents who want to follow the Board's deliberations. All of the conclusions reported are tentative and may be changed at future Board meetings. Decisions become final only after a formal written ballot to issue a final Statement, Interpretation, or FASB Staff Position.

Topics: FASB Statement No. 5, *Accounting for Contingencies*

Basis for Discussion: Board Memorandums No. 1–3

Length of Discussion: 8:00–10:00 a.m.

Attendance:

Board members present: Batavick, Crooch, Herz, Linsmeier, Seidman, Smith, and Young

Board members absent: None

Other Participants: None

Staff in charge of topic: Elsbree, Roberge, and Cizek

Other staff at Board table: Golden, Cosper, and Hood

Summary of Decisions Reached:

The Board decided to expose for comment a proposed amendment to FASB Statement No. 5, *Accounting for Contingencies.* The Board decided that the proposed amendment will have a 60-day comment period. The Board also decided to hold a public roundtable discussion on the Exposure Draft.

The Board decided that the Exposure Draft will address the following issues:

1. Principle—The Board affirmed the recommended principle requiring an entity to provide disclosures that are sufficient to enable users of financial statements to assess the likelihood, timing, and amount of future cash flows associated with loss contingencies. Those disclosures should include discussion of the risks loss contingencies pose to the entity and their effects on the financial statements.
2. Scope—The Board agreed with the proposed principle that all loss contingencies should be disclosed unless certain narrow criteria are met. If management determines that the likelihood of a loss is remote, disclosure would not be required. However, the Board decided that any contingency, regardless of the likelihood of a loss, with the potential to result in a near-term and severe impact on the financial position, cash flows, or results of operations of an entity should be included within the scope of the proposed amendment.
3. Quantitative Requirements—The Board decided to require that an entity disclose the claim amount or, in the absence of a claim amount, an estimate of the maximum potential exposure to loss. An entity would be allowed the option to include a supplemental disclosure of its best estimate of the possible loss or range of loss if it believes the claim or maximum amount is not indicative of the entity's actual exposure. Other disclosures that will be required include:
    a. Reconciliation—The Board decided to require a tabular reconciliation of the aggregated changes in the total amount recognized for loss contingencies in the statement of financial position from the beginning to the end of each reporting period.
    b. Recoveries—The Board decided to require a qualitative and quantitative description of the terms of relevant insurance or indemnification

arrangements that could lead to a recovery of some or all of the possible loss and disclosure of the amount accrued for recoveries.

c. Legal fees—The Board decided that an entity would not be required to disclose legal fees associated with defending against loss contingencies.

4. Qualitative Requirements—The Board decided to require that an entity disclose information, including the description of the contingency, a description of the factors that are likely to affect the ultimate outcome of the contingency, management's qualitative assessment of the most likely outcome of the contingency, and any assumptions made by management in estimating the amounts in its quantitative disclosures and in assessing the most likely outcome.
5. Reporting Period—The Board decided that the proposed tabular reconciliation should be provided in both annual and interim reporting periods.
6. Prejudicial Exemption—The Board decided to include a prejudicial exemption that would consist of a two-step process. First, an entity would be allowed to aggregate the required disclosures about loss contingencies at a higher level than otherwise allowed such that the information is not prejudicial. Second, in rare cases in which disclosures aggregated at a higher level still would be prejudicial (for example, if an entity is involved in only one legal dispute), the entity would be allowed to forego disclosing only the information that would be prejudicial to the entity's case. The Board asked the staff to clarify that in no circumstance may an entity forego providing the amount of the claim, a description of the contingency, and a description of the factors that are expected to affect the ultimate outcome of the contingency.
7. Business Combinations—The Board decided that loss contingencies assumed in a business combination and accounted for under FASB Statement No. 141 (revised 2007), *Business Combinations,* should be in the scope of the proposed amendment both at the time of acquisition and subsequently. That would require an amendment to Statement 141(R).
8. Guarantees—The Board decided that guarantees within the scope of the disclosure requirements of FASB Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others,* would not be included within the scope of the proposed

amendment. The Board also decided not to amend the disclosure requirements in Interpretation 45 as part of this project.

9. Transition and Effective Date—The Board decided that the proposed amendment should be effective for annual financial statements issued for fiscal years ending after December 15, 2008, and for interim and annual periods in subsequent fiscal years.

The Board directed the staff to proceed to a draft of a proposed Statement for vote by written ballot.

