

Financial Accounting Series

EXPOSURE DRAFT

Proposed Statement of Financial Accounting Standards

Disclosure of Certain Loss Contingencies

an amendment of FASB Statements No. 5 and 141(R)

This Exposure Draft of a proposed Statement of Financial Accounting Standards is issued by the Board for public comment. Written comments should be addressed to:

Technical Director
File Reference No. 1600-100

Comment Deadline: August 8, 2008



Financial Accounting Standards Board
of the Financial Accounting Foundation

Responses from interested parties wishing to comment on the Exposure Draft must be **received** in writing by August 8, 2008. Interested parties should submit their comments by email to director@fasb.org, File Reference No. 1600-100. Those without email may send their comments to the “Technical Director—File Reference No. 1600-100” at the address at the bottom of this page. Responses should **not** be sent by fax.

All comments received by the FASB are considered public information. Those comments will be posted to the FASB’s website and will be included in the project’s public record.

Any individual or organization may obtain one copy of this Exposure Draft without charge until August 8, 2008, on written request only. **Please ask for our Product Code No. E195.** For information on applicable prices for additional copies and copies requested after August 8, 2008, contact:

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Financial Accounting Standards Board
of the Financial Accounting Foundation
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Notice for Recipients of This Proposed FASB Statement

This proposed Statement would replace and enhance the disclosure requirements in FASB Statement No. 5, *Accounting for Contingencies*, for loss contingencies that are recognized as liabilities in a statement of financial position and for unrecognized loss contingencies that would be recognized as liabilities if the criteria for recognition in paragraph 8 of Statement 5 were met. It would not change the disclosure requirements for loss contingencies that are (or would be) recognized as asset impairments. This proposed Statement also would apply to loss contingencies recognized in a business combination accounted for under FASB Statement No. 141 (revised 2007), *Business Combinations*.

Effective Date and Transition

The disclosures about loss contingencies required by this proposed Statement would be effective for annual financial statements issued for fiscal years ending after December 15, 2008, and interim and annual periods in subsequent fiscal years.

Request for Comments

The Board invites individuals and organizations to send written comments on all matters in this proposed Statement, particularly on the questions listed below. Respondents need not comment on each issue and are encouraged to comment on additional matters they believe should be brought to the Board's attention. Comments are requested from those who agree with the provisions of this proposed Statement as well as from those who do not. Comments are most helpful if they identify the issues to which they relate and clearly explain the reasons for the positions taken. Those who disagree with provisions of this proposed Statement are asked to describe their suggested alternatives, supported by specific reasoning. Respondents must submit comments in writing by August 8, 2008.

The Board requests that constituents provide comments on the following questions:

1. Will the proposed Statement meet the project's objective of providing enhanced disclosures about loss contingencies so that the benefits of those disclosures justify the incremental costs? Why or why not? What costs do you expect to incur if the Board were to issue this proposed Statement in its current form as a final Statement? How could the Board further reduce the costs of applying these requirements without significantly reducing the benefits?
2. Do you agree with the Board's decision to include within the scope of this proposed Statement obligations that may result from withdrawal from a multiemployer plan for a portion of its unfunded benefit obligations, which are currently subject to the provisions of Statement 5? Why or why not?
3. Should an entity be required to provide disclosures about loss contingencies, regardless of the likelihood of loss, if the resolution of the contingencies is

expected to occur within one year of the date of the financial statements and the loss contingencies could have a severe impact upon the operations of the entity? Why or why not?

4. Paragraph 10 of Statement 5 requires entities to “give an estimate of the possible loss or range of loss or state that such an estimate cannot be made.” One of financial statement users’ most significant concerns about disclosures under Statement 5’s requirements is that the disclosures rarely include quantitative information. Rather, entities often state that the possible loss cannot be estimated. The Board decided to require entities to disclose the amount of the claim or assessment against the entity, or, if there is no claim or assessment amount, the entity’s best estimate of the maximum possible exposure to loss. Additionally, entities would be permitted, but not required, to disclose the possible loss or range of loss if they believe the amount of the claim or assessment is not representative of the entity’s actual exposure.
 - a. Do you believe that this change would result in an improvement in the reporting of quantitative information about loss contingencies? Why or why not?
 - b. Do you believe that disclosing the possible loss or range of loss should be required, rather than optional, if an entity believes the amount of the claim or assessment or its best estimate of the maximum possible exposure to loss is not representative of the entity’s actual exposure? Why or why not?
 - c. If you disagree with the proposed requirements, what quantitative disclosures do you believe would best fulfill users’ needs for quantitative information and at the same time not reveal significant information that may be prejudicial to an entity’s position in a dispute?
5. If a loss contingency does not have a specific claim amount, will an entity be able to provide a reliable estimate of the maximum exposure to loss (as required by paragraph 7(a)) that is meaningful to users? Why or why not?
6. Financial statement users suggested that the Board require disclosure of settlement offers made between counterparties in a dispute. The Board decided not to require that disclosure because often those offers expire quickly and may not reflect the status of negotiations only a short time later. Should disclosure of the amount of settlement offers made by either party be required? Why or why not?
7. Will the tabular reconciliation of recognized loss contingencies, provided on an aggregated basis, provide useful information about loss contingencies for assessing future cash flows and understanding changes in the amounts recognized in the financial statements? Why or why not?
8. This proposed Statement includes a limited exemption from disclosing prejudicial information. Do you agree that such an exemption should be provided? Why or why not?
9. If you agree with providing a prejudicial exemption, do you agree with the two-step approach in paragraph 11? Why or why not? If not, what approach would you recommend and why?

10. The International Accounting Standards Board (IASB) continues to deliberate changes to IAS 37, *Provisions, Contingent Liabilities and Contingent Assets*, but has not yet reconsidered the disclosure requirements. The existing disclosure requirements of IAS 37 include a prejudicial exemption with language indicating that the circumstances under which that exemption may be exercised are expected to be *extremely rare*. This proposed Statement includes language indicating that the circumstances under which the prejudicial exemption may be exercised are expected to be *rare* (instead of *extremely rare*). Do you agree with the Board's decision and, if so, why? If not, what do you recommend as an alternative and why?
11. Do you agree with the description of *prejudicial information* as information whose "disclosure . . . could affect, to the entity's detriment, the outcome of the contingency itself"? If not, how would you describe or define *prejudicial information* and why?
12. Do you believe it is operational for entities to disclose all of the proposed requirements for interim and annual reporting periods? Should the tabular reconciliation be required only annually? Why or why not?
13. Do you believe other information about loss contingencies should be disclosed that would not be required by this proposed Statement? If so, what other information would you require?
14. Do you believe it is operational for entities to implement the proposed Statement in fiscal years ending after December 15, 2008? Why or why not?

Public Roundtable Meeting

The Board plans to hold one or more public roundtable meetings on this Exposure Draft. The purpose of roundtable meetings is to listen to the views of, and obtain information from, interested constituents about the Exposure Draft. The Board plans to seek participants for the meetings that represent a wide variety of constituents, including investors, preparers of financial statements, auditors, and others to ensure that it receives broad input. Any individual or organization desiring to participate must notify the FASB by sending an email to director@fasb.org by July 25, 2008, and submit their comments on the Exposure Draft in writing by August 8, 2008. Roundtable meetings can accommodate a limited number of participants. Depending on the number of responses received, the Board may not be able to accommodate all requests to participate.

Field Testing Volunteers

The Board also is soliciting entities that would be willing to participate with the staff, on a confidential basis, in field testing the provisions of this proposed Statement. The purpose of the field tests is to assess the workability of the proposed guidance and evaluate the cost and benefits of the proposed change. Those interested parties can contact David B. Elsbree, Jr., practice fellow, at 203-956-3453 or dbelsbree@fasb.org.

Summary

Why Is the FASB Issuing This Proposed Statement and When Is It Effective?

Investors and other users of financial information have expressed concerns that disclosures about loss contingencies under the existing guidance in FASB Statement No. 5, *Accounting for Contingencies*, do not provide adequate information to assist users of financial statements in assessing the likelihood, timing, and amount of future cash flows associated with loss contingencies. This proposed Statement would expand disclosures about certain loss contingencies in the scope of Statement 5 or FASB Statement No. 141 (revised 2007), *Business Combinations*. This proposed Statement would require expanded disclosures for those loss contingencies unless certain criteria are met. This proposed Statement would be effective for fiscal years ending after December 15, 2008, and interim and annual periods in subsequent fiscal years.

What Is the Scope of This Proposed Statement?

This proposed Statement would apply to all loss contingencies that are within the scope of either Statement 5 or Statement 141(R) except for the following:

- a. Loss contingencies that are (or would be) recognized as asset impairments in a statement of financial position. Such loss contingencies would continue to be disclosed in accordance with Statement 5. Creditors would continue to disclose information about impaired loans in accordance with FASB Statement No. 114, *Accounting by Creditors for Impairment of a Loan*.
- b. Guarantees within the scope of the disclosure requirements in FASB Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*, including guarantees that are recognized either initially or subsequently based on the Statement 5 accounting guidance.
- c. Liabilities for unpaid claim costs related to insurance contracts or reinsurance contracts of an insurance entity or a reinsurance entity within the scope of FASB Statement No. 60, *Accounting and Reporting by Insurance Enterprises*, No. 97, *Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments*, No. 113, *Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts*, No. 120, *Accounting and Reporting by Mutual Life Insurance Enterprises and by Insurance Enterprises for Certain Long-Duration Participating Contracts*, or No. 163, *Accounting for Financial Guarantee Insurance Contracts*.
- d. Liabilities for insurance-related assessments within the scope of AICPA Statement of Position 97-3, *Accounting by Insurance and Other Enterprises for Insurance-Related Assessments*.
- e. Liabilities for employment-related costs, including pensions and other postemployment benefits. However, obligations that may result from

withdrawal from a multiemployer plan for a portion of its unfunded benefit obligations would be disclosed in accordance with this Statement.

How Will This Proposed Statement Improve Current Accounting Practice?

This proposed Statement would enhance disclosures about loss contingencies that are (or would be) recognized as liabilities in a statement of financial position. Specifically, this proposed Statement would (a) expand the population of loss contingencies that are required to be disclosed, (b) require disclosure of specific quantitative and qualitative information about those loss contingencies, (c) require a tabular reconciliation of recognized loss contingencies to enhance financial statement transparency, and (d) provide an exemption from disclosing certain required information if disclosing that information would be prejudicial to an entity's position in a dispute. The Board believes that these enhanced disclosure requirements will significantly improve the overall quality of disclosures about loss contingencies by providing financial statement users with important information.

How Does This Proposed Statement Relate to International Convergence?

The disclosures that would be required by this proposed Statement are similar, but not identical, to those required by IAS 37, *Provisions, Contingent Liabilities and Contingent Assets*. This proposed Statement would require disclosures about a broader population of contingencies than required by IAS 37. Specifically, this proposed Statement would require disclosures about loss contingencies, regardless of the likelihood of loss, if the contingencies are expected to be resolved in the near term and if the contingencies could have a severe impact on the entity's financial position, cash flows, or results of operations. IAS 37 does not require disclosures for remote loss contingencies regardless of the expected timing of resolution or potential severity of the contingency. The IASB currently is deliberating changes to IAS 37 but has not yet considered its disclosure requirements. The IASB is expected to evaluate the disclosure requirements in this proposed Statement when it reconsiders the IAS 37 disclosure requirements, which will provide a potential convergence opportunity.

Proposed Statement of Financial Accounting Standards

Disclosure of Certain Loss Contingencies

an amendment of FASB Statements No. 5 and 141(R)

June 5, 2008

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Proposed Statement of Financial Accounting Standards

Disclosure of Certain Loss Contingencies

an amendment of FASB Statements No. 5 and 141(R)

June 5, 2008

OBJECTIVE

1. FASB Statement No. 141 (revised 2007), *Business Combinations*, establishes the accounting and reporting for gain and loss contingencies recognized in a business combination. FASB Statement No. 5, *Accounting for Contingencies*, establishes the accounting and reporting for all other gain and loss contingencies. The objective of this Statement is to improve the disclosures about certain loss contingencies by amending Statements 5 and 141(R). This Statement does not change the recognition and measurement guidance for loss contingencies contained in those Statements.

2. The term *loss contingency*, as defined in Statement 5, includes losses that may result from the loss or impairment of an asset or the incurrence of a liability. This Statement replaces the disclosure requirements in Statement 5 for loss contingencies that are recognized as liabilities in a statement of financial position and for unrecognized loss contingencies that would be recognized as liabilities if the criteria for recognition in paragraph 8 of Statement 5 were met. Loss contingencies that are (or would be) recognized as asset impairments should continue to be disclosed in accordance with Statement 5. This Statement also amends Statement 141(R) to require the disclosures included in this Statement for loss contingencies recognized in a business combination.

<p>All paragraphs in this Statement have equal authority. Paragraphs in bold set out the main principles.</p>

STANDARDS OF FINANCIAL ACCOUNTING AND REPORTING

Scope

3. This Statement applies to all loss contingencies that are within the scope of either Statement 5 or Statement 141(R), except for the following:
 - a. Loss contingencies that are (or would be) recognized as asset impairments in a statement of financial position. Such loss contingencies shall continue to be disclosed in accordance with Statement 5. Creditors shall continue to disclose information about impaired loans in accordance with FASB Statement No. 114, *Accounting by Creditors for Impairment of a Loan*.
 - b. 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*, including guarantees that are recognized either initially or subsequently based on the Statement 5 accounting guidance.
 - c. Liabilities for unpaid claim costs related to insurance contracts or reinsurance contracts of an insurance entity or a reinsurance entity within the scope of FASB Statement No. 60, *Accounting and Reporting by Insurance Enterprises*, No. 97, *Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments*, No. 113, *Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts*, No. 120, *Accounting and Reporting by Mutual Life Insurance Enterprises and by Insurance Enterprises for Certain Long-Duration Participating Contracts*, or No. 163, *Accounting for Financial Guarantee Insurance Contracts*.
 - d. Liabilities for insurance-related assessments within the scope of AICPA Statement of Position 97-3, *Accounting by Insurance and Other Enterprises for Insurance-Related Assessments*.
 - e. Liabilities for employment-related costs, including pensions and other postemployment benefits. However, obligations that may result from withdrawal from a multiemployer plan for a portion of its unfunded benefit obligations shall be disclosed in accordance with this Statement.

Disclosures

4. An entity shall provide disclosures to assist users of financial statements in assessing the likelihood, timing, and amount of future cash flows associated with loss contingencies that are (or would be) recognized as liabilities in a statement of financial position. Those disclosures shall include information about the risks those loss contingencies pose to the entity and their potential and actual effects on the entity's financial position, cash flows, and results of operations.