Objectives of Meeting:

The objectives of the meeting were to discuss the proposed Statement that would amend disclosures about loss contingencies in Statement 5, including significant issues raised by external reviewers, and whether the staff should proceed with the process to expose the proposed Statement for comment. The objectives of the meeting were met.

Matters Discussed and Decisions Reached:

DISCLOSURE PRINCIPLE

1. Mr. Elsbree stated that consistent with the FASB's understandability initiative, the proposed disclosure begins with an overall principle for disclosure of loss contingencies. This change will improve financial statements by providing preparers and auditors a general guideline for assessing whether the overall quality and informational value of the disclosure sufficiently meets the stated objective.

Staff Recommendation

2. The staff recommended that the Board include the following principle in the amendment:

> An entity shall provide disclosures that are sufficient to enable users of financial statements to assess the likelihood, timing, and amount of future cash flows associated with loss contingencies. Such disclosure shall include discussion of the risks loss contingencies pose to the entity and their effects on the financial statements.

Board Vote

3. The Board voted to include a principle in the proposed amendment with wording slightly redrafted by the staff. All Board members agreed.

Board Comments

4. Mr. Batavick stated that the language in the last sentence might be interpreted to mean disclosure should be provided only for loss contingencies that were recognized in the financial statements. Instead, the language should say the "possible or potential effects on the operations of the entity."

5. Ms. Seidman stated her assumption that such a principle would be followed with language such as "an entity shall provide at a minimum." Mr. Crooch had similar concerns to Ms. Seidman with such language. Mr. Elsbree responded that those concerns would be addressed in the drafting process.

SCOPE

6. Ms. Cizek stated that the basic principle underlying the proposed scope requirements is that entities would disclose information about all loss contingencies except those that meet certain narrow criteria. This creates a presumption that all loss contingencies should be disclosed unless they meet one or both of the exceptions. Those criteria are that the entity has made an assessment of the contingency and positively determined that the likelihood of loss is remote, and that the contingency could not have a near-term, severe impact on the entity, as those terms are defined in AICPA Statement of Position 94-6, *Disclosure of Certain Significant Risks and Uncertainties.*

Staff Recommendation

7. The staff recommended that the Board require the proposed scope described above in the amendment to increase the population of loss contingencies that are disclosed under the current requirements.

Board Vote

8. Messrs. Batavick, Herz, and Smith and Ms. Seidman voted to remove the word *positive* from the proposed scope, such that the scope would instead read, "the entity has made an assessment of the contingency and determined that the likelihood of loss is remote. Messrs. Crooch, Linsmeier, and Young voted against this change.

9. Messrs. Crooch, Herz, Linsmeier, Smith, and Young and Ms. Seidman voted to include the scope requirement that contingencies that could have a near-term and severe impact on the entity, even when the entity determined the likelihood of loss is remote, should be included in the disclosure population. Mr. Batavick voted against this scope requirement.

Board Comments

Positive Determination

10. Mr. Smith felt that the requirement for an entity to make an assessment and positively determine the likelihood of loss is redundant. Further, he did not understand how a positive determination would be different from making a determination as required in other GAAP literature. Mr. Smith expressed concern that this would cause confusion by suggesting that this determination had a higher threshold than other determinations. Ms. Seidman agreed that the language seemed redundant and seemed to raise the threshold to certainty for the likelihood of the outcome.

11. Mr. Young responded that he believed the positive determination language was intended to require that if an entity cannot determine the probability of the likelihood of a loss, the loss contingency should be disclosed. He stated that he would support removing the term *positive* if a sentence was added to the scope requirement clarifying this concept. Ms. Seidman responded that the requirement did not allow entities the option not to make a determination. Therefore, requiring that a loss contingency be disclosed when an assessment cannot be made would not be necessary. She also stated that this language required the assessment to be current for each reporting period.

12. Mr. Herz asked whether the basis for conclusions could be developed to further clarify this scope principle. Mr. Smith responded that language necessary to implement a standard should be in the body of the standard, not in the basis.

Near-term and Severe Impact

13. Mr. Batavick objected to including a requirement that entities disclose information about loss contingencies with a near-term and severe impact if the likelihood of loss is remote. He felt this added an unnecessary level of complexity to the financial statements. Mr. Herz responded that even if the likelihood of loss is remote, shareholders may want to know about loss contingencies with the potential to have a significant impact on the operations of the entity in the near term.

14. Mr. Young asked what it means for a loss contingency to have a potential near-term impact on an entity. Mr. Golden answered that the staff intended this to include loss contingencies that could require a significant cash outflow or recognition event in the next 12 months. As the cash flow impact could occur after the recognition event, Mr. Golden suggested that the requirement be amended to state that the recognition would occur in the near term.

15. Mr. Smith expressed concern that language in the Board handout required an entity to determine that the loss contingency could not have a near-term and severe impact on the entity. He felt that almost all legal disputes, when considering possible recovery assessments, would likely meet this definition. Mr. Batavick agreed with this concern. Mr. Herz clarified that the principle of the requirement was that the loss could have a major damaging effect on the entity within the next 12 months. Mr. Smith stated that he agreed with the principle, but would ask the staff to redraft the language in the proposed standard.

16. Ms. Seidman asked whether this would require an incremental disclosure from that required in SOP 94-6. Mr. Elsbree responded that SOP 94-6 requires disclosure of reasonably possible losses, not the entire population as would be required by this proposal.

QUANTITATIVE INFORMATION—EXPOSURE TO LOSS

17. Mr. Elsbree explained that for all loss contingencies within the proposed scope, the amendment would include a requirement that entities disclose the claim amount or, in the absence of a claim amount, an estimate of the maximum potential exposure to loss. The amendment would allow entities to additionally include a supplemental disclosure of the best estimate of the possible loss or range of loss if it believes the claim or maximum amount is not indicative of the entity's actual loss exposure. This change addresses users' concerns about a lack of quantitative information in contingency disclosures.

Staff Recommendation

18. The staff recommended that the Board include the quantitative requirement mentioned above.

Board Vote

19. The Board voted for the staff's recommendation. All Board members agreed.

Board Comments

20. Mr. Linsmeier asked why the staff did not require the exposure amount to be disclosed in excess of the amount accrued. Mr. Smith agreed that there may be an information gap between the amount accrued in the financial statements and the amounts included in the notes to the financial statements. Mr. Elsbree replied that the claim amount is fixed and users wanted to understand the maximum exposure to loss faced by an entity. However, wording could be included in the proposed amendment to clarify the relationship between the amounts recognized in the financial statements and the amounts disclosed in the notes to the financial statements. Mr. Linsmeier added that the reconciliation disclosure would allow users to understand changes in the amounts recognized.

21. Mr. Linsmeier also asked why the staff did not recommend that the amendment include disclosure of settlement amounts as suggested by the ITAC committee at a previous meeting. Ms. Seidman replied that she expected the amount recognized to

be changed based on settlement information. As the proposed amendment highlights the need for a current assessment to be made each reporting period, she felt that settlement information would be sufficiently available for users' needs. Mr. Golden added that often settlement offers expire quickly during negotiations. Therefore, a settlement that is outstanding and included in the disclosures may not represent the realistic settlement outcome. Mr. Linsmeier requested that a question be included in the Notice for Recipients about settlement offers.

QUANTITATIVE INFORMATION—TABULAR RECONCILIATION

22. Mr. Elsbree stated that the proposed amendment also would include a requirement for a tabular reconciliation of the total amount recognized in the aggregate for loss contingencies in the statement of financial position at the beginning and end of each annual period. Similar reconciliations were included in other recently issued accounting standards such as FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*. At a minimum, the reconciliation would include increases for loss contingencies newly recognized, increases resulting from changes in estimates of the amounts of loss contingencies previously recognized, decreases resulting from changes in estimate of the amount of loss contingencies previously recognized or for derecognition of loss contingencies that are no longer probable, and decreases for derecognition of loss contingencies paid or otherwise settled.

Staff Recommendation

23. The staff recommended that the proposed reconciliation of the aggregated amount of loss contingencies recognized in the statement of financial position be included in the proposed amendment.

Board Vote

24. The Board voted for the staff's recommendation. All Board members agreed.

Board Comments

25. Mr. Young stated that he agreed with the staff's recommendation as the tabular reconciliation applies to loss contingencies. However, he suggested that the Board

consider the letter sent by the ITAC committee requesting a disclosure framework for all reported accounts. Specifically, Mr. Young suggested that the line item in the proposed reconciliation for derecognition of loss contingencies that no longer meet the probable threshold and for changes in estimate be segregated into two line items. While this aggregation may work for contingencies, he suggested that the items be separated to enhance consistency in a future disclosure framework.