5. An entity shall disclose all loss contingencies within the scope of this Statement, except as follows (or as required by paragraph 6):

- a. Disclosure is not required for a loss contingency for which the entity has made an assessment and determined that the likelihood of a loss is remote.
- b. Disclosure is not required for a loss contingency involving an unasserted claim or assessment in which there has been no manifestation by a potential claimant of an awareness of a possible claim or assessment, unless:
 - (1) It is probable that a claim will be asserted; and
 - (2) The likelihood of a loss, if the claim or assessment were to be asserted, is more than remote.

6. Notwithstanding the guidance in paragraph 5, an entity shall disclose a loss contingency, or a combination of loss contingencies, regardless of the likelihood of loss, if both:

- a. The contingency or contingencies are expected to be resolved in the near term;¹ and
- b. The contingency or contingencies could have a severe impact² on the entity's financial position, cash flows, or results of operations.

7. An entity shall disclose the following information about loss contingencies required to be disclosed under paragraph 5 or 6:

- a. Quantitative information about the entity's exposure to loss from the contingency (including any amounts already recognized in the financial statements but excluding potential recoveries disclosed under paragraph 7(c)), as follows:
 - (1) The amount of the claim or assessment against the entity (including damages, such as treble or punitive damages), if applicable
 - (2) If there is no claim or assessment amount, the entity's best estimate of the maximum exposure to loss.

An entity also may disclose its best estimate of the possible loss or range of loss if it believes that the amount of the claim or assessment or the maximum exposure to loss is not representative of the entity's actual exposure.

- b. Qualitative information about the contingency sufficient to enable users to understand the risks posed to the entity. This information shall include, at a minimum, a description of the contingency, including how it arose, its legal or contractual basis, its current status, and the anticipated timing of its resolution;

¹The term *near term* means a period of time not to exceed one year from the date of the financial statements. [AICPA Statement of Position 94-6, *Disclosure of Certain Significant Risks and Uncertainties*]

²The term *severe impact* means a significant financially disruptive effect on the normal functioning of an entity. Severe impact is a higher threshold than material. Matters that are important enough to influence a user's decisions are deemed to be material, yet they may not be so significant as to disrupt the normal functioning of the entity. Some events are material to an investor because they might affect the price of an entity's capital stock or its debt securities, but they would not necessarily have a severe effect on (disrupt) the entity itself. The concept of severe impact, however, includes matters that are less than catastrophic. Matters that are catastrophic include, for example, those that would result in bankruptcy. [SOP 94-6]

a description of the factors that are likely to affect the ultimate outcome of the contingency along with their potential effect on the outcome; the entity's qualitative assessment of the most likely outcome of the contingency; and significant assumptions made by the entity in estimating the amounts disclosed in paragraph 7(a) and in assessing the most likely outcome.

- c. 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, including any caps, limitations, or deductibles that could affect the amount of recovery.

The disclosures required by this paragraph may be aggregated by the nature of the loss contingency (for example, product liability or antitrust matters).

Tabular Reconciliation of Recognized Loss Contingencies

8. For each period for which a statement of income is presented, an entity shall provide a reconciliation, in tabular format, of the total amount recognized in the aggregate for loss contingencies in its statement of financial position at the beginning and end of the period. Amounts recognized for loss contingencies that are accounted for in accordance with Statement 141(R) shall be shown separately from amounts for loss contingencies that are accounted for in accordance with Statement 5. The reconciliation shall include at a minimum:

- a. Increases for loss contingencies recognized during the period
- b. Increases resulting from changes in estimates of the amounts of loss contingencies previously recognized
- c. Decreases resulting from changes in estimates or derecognition of loss contingencies previously recognized
- d. Decreases resulting from cash payments (or other forms of settlement) for loss contingencies.

An entity shall provide a qualitative description of the significant activity in the reconciliation and shall disclose the line items in the statement of financial position in which recognized loss contingencies are included. All loss contingencies recognized in a business combination shall be included in the reconciliation. However, other loss contingencies whose underlying cause and ultimate settlement occur in the same period shall be excluded from the reconciliation.

9. An entity also shall disclose the total amount of recoveries from insurance or indemnification arrangements recognized in each statement of financial position and statement of income presented that are related to the loss contingencies included in the tabular reconciliation required by paragraph 8.

Subsequent Events

10. After the date of an entity's financial statements but before those financial statements are issued, information may become available indicating that a liability was

incurred after the date of the financial statements or that it is more than remote that a liability was incurred after that date. In those situations, an entity shall provide the disclosures required in paragraph 7. In the case of a loss arising after the date of the financial statements in which the amount of the liability incurred can be reasonably estimated, an entity may supplement the historical financial statements by disclosing pro forma financial data giving effect to the loss as if it had occurred at the date of the financial statements. It may be desirable to present pro forma statements, usually a statement of financial position only, in columnar form on the face of the historical financial statements.

Exemption from Disclosing Prejudicial Information

11. For certain contingencies, such as pending or threatened litigation, disclosure of certain information about the contingency may be prejudicial to an entity's position (that is, disclosure of the information could affect, to the entity's detriment, the outcome of the contingency itself). In those circumstances, an entity may aggregate the disclosures required by paragraph 7 at a level higher than by the nature of the contingency such that disclosure of the information is not prejudicial. In those rare³ instances in which the disclosure of the information required by paragraph 7, when aggregated at a level higher than by the nature of the contingency, or of the tabular reconciliation would be prejudicial (for example, if an entity is involved in only one legal dispute), the entity may forgo disclosing only the information that would be prejudicial to the entity's position. In those circumstances, an entity shall disclose the fact that, and the reason why, the information has not been disclosed. In no circumstance may an entity forgo disclosing the amount of the claim or assessment against the entity (or, if there is no claim amount, an estimate of the entity's maximum exposure to loss); providing a description of the loss contingency, including how it arose, its legal or contractual basis, its current status, and the anticipated timing of its resolution; and providing a description of the factors that are likely to affect the ultimate outcome of the contingency along with the potential impact on the outcome.

EFFECTIVE DATE AND TRANSITION

12. This Statement shall be effective for annual financial statements issued for fiscal years ending after December 15, 2008, and interim and annual periods in subsequent fiscal years. A tabular reconciliation of recognized loss contingencies is not required for earlier periods that are provided for comparative purposes.

**The provisions of this Statement need
not be applied to immaterial items.**

³The term *rare* is not intended to mean *never*. The example provided is not intended to represent the only circumstance in which a disclosure might be sufficiently prejudicial as to warrant omission of that disclosure. All of the facts and circumstances must be considered and significant judgment must be applied to determine in what circumstances disclosures might be prejudicial.

Appendix A

BACKGROUND INFORMATION AND BASIS FOR CONCLUSIONS

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Appendix A

BACKGROUND INFORMATION AND BASIS FOR CONCLUSIONS

Introduction

A1. This appendix summarizes considerations that Board members deemed significant in reaching the conclusions in this proposed Statement. It includes the reasons for accepting certain approaches and rejecting others. Individual Board members gave greater weight to some factors than to others.

Background Information

A2. In September 2007, the Board added a project to its agenda on the accounting for certain nonfinancial liabilities and contingencies, including contingencies under FASB Statement No. 5, *Accounting for Contingencies*. The Board decided to conduct this project in two phases: a short-term phase to amend and enhance the disclosure requirements for Statement 5 loss contingencies and a long-term phase to comprehensively reconsider the recognition and measurement guidance for certain nonfinancial liabilities.