26. Mr. Linsmeier responded that the ITAC committee acknowledged that the reconciliation columns for each account may be slightly different due to the different nature of each account in the financial statements.

QUANTITATIVE INFORMATION—RECOVERIES

Staff Recommendation

27. Mr. Elsbree explained that consistent with the prohibition against netting certain assets and liabilities in FASB Interpretation No. 39, *Offsetting of Amounts Related to Certain Contracts*, the quantitative disclosures would be provided without consideration of potential recoveries such as those from insurance arrangements. However, Mr. Elsbree noted that the staff recommends that the proposed amendment require a qualitative and quantitative description of the terms of relevant insurance or indemnification arrangements that could lead to a recovery of some or all of the possible loss. Additionally, entities would be required to disclose amounts recognized in the financial statements for such recoveries.

Board Vote

28. The Board voted for the staff's recommendation. All Board members agreed.

QUANTITATIVE INFORMATION—LEGAL FEES

29. The staff received a suggestion from a Board member to require the inclusion of legal fees incurred by entities related to loss contingencies, as an indicator of the effort required to defend the entity in lawsuits. The staff included the proposal for disclosure of the total amount recognized for external legal fees associated with

Board Vote

30. The Board voted not to require the disclosure of legal fees in the proposed amendment. All Board members agreed.

Board Comments

31. Ms. Seidman stated that the financial statement presentation project is currently addressing the disclosure of expenses by nature, such as legal fees. She stated that this project would not be a good place to address the disclosure of different types of expenses.

32. Ms. Seidman also stated that it would be difficult to determine what types of expenses should be included in legal fees. For example, some work done by internal legal staff may be related to lawsuits while other time may be spent writing contracts. If internal legal expenses were included in the disclosure, entities would need to bifurcate out these internal legal department expenses. Mr. Batavick agreed and added that showing trends in legal fees may mislead users. For example, high upfront legal costs may be necessary for researching a new case that ultimately is determined to have a remote likelihood of loss.

33. Mr. Linsmeier replied that a lack of quantitative information is available about lawsuits until very close to the ultimate settlement time. Disclosure of legal fees would provide users with some quantitative information to analyze.

QUALITATIVE INFORMATION

Staff Recommendation

34. Ms. Cizek stated that the staff recommends the proposed amendment require an entity to disclose information to help the reader understand the facts surrounding the contingency and the risks it poses to the entity. That information would include a description of the contingency, a description of the factors that are likely to affect the

Board Vote

35. The Board voted for the staff's recommendation. All Board members agreed.

REPORTING PERIOD

Staff Recommendation

36. The staff recommended that the tabular reconciliation be required only for annual financial statements. The staff also recommended that for interim periods, disclosures about loss contingencies required by paragraph 22 of APB Opinion No. 28, *Interim Financial Reporting*, and qualitative and quantitative disclosures of significant gross increases and decreases to recognized loss contingencies be included explicitly in the proposed amendment.

Board Vote

37. Messrs. Crooch, Linsmeier, and Young and Ms. Seidman voted that the reconciliation table be provided for both interim and annual periods along with the other proposed disclosures. Messrs. Batavick, Herz, and Smith voted for the staff's recommendation.

Board Comments

38. Mr. Young stated that he did not understand how requiring the reconciliation table to be provided in interim periods would add extra work for preparers. He also stated that users operate on quarterly schedules, not annually. Therefore, this information would be valuable to provide to users to of financial statements. Mr. Smith disagreed with this and stated his belief that large multinational companies would have difficulties accumulating this information quarterly.

39. Ms. Seidman noted that Opinion 28 seems to require some of the information required in the reconciliation. The reconciliation could be provided as entities will need to assess loss contingencies on a quarterly basis to comply with the disclosure requirements.

40. Ms. Seidman asked that field visits be included as a part of this standard's process to issuance. She stated that this would require a low-cost effort that could help Board members and staff better understand implementation issues.

PREJUDICIAL EXEMPTION

Staff Recommendation

41. Mr. Elsbree stated that the staff recommends a prejudicial exemption be included to allow entities to aggregate the required disclosures about loss contingencies at a higher level than otherwise allowed such that the information is not prejudicial. In rare cases in which disclosures aggregated at a higher level would still be prejudicial (for example, if an entity is involved in only one legal dispute), the entity would be allowed to forego disclosing only the information that would be prejudicial to the entity's case. An entity would still be required to disclose information about the nature of the loss contingency, include a description of the loss contingency, and disclose the amount of the claim or assessment against the entity.