A3. The short-term phase of the project was undertaken to address constituents' concerns that the disclosures about certain loss contingencies under existing guidance do not provide sufficient information in a timely manner to assist users in assessing the likelihood, timing, and amounts of cash flows associated with loss contingencies. The loss contingencies affected are those that are (or would be, if the criteria in paragraph 8 of Statement 5 were met) recognized as liabilities in a statement of financial position that do not have other applicable disclosure guidance, such as liabilities arising from litigation. The following are the primary criticisms of disclosures about such loss contingencies that are addressed in this project:

- a. The initial disclosure of specific information about a loss contingency often does not occur until a material accrual is recognized for that loss contingency.
- b. The *at least reasonably possible* threshold for disclosing loss contingencies has not resulted in the disclosure of the full population of an entity's existing loss contingencies that would be of interest to financial statement users.
- c. The option to state that "an estimate of the possible loss or range of loss cannot be made" is exercised with such frequency by financial statement preparers that users often have no basis for assessing an entity's possible future cash flows associated with loss contingencies.
- d. The amounts recognized in the financial statements related to loss contingencies are not transparent to users.

A4. To address these concerns, this proposed Statement expands the disclosures about certain loss contingencies by replacing the disclosure requirements of Statement 5 for

those loss contingencies with the new, enhanced disclosure requirements in this proposed Statement.

Scope

A5. Loss contingencies that are recognized as asset impairments in a statement of financial position, such as allowances for uncollectible accounts receivable and impairments of loans, are outside the scope of this proposed Statement and, therefore, would continue to be subject to the existing disclosure requirements of Statement 5. The Board has a separate project on its agenda to consider disclosures related to allowances for credit losses associated with finance receivables.

Business Combinations

A6. Loss contingencies assumed in a business combination in accordance with FASB Statement No. 141 (revised 2007), *Business Combinations*, are within the scope of this proposed Statement. The Board reasoned that those loss contingencies have a similar economic nature to loss contingencies arising from the normal operations of the entity and, thus, also should be subject to the disclosure requirements of this proposed Statement. However, because loss contingencies recognized under Statement 141(R) have a different measurement attribute than those recognized under Statement 5, the Board decided that these amounts would be shown separately in the tabular reconciliation required by paragraph 8 of this proposed Statement.

Guarantees

A7. The Board considered whether guarantees within the scope of FASB Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*, should be included in the scope of this proposed Statement. The Board determined that because of the nature of guarantees, separate disclosure requirements were needed that reflect the specific recognition and measurement guidance to which they are subject in Interpretation 45. The Board also noted that including guarantees in the tabular reconciliation required by this proposed Statement would result in additional complexity because of the various subsequent measurement methods used for guarantees. As a result, the Board decided to exclude all guarantees within the scope of Interpretation 45 from the scope of this proposed Statement. This exclusion would include guarantees for which the subsequent recognition and measurement of a guarantee within the scope of Interpretation 45 are based on the Statement 5 criteria. For those guarantees, the Board concluded that the associated liability is still within the scope of Interpretation 45 and should follow the disclosure requirements of that Interpretation.

Insurance

A8. The Board does not intend to change the accounting and disclosure requirements for insurance and reinsurance entities in this project. Accordingly, liabilities for unpaid claim costs related to insurance contracts or reinsurance contracts of an insurance entity or a

reinsurance entity are outside the scope of this proposed Statement. However, the existing disclosure requirements of Statement 5 apply in certain circumstances, as required by AICPA Statement of Position 94-5, *Disclosures of Certain Matters in the Financial Statements of Insurance Enterprises*. This Statement amends that SOP to include within its body the existing Statement 5 disclosure requirements. Similarly, liabilities for insurance-related assessments also are outside the project's scope; thus, AICPA Statement of Position 97-3, *Accounting by Insurance and Other Enterprises for Insurance-Related Assessments*, also is being amended to reflect the existing Statement 5 disclosure requirements, rather than the requirements in this proposed Statement.

A9. Loss contingencies of insurance and reinsurance entities that are unrelated to insurance or reinsurance contracts are within the scope of Statement 5; therefore, the disclosure requirements of this proposed Statement would apply to those contingencies. Additionally, loss contingencies that are self-insured are in the scope of Statement 5 and, therefore, also would be in the scope of this proposed Statement.

Multiemployer Plans

A10. The Board noted that under the existing accounting model for multiemployer plans, obligations that may result from withdrawal from a multiemployer plan represent loss contingencies that are within the scope of Statement 5. The Board decided that those loss contingencies also are in the scope of this proposed Statement.

Disclosure Principle

A11. The Board agreed to include a disclosure principle to communicate the objective of the disclosure requirements. By including an objective, an entity could better understand what information about loss contingencies should be included in the notes to the financial statements. The disclosure principle is based on paragraph 37 of FASB Concepts Statement No. 1, *Objectives of Financial Reporting by Business Enterprises*, which states that "financial reporting should provide information to help investors, creditors, and others assess the amounts, timing, and uncertainty of prospective net cash inflows to the related enterprise" (footnote reference omitted). To meet this objective, the principle requires that an entity also provide a discussion of the risks associated with loss contingencies and their actual and potential effects on the entity's financial position, cash flows, and results of operations.

Disclosure Threshold

A12. Financial statement users have stated that, on balance, the *at least reasonably possible* threshold in Statement 5 results in delayed disclosure of relevant information about loss contingencies. The disclosure threshold in this proposed Statement would expand the population of loss contingencies that are required to be disclosed, resulting in more timely disclosure of loss contingencies for financial statement users. The Board decided that this proposed Statement should require disclosures of the entire population of loss contingencies except those contingencies that meet certain narrow criteria. Disclosure would not be required for a loss contingency for which the entity has made an

assessment and determined that the likelihood of a loss is remote, except as discussed in paragraph A13. The Board wanted this proposed Statement to emphasize that an entity should make an assessment of the likelihood of loss for its population of loss contingencies each reporting period. Additionally, the Board believes that if an entity is unable to assert that the likelihood of loss is remote, it should disclose the contingency.

A13. The Board also decided to require disclosure of loss contingencies if the contingencies are expected to be resolved in the *near term* and if the contingencies could have a *severe impact* on the entity (as those terms are defined in AICPA Statement of Position 94-6, *Disclosures of Certain Significant Risks and Uncertainties*), without regard to the likelihood of loss. The Board agreed that users should be aware of all loss contingencies with the potential to have a significantly disruptive effect on the financial health or operations of an entity within one year. Initially, the Board considered requiring disclosure of all loss contingencies that could have a severe impact on the entity, without regard to the expected timing of resolution. However, the Board decided to narrow this requirement because it believes that disclosure of all contingencies that could severely affect the entity would result in disclosure of a significant amount of information that would not be cost-beneficial.

Unasserted Claims and Assessments

A14. The Board decided to substantially retain existing language from Statement 5 about unasserted claims or assessments against an entity. This language states that disclosure of a loss contingency related to an unasserted claim or assessment is not necessary unless it is probable that a claim or assessment will be asserted and the likelihood of loss, if the claim or assessment were to be asserted, is more than remote. The Board believes that unasserted claims and assessments represent a unique set of loss contingencies for which specific guidance is necessary.

Disclosure of the Claim Amount or the Maximum Exposure to Loss

A15. To enhance the quantitative disclosure requirements, the Board decided to require disclosure of the amount of the claim or assessment against an entity, or an entity's best estimate of the maximum exposure to loss if there is no claim or assessment amount. The Board decided that disclosing the claim or assessment amount would provide relevant information about the maximum potential for loss, even if it is unlikely that a loss would ever be realized in this amount. The amount of the claim is an objective amount that often can be determined by reference to court documents, which are publicly available. Therefore, it is not prejudicial to disclose this amount. Furthermore, if the entity believes that the amount of the claim or maximum exposure is not representative of the entity's actual exposure to loss, it may explain why it is unlikely that the amount would ever be incurred and what a more reasonable range of the possible loss would be. Therefore, additional disclosure of the entity's best estimate of the possible loss, or range of loss, is permitted, but not required, by this proposed Statement.

A16. The Board decided not to retain the disclosure exemption that if an amount cannot be reasonably estimated, an entity would not have to provide an amount in the disclosure

but, instead, would provide the reasons why an estimate cannot be made. Financial statement users indicated that this exemption in Statement 5 is used with such regularity that rarely does any quantitative information accompany loss contingency disclosures. They prefer to have a highly uncertain estimate supplemented with a qualitative description than no quantification of a potential loss as commonly occurs in existing practice.

Qualitative Nature of Loss Contingencies

A17. Under this proposed Statement, the required disclosures include a description of the contingency, including how it arose, its legal or contractual basis, its current status, and the anticipated timing of its resolution. The Board believes that an entity generally includes much of this information when describing the nature of the contingency under the existing Statement 5 requirements.

A18. This proposed Statement also requires disclosure of the factors that are likely to affect the ultimate outcome of the contingency along with their potential effect on the outcome, a qualitative assessment of the most likely outcome of the contingency, and any assumptions made in estimating the amounts in the quantitative disclosures and in assessing the most likely outcome. The Board decided that this information would provide users with data to perform analysis and better understand the potential future cash flows of the entity. In particular, disclosure of the factors that are likely to affect the ultimate outcome and their potential effects will assist users in making their own assessments about the likelihood of future events related to the loss contingency as well as the potential cash flows related to those future events.

Recoveries

A19. FASB Interpretation No. 39, *Offsetting of Amounts Related to Certain Contracts*, specifies the criteria that must be met in order to offset an asset and a liability in a statement of financial position. The Board believes it would be unusual for those criteria to be met in the case of a possible recovery from an insurance, indemnification, or other similar arrangement related to a loss contingency primarily because there is usually more than one counterparty involved. Accordingly, loss contingencies and their related recoveries usually must be presented separately in a statement of financial position at their gross amounts. Consistent with this presentation, the Board decided that the quantitative disclosures required by paragraph 7 and the amounts in the tabular reconciliation required by paragraph 8 of this proposed Statement should exclude the effect of possible recoveries from insurance, indemnifications, or other similar arrangements. The Board decided that information about these arrangements and any amounts recognized in the statement of position should be disclosed separately.

Aggregation of Disclosures about Loss Contingencies

A20. To simplify the disclosure presentation and reduce the possibility of disclosing prejudicial information, the Board decided that the qualitative and quantitative disclosures required by paragraph 7 may be aggregated by the nature of the contingency. The Board

believes that many financial statement preparers already aggregate their disclosures about loss contingencies in a meaningful way. Therefore, this option is not likely to result in a significant change to current practice.

Tabular Reconciliation

A21. To provide more transparency about the effects of loss contingencies on the financial statements, the Board decided to include a requirement for a tabular reconciliation for recognized loss contingencies in this proposed Statement. The Board believes that a tabular reconciliation will provide users with valuable information about significant and sensitive estimates and changes in those estimates that are subject to significant measurement judgment.

A22. The Board is aware of the concerns of financial statement preparers that information about recognized loss contingencies could be used against them in legal disputes. To address those concerns, the Board decided to allow amounts recognized for all loss contingencies to be aggregated. The Board believes that disaggregating the information in the tabular reconciliation would not incrementally improve a user's ability to predict future cash flows and may provide excess information that is not cost-beneficial. Additionally, the Board decided that the tabular reconciliation would be subject to the exemption from disclosing prejudicial information.

A23. The Board considered whether the tabular reconciliation should be required for annual periods only or for both interim and annual periods. Some Board members expressed concerns about the amount of effort required for preparers to collect and auditors to review this information in the short time available for performing these activities between the end of an interim period and the quarterly filing deadline for SEC registrants. However, a majority of Board members supported requiring the tabular reconciliation in both interim and annual financial statements because financial statement users generally consider interim information to be as important as annual information. Therefore, it is important to provide information about the effect of recognized loss contingencies on the financial statements on an interim and annual basis.

A24. The Board decided that loss contingencies whose underlying cause and ultimate settlement occur in the same period should be excluded from the tabular reconciliation. The Board reasoned that the short period of time involved in those circumstances raises questions about whether the item meets the definition of a contingency. Additionally, the Board noted that for those items, the loss is recognized in the same period as cash is paid or other assets transferred. Therefore, there is no effect on the financial statements across reporting periods, and including those items would not fulfill the purpose of the tabular reconciliation. The Board noted that, in contrast, loss contingencies initially recognized in a business combination are not recognized in earnings. The Board concluded that it was important to include those loss contingencies in the tabular reconciliation because they result in payments of cash, transfers of assets, or recognition of income for which no corresponding loss was recognized at the time of initial recognition.

Prejudicial Exemption

A25. This proposed Statement provides a limited disclosure exemption for instances in which an entity concludes that disclosing quantitative or qualitative information about a loss contingency as required by this proposed Statement, either separately or aggregated by the nature of the contingency, would be prejudicial to its position in a dispute (that is, disclosure of the information could affect, to the entity's detriment, the outcome of the contingency itself).

A26. Financial statement users generally opposed providing any exemption from disclosing prejudicial information. They stated their concern that preparers would use such an exemption excessively, resulting in no significant improvement in the quality of disclosures about loss contingencies. Financial statement preparers, on the other hand, raised concerns about being required to disclose information that would be harmful to the entity and its shareholders, who represent a significant financial statement user constituency.

A27. The Board considered those concerns and decided to include an exemption from the disclosure requirements that would strike a balance between the interest of both users and preparers. Specifically, the Board considered under what conditions such an exemption would be allowed and also considered the information that an entity would still be required to disclose if the criteria for the exemption were met. The Board decided on a two-step approach for entities to follow. In the first step, entities would be allowed to aggregate information about loss contingencies at a higher level than by the nature of the contingency. The Board believes that this step will enable preparers to disclose information that is valuable to users without enabling the counterparty in a dispute to take advantage of the information to the detriment of the entity, because the information could not be linked to its specific case. In the second step, if disclosure of the information would still be prejudicial even when aggregated at this higher level, an entity would be allowed to forgo disclosing only the information that would be prejudicial.

A28. The Board noted that a prejudicial exemption already exists under International Financial Reporting Standards. The Board considered whether to include language from paragraph 92 of IAS 37 indicating that the circumstances under which that exemption may be exercised are expected to be *extremely rare*. Some Board members felt that including this language was appropriate, as they expect the ability to first aggregate disclosures at a higher level will reduce the frequency with which a prejudicial exemption would need to be utilized. Those Board members also were sensitive to the broad concern of financial statement users that providing the exemption would result in a lack of transparency about loss contingencies (a situation that users assert exists currently).

A29. A majority of Board members, however, expressed concern about how the words *extremely rare* may be interpreted in practice. Consequently, the Board agreed that the circumstances under which a prejudicial exemption would be exercisable should be characterized as *rare* rather than *extremely rare*. The Board decided to include language clarifying that *rare* is not intended to mean *never* and that the determination of when it is

appropriate to exercise this exemption is a matter of significant judgment that depends on the facts and circumstances.