42. Mr. Elsbree mentioned a suggestion brought up at the Education Session that entities not be allowed the prejudicial exemption for loss contingencies with a potential near-term and severe impact on the entity.

Board Vote

43. Messrs. Crooch, Herz, Linsmeier, Smith and Young and Ms. Seidman voted to include a prejudicial exemption in the proposed amendment and require that entities always disclose a description of the factors that are likely to affect the ultimate outcome of the contingency as this information should not be prejudicial. Mr. Batavick voted against this proposal. Additionally, Messrs. Batavick, Smith and Ms.

Seidman voted to remove the term *rare* from the prejudicial exemption. Messrs. Crooch, Linsmeier, Herz, and Young voted for the staff's recommendation.

Board Comments

44. Mr. Linsmeier stated that he did not believe it would be prejudicial for an entity to disclose a description of the factors that are likely to affect the ultimate outcome of the contingency along with their potential effect on the outcome. Mr. Batavick responded that he felt it would be better to provide a principle that would require management judgment about what information would not be prejudicial to disclose.

45. Mr. Smith stated that he disagreed with including the term *rare* in the prejudicial exemption as he believed that it would not be rare for information to be prejudicial and that some accounting firms have interpreted the term *rare* to mean *never*. He suggested that the staff include language to clarify what is meant by the word *rare*.

BUSINESS COMBINATIONS

Staff Recommendation

46. Ms. Cizek stated that the staff recommends that loss contingencies assumed in a business combination accounted for under Statement 141(R) should be within the scope of the proposed Statement, both at the acquisition date and subsequently. However, because loss contingencies recognized under Statement 141(R) have a different measurement attribute than those recognized under Statement 5, the staff recommended that those amounts be shown separately in the proposed tabular reconciliation. Ms. Cizek noted that this change would require an amendment to Statement 141(R).

Board Vote

47. The Board voted for the staff's recommendation. All Board members agreed.

GUARANTEE DISCLOSURES

Staff Recommendation

48. Ms. Cizek stated that the staff recommends that guarantees within the scope of Interpretation 45 be excluded from the scope of the proposed amendment to Statement 5. However, the staff believes the disclosure requirements in Interpretation 45 could be amended to enhance disclosures about guarantees as part of this project to make them consistent with the proposed disclosure requirements. For example, the Interpretation 45 disclosures could require a tabular reconciliation for all guarantees and not just product warranty guarantees.

Board Vote

49. Messrs. Batavick, Crooch, Herz, and Smith and Ms. Seidman voted that anything within the scope of Interpretation 45 be excluded from the proposed amendment and that the staff not amend the Interpretation 45 disclosures as a part of this project. Messrs. Linsmeier and Young voted that Interpretation 45 disclosures be amended as a part of this project.

Board Comments

50. Ms. Seidman stated that Interpretation 45 does not include subsequent measurement guidance. Therefore, including guarantees in the tabular reconciliation may introduce a mixed measurement attribute as not all guarantees are subsequently accounted for according to Statement 5's recognition and disclosure requirements. Mr. Golden asked whether guarantees subsequently measured according to Statement 5 should be included in the Statement 5 disclosure requirements. The Board agreed that once an item is in the scope of Interpretation 45 and, therefore, scoped out of the Statement 5 disclosure requirements, this item should also be scoped out of the proposed amendment disclosures.

TRANSITION AND EFFECTIVE DATE

Staff Recommendation

51. Mr. Roberge stated that the staff recommends a prospective transition approach under which the effective date for the proposed amendment would be for annual financial statements issued for years beginning after December 15, 2008, and interim periods within those fiscal years.

Board Vote

52. Messrs. Crooch, Herz, Linsmeier, and Young voted for the staff's recommendation except that the effective date should be for annual financial statements issued for years ending after December 15, 2008. Messrs. Batavick and Smith and Ms. Seidman voted for the staff's recommendation.

DUE PROCESS CONSIDERATIONS

Staff Recommendation

53. Mr. Roberge stated that the staff recommends a 60-day comment period for this Exposure Draft and scheduling a roundtable discussion that would include preparers, auditors, financial statement users, and attorneys.

Board Vote

54. The Board voted for the staff's recommendation. All Board members agreed.