Effective Date and Transition

A30. The Board decided that this proposed Statement should be effective for annual financial statements issued for fiscal years ending after December 15, 2008, and for interim and annual financial statements thereafter. The Board believes it is important that enhanced disclosures be available to financial statement users as soon as practicable. The Board also believes that most of the information required by this proposed Statement is already available and that collecting those data from various locations in year-end reporting packages should be feasible for entities whose fiscal year ends on December 31, 2008. The Board also decided that the tabular reconciliation should not be required for earlier periods that are presented for comparative purposes, because of concerns that it may be impracticable for entities to gather the necessary information.

Similarities and Differences with International Accounting Standards

A31. Deliberations continue in the International Accounting Standards Board's (IASB's) project to reconsider IAS 37; however, those deliberations have not progressed to the point of reconsidering the disclosure requirements of IAS 37. The Exposure Draft issued by the IASB in June 2005 included disclosure requirements that are largely consistent with the existing disclosure requirements of IAS 37. Those requirements are similar to the disclosures included in this proposed Statement. The IASB is expected to evaluate the disclosure requirements in this proposed Statement when it reconsiders the IAS 37 disclosure requirements, which will provide a potential convergence opportunity. Similarly, the FASB expects to consider the IASB's decisions on recognition and measurement when it deliberates those issues in the long-term phase of this project.

A32. IAS 37 requires disclosure of the carrying amount of provisions at the beginning and end of the period as well as changes during the period. This requirement is largely consistent with the tabular reconciliation of recognized loss contingencies in this proposed Statement. Under IAS 37, separate disclosure is required for additional provisions, amounts incurred against provisions, and unused amounts reversed during the period. Increases during the period in the discounted amount arising from the passage of time and the effect of any change in the discount rate also are required to be disclosed. This proposed Statement does not require that last disclosure because contingencies usually are not measured at a discounted amount under Statement 5.

A33. This proposed Statement would require disclosures about a broader population of contingencies than required by IAS 37. Specifically, this proposed Statement would require disclosures about loss contingencies, regardless of the likelihood of loss, if the contingencies are expected to be resolved in the near term and if the contingencies could have a severe impact on the entity's financial position, cash flows, or results of operations. IAS 37 does not require disclosures for remote loss contingencies regardless of the expected timing of resolution or potential severity of the contingency.

Benefits and Costs

A34. The objective of financial reporting is to provide information that is useful to present and potential investors, creditors, donors, and other capital market participants in making rational investment, credit, and similar resource allocation decisions. However, the benefits of providing information for that purpose should justify the related costs. Current and potential investors, creditors, donors, and other users of financial information benefit from the improvements in financial reporting, while the costs to implement a new standard are borne primarily by current investors. The Board's assessment of the costs and benefits of issuing an accounting standard is unavoidably more qualitative than quantitative because there is no method to objectively measure the costs to implement an accounting standard or to quantify the value of improved information in financial statements.

A35. The Board's assessment of this proposed Statement's benefits and costs is based on discussions with preparers, auditors, regulators, and users of financial statements. The Board considered the incremental costs of providing the additional disclosure requirements, particularly the tabular reconciliation of recognized loss contingencies, and concluded that those costs do not outweigh the benefits of improved information about loss contingencies.

A36. The Board recognizes that the effort for gathering the necessary data to provide the disclosures required in this proposed Statement may be significant for some entities and that the review and audit procedures of such disclosures may require additional effort. Notwithstanding the above additional costs, these disclosures were developed with the goal of providing users of financial statements with pertinent information about potential cash flow requirements of an entity. Furthermore, the Board believes that many entities already have the information necessary to fulfill these disclosure requirements and that including the information should not require substantial additional cost or effort. The Board plans to conduct field testing of these disclosure requirements before issuing a final Statement to better assess the relative costs and benefits of the disclosures that would be required.

A37. The Board believes that this proposed Statement requires disclosures that provide more specific information about loss contingencies. This will enable users to make a more informed assessment of the likelihood, timing, and amount of future cash flows. Discussions with users and regulators, as well as the Board's research, indicated that the recognition or derecognition of a loss contingency, or a change in the estimate of a loss contingency, can have a significant impact on an entity's financial statements. Therefore, the Board concluded that the benefits of the disclosures in this proposed Statement outweigh the costs.

Appendix B

AMENDMENTS TO FASB PRONOUNCEMENTS AND OTHER AUTHORITATIVE LITERATURE

B1. FASB Statement No. 5, *Accounting for Contingencies*, is amended as follows:
[Added text is underlined and deleted text is ~~struck out~~.]

- a. Paragraph 7A, as added:

The accounting requirements in this Statement ~~do~~es not apply to contingent gains or losses that are recognized at the acquisition date in a business combination. FASB Statement No. 141 (revised 2007), *Business Combinations*, provides the subsequent accounting ~~and disclosure~~ requirements for both contingent gains ~~or~~ and contingent losses recognized as part of a business combination. The accounting requirements in this Statement ~~do~~es, however, apply to contingent gains or losses that were acquired or assumed in a business combination but that were not recognized at the acquisition date because they did not meet the recognition threshold in Statement 141(R) at that date.

- b. Paragraphs 7B and 7C are added as follows:

7B. The disclosure requirements in paragraphs 9–11 of this Statement apply to loss contingencies that are (or would be, if the recognition criteria in paragraph 8 of this Statement were met) recognized as asset impairments in a statement of financial position. Loss contingencies that are (or would be) recognized as liabilities shall be disclosed in accordance with FASB Statement No. 16x, *Disclosure of Certain Loss Contingencies*.

7C. Gain contingencies accounted for in accordance with this Statement shall be disclosed in accordance with paragraph 17 of this Statement. Gain contingencies accounted for in accordance with Statement 141(R) shall be disclosed in accordance with that Statement.

- c. Paragraphs 9–11 and the related heading and footnotes 5 and 6:

Disclosure of Loss Contingencies That Are (or Would Be) Recognized as Asset Impairments

9. Disclosure of the nature of an asset impairment recognized ~~accrual~~⁵ made pursuant to the provisions of paragraph 8, and in some circumstances the amount of that impairment ~~accrued~~, may be necessary for the financial statements not to be misleading.

10. If no asset impairment ~~accrual~~ is recognized ~~made~~ for a loss contingency because one or both of the conditions in paragraph 8 are not

met, or if an exposure to loss exists in excess of the amount recognized accrued—pursuant to the provisions of paragraph 8, disclosure of the contingency shall be made when there is at least a reasonable possibility that a loss or an additional loss may have been incurred.⁶ The disclosure shall indicate the nature of the contingency and shall give an estimate of the possible loss or range of loss or state that such an estimate cannot be made. Disclosure is not required of a loss contingency involving an unasserted claim or assessment when there has been no manifestation by a potential claimant of an awareness of a possible claim or assessment unless it is considered probable that a claim will be asserted and there is a reasonable possibility that the outcome will be unfavorable.

11. After the date of an enterprise's financial statements but before those financial statements are issued, information may become available indicating that an asset was impaired ~~or a liability was incurred~~ after the date of the financial statements or that there is at least a reasonable possibility that an asset was impaired ~~or a liability was incurred~~ after that date. The information may relate to a loss contingency that existed at the date of the financial statements, e.g., an asset that was not insured at the date of the financial statements. On the other hand, the information may relate to a loss contingency that did not exist at the date of the financial statements, e.g., threat of expropriation of assets after the date of the financial statements ~~or the filing for bankruptcy by an enterprise whose debt was guaranteed after the date of the financial statements~~. In none of the cases cited in this paragraph was an asset impaired ~~or a liability incurred~~ at the date of the financial statements, and the condition for recognition accrual in paragraph 8(a) is, therefore, not met. Disclosure of those kinds of losses or loss contingencies may be necessary, however, to keep the financial statements from being misleading. If disclosure is deemed necessary, the financial statements shall indicate the nature of the loss or loss contingency and give an estimate of the amount or range of loss or possible loss or state that such an estimate cannot be made. Occasionally, in the case of a loss arising after the date of the financial statements where the amount of the asset impairment or liability incurrence can be reasonably estimated, disclosure may best be made by supplementing the historical financial statements with pro forma financial data giving effect to the loss as if it had occurred at the date of the financial statements. It may be desirable to present pro forma statements, usually a statement of financial position balance sheet only, in columnar form on the face of the historical financial statements.

⁵Terminology used shall be descriptive of the nature of the accrual (see paragraphs 57-64 of *Accounting Terminology Bulletin No. 1*, "Review and Resume").

⁶For example, disclosure shall be made of any loss contingency that meets the condition in paragraph 8(a) but that is not accrued because the amount of loss cannot be reasonably estimated (paragraph 8(b)). Disclosure is also required of some loss contingencies that do not meet the condition in paragraph 8(a)—namely, those contingencies for which there is a *reasonable possibility* that a loss may have been incurred even though information may not

indicate that it is *probable* that an asset had been impaired or a liability had been incurred at the date of the financial statements.

d. Paragraph 12:

~~Certain loss contingencies are presently being disclosed in financial statements even though the possibility of loss may be remote. The common characteristic of those contingencies is a guarantee, normally with a right to proceed against an outside party in the event that the guarantor is called upon to satisfy the guarantee. Examples include (a) guarantees of indebtedness of others, (b) obligations of commercial banks under “standby letters of credit,” and (c) guarantees to repurchase receivables (or, in some cases, to repurchase the related property) that have been sold or otherwise assigned. The Board concludes that disclosure of those loss contingencies, and others that in substance have the same characteristic, shall be continued. The disclosure shall include the nature and amount of the guarantee. Consideration should be given to disclosing, if estimable, the value of any recovery that could be expected to result, such as from the guarantor’s right to proceed against an outside party.~~

e. Paragraph 25:

If, based on available information, it is probable that customers will make claims under warranties relating to goods or services that have been sold, the condition in paragraph 8(a) is met at the date of an enterprise’s financial statements because it is probable that a liability has been incurred. Satisfaction of the condition in paragraph 8(b) will normally depend on the experience of an enterprise or other information. In the case of an enterprise that has no experience of its own, reference to the experience of other enterprises in the same business may be appropriate. Inability to make a reasonable estimate of the amount of a warranty obligation at the time of sale because of significant uncertainty about possible claims (i.e., failure to satisfy the condition in paragraph 8(b)) precludes accrual and, if the range of possible loss is wide, may raise a question about whether a sale should be recorded prior to expiration of the warranty period or until sufficient experience has been gained to permit a reasonable estimate of the obligation; in addition, the disclosures called for by paragraphs ~~13–16~~ 10 of FASB Interpretation No. 45, *Guarantor’s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*, ~~this Statement~~ should be made.

f. Paragraph 34:

As a condition for accrual of a loss contingency, paragraph 8(a) requires that information available prior to the issuance of financial statements indicate that it is probable that an asset had been impaired or a liability had been incurred at the date of the financial statements. Accordingly, accrual would clearly be inappropriate for litigation, claims, or assessments whose

underlying cause is an event or condition occurring after the date of financial statements but before those financial statements are issued, for example, a suit for damages alleged to have been suffered as a result of an accident that occurred after the date of the financial statements. Disclosure may be required, however, by Statement 16x~~paragraph 11~~.

g. Paragraphs 37 and 38 and 39, as amended:

37. The filing of a suit or formal assertion of a claim or assessment does not automatically indicate that accrual of a loss may be appropriate. The degree of probability of an unfavorable outcome must be assessed. The condition for accrual in paragraph 8(a) would be met if an unfavorable outcome is determined to be probable. If an unfavorable outcome is determined to be reasonably possible but not probable, or if the amount of loss cannot be reasonably estimated, accrual would be inappropriate, but disclosure would be required by Statement 16x~~paragraph 10 of this Statement~~.

38. With respect to unasserted claims and assessments, an enterprise must determine the degree of probability that a suit may be filed or a claim or assessment may be asserted and the possibility of an unfavorable outcome. For example, a catastrophe, accident, or other similar physical occurrence predictably engenders claims for redress, and in such circumstances their assertion may be probable; similarly, an investigation of an enterprise by a governmental agency, if enforcement proceedings have been or are likely to be instituted, is often followed by private claims for redress, and the probability of their assertion and the possibility of loss should be considered in each case. By way of further example, an enterprise may believe there is a possibility that it has infringed on another enterprise's patent rights, but the enterprise owning the patent rights has not indicated an intention to take any action and has not even indicated an awareness of the possible infringement. In that case, a judgment must first be made as to whether the assertion of a claim is probable. If the judgment is that assertion is not probable, no accrual ~~or disclosure~~ would be required. On the other hand, if the judgment is that assertion is probable, then a second judgment must be made as to the degree of probability of an unfavorable outcome. If an unfavorable outcome is probable and the amount of loss can be reasonably estimated, accrual of a loss is required by paragraph 8. If an unfavorable outcome is probable but the amount of loss cannot be reasonably estimated, accrual would not be appropriate, ~~but disclosure would be required by paragraph 10. If an unfavorable outcome is reasonably possible but not probable, disclosure would be required by paragraph 10.~~ Disclosures shall be made in accordance with Statement 16x.

39. As a condition for accrual of a loss contingency, paragraph 8(b) requires that the amount of loss can be reasonably estimated. In some cases, it may be determined that a loss was incurred because an unfavorable outcome of the litigation, claim, or assessment is probable (thus satisfying

the condition in paragraph 8(a)), but the range of possible loss is wide. For example, an enterprise may be litigating a dispute with another party. In preparation for the trial, it may determine that, based on recent developments involving one aspect of the litigation, it is probable that it will have to pay \$2 million to settle the litigation. Another aspect of the litigation may, however, be open to considerable interpretation, and depending on the interpretation by the court the enterprise may have to pay an additional \$8 million over and above the \$2 million. In that case, paragraph 8 requires accrual of the \$2 million if that is considered a reasonable estimate of the loss. Additionally, disclosures shall be made in accordance with Statement 16x~~Paragraph 10 requires disclosure of the additional exposure to loss if there is a reasonable possibility that the additional amounts will be paid. Depending on the circumstances, paragraph 9 may require disclosure of the \$2 million that was accrued.~~

B2. FASB Statement No. 15, *Accounting by Debtors and Creditors for Troubled Debt Restructurings*, is amended as follows:

a. Paragraph 26:

A debtor shall disclose in financial statements for periods after a troubled debt restructuring the extent to which amounts contingently payable are included in the carrying amount of restructured payables pursuant to the provisions of paragraph 18. ~~If required by paragraphs 9-13 of FASB Statement No. 5, a~~ A debtor shall also disclose in those financial statements total amounts that are contingently payable on restructured payables and the conditions under which those amounts would become payable or would be forgiven.

B3. FASB Statement No. 87, *Employers' Accounting for Pensions*, is amended as follows:

a. Paragraph 70:

In some situations, withdrawal from a multiemployer plan may result in an employer's having an obligation to the plan for a portion of its unfunded benefit obligations. ~~If w~~ Withdrawal under circumstances that would give rise to an obligation shall be accounted for in accordance with is either probable or reasonably possible, the provisions of FASB Statement No. 5, Accounting for Contingencies, and shall be disclosed in accordance with FASB Statement No. 16x, Disclosure of Certain Loss Contingencies shall apply. Paragraph 7 of Statement 5 is amended to delete the references to accounting for pension cost and Opinion 8.

B4. FASB Statement No. 88, *Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits*, is amended as follows:

- a. Footnote 13 to paragraph C26:

Paragraph 70 of Statement 87 states, in part: “In some situations, withdrawal from a multiemployer plan may result in an employer’s having an obligation to the plan for a portion of its unfunded benefit obligations. ~~If~~ Withdrawal under circumstances that would give rise to an obligation shall be accounted for in accordance with is either probable or reasonably possible, the provisions of FASB Statement No. 5, Accounting for Contingencies, and shall be disclosed in accordance with FASB Statement No. 16x, Disclosure of Certain Loss Contingencies shall apply.”

B5. FASB Statement No. 106, *Employers’ Accounting for Postretirement Benefits Other Than Pensions*, is amended as follows:

- a. Paragraph 83:

In some situations, withdrawal from a multiemployer plan may result in an employer’s having an obligation to the plan for a portion of the plan’s unfunded accumulated postretirement benefit obligation. If it is ~~either probable or reasonably possible~~ that (a) an employer would withdraw from the plan under circumstances that would give rise to an obligation or (b) an employer’s contribution to the fund would be increased during the remainder of the contract period to make up a shortfall in the funds necessary to maintain the negotiated level of benefit coverage (a “maintenance of benefits” clause), the employer shall apply the accounting guidance in provisions of FASB Statement No. 5, Accounting for Contingencies. Disclosure shall be made in accordance with FASB Statement No. 16x, Disclosure of Certain Loss Contingencies.

B6. FASB Statement No. 132 (revised 2003), *Employers’ Disclosures about Pensions and Other Postretirement Benefits*, is amended as follows:

- a. Paragraph 13:

In some situations, withdrawal from a multiemployer plan may result in an employer having an obligation to the plan for a portion of the unfunded benefit obligation of the pension plans and other postretirement benefit plans. ~~If~~ Withdrawal under circumstances that would give rise to an obligation shall be accounted for in accordance with is either probable or reasonably possible, the provisions of FASB Statement No. 5, Accounting for Contingencies, and shall be disclosed in accordance with FASB Statement No. 16x, Disclosure of Certain Loss Contingencies shall apply (Statement 87, paragraph 70). If it is more than remote~~either probable or reasonably possible~~ that (a) an employer would withdraw from the plan under circumstances that would give rise to an obligation or (b) an employer’s contribution to the fund would be increased during the remainder of the contract period to make up a shortfall in the funds

necessary to maintain the negotiated level of benefit coverage (a “maintenance of benefits” clause), the employer shall apply the accounting guidance in provisions of Statement 5 and the disclosure guidance in Statement 16x (Statement 106, paragraph 83).

B7. FASB Statement No. 141 (revised 2007), *Business Combinations*, is amended as follows:

a. Paragraph 68(j):

For assets ~~and liabilities~~ arising from gain contingencies:

- (1) The amounts recognized at the acquisition date or an explanation of why no amount was recognized (paragraph 24)
- (2) The nature of recognized and unrecognized gain contingencies
- (3) An estimate of the range of outcomes (undiscounted) for gain contingencies (recognized and unrecognized) or, if a range cannot be estimated, that fact and the reasons why a range cannot be estimated.

An acquirer may aggregate disclosures for assets ~~and liabilities~~ arising from gain contingencies that are similar in nature.

b. Paragraph 68(jj) is added as follows:

For liabilities arising from loss contingencies:

- (1) The amounts recognized at the acquisition date or an explanation of why no amount was recognized (paragraph 24)
- (2) The disclosures required by FASB Statement No. 16x, *Disclosure of Certain Loss Contingencies*.

c. Paragraph 72(c):

For each reporting period after the acquisition date until the acquirer collects, sells, or otherwise loses the right to recognized assets arising from gain contingencies, ~~or the acquirer settles recognized liabilities or its obligation to settle them is cancelled or expires:~~

- (1) Any changes in the recognized amounts of assets ~~and liabilities~~ arising from gain contingencies and the reasons for those changes
- (2) Any changes in the range of outcomes (undiscounted) for both recognized and unrecognized assets ~~and liabilities~~ arising from gain contingencies and the reasons for those changes.

d. Paragraph 72(cc) is added as follows:

For each reporting period after the acquisition date until the acquirer settles recognized liabilities or its obligation to settle them is cancelled or expires, the disclosures required by Statement 16x.

B8. FASB Interpretation No. 14, *Reasonable Estimation of the Amount of a Loss*, is amended as follows:

a. Paragraphs 3–7:

3. When condition (a) in paragraph 8 is met with respect to a particular loss contingency and the reasonable estimate of the loss is a range, condition (b) in paragraph 8 is met and an amount shall be accrued for the loss. When some amount within the range appears at the time to be a better estimate than any other amount within the range, that amount shall be accrued. When no amount within the range is a better estimate than any other amount, however, the minimum amount in the range shall be accrued.¹ If the loss is recognized as an asset impairment in the statement of financial position, the disclosures in paragraphs 9 and 10 of Statement 5 are required. If the loss is recognized as a liability in the statement of financial position, disclosure should be made in accordance with FASB Statement No. 16x, *Disclosure of Certain Loss Contingencies*.~~In addition, paragraph 9 of the Statement may require disclosure of the nature and, in some circumstances, the amount accrued, and paragraph 10 requires disclosure of the nature of the contingency and the additional exposure to loss if there is at least a reasonable possibility of loss in excess of the amount accrued.~~

4. As an example, assume that an enterprise is involved in litigation at the close of its fiscal year ending December 31, 1976, and information available indicates that an unfavorable outcome is probable. Subsequently, after a trial on the issues, a verdict unfavorable to the enterprise is handed down, but the amount of damages remains unresolved at the time the financial statements are issued. Although the enterprise is unable to estimate the exact amount of loss, its reasonable estimate at the time is that the judgment will be for not less than \$3 million or more than \$9 million. No amount in that range appears at the time to be a better estimate than any other amount. *FASB Statement No. 5* requires accrual of the \$3 million at December 31, 1976, and the disclosures in Statement 16x are required~~disclosure of the nature of the contingency and the exposure to an additional amount of loss of up to \$6 million, and possibly disclosure of the amount of the accrual.~~

5. The same answer would result under the example in paragraph 4 above if it is probable that a verdict will be unfavorable even though the trial has not been completed before the financial statements are issued. In that situation, condition (a) in paragraph 8 would be met because information available to the enterprise indicates that an unfavorable verdict is probable. An assessment that the range of loss is between \$3 million and \$9 million would meet condition (b) in paragraph 8. If no single amount in that range is a better estimate than any other amount, *FASB Statement No. 5* requires an accrual of \$3 million at December 31, 1976, and the disclosures in Statement 16x are required~~disclosure of the nature of the contingency and~~

~~the exposure to an additional amount of loss of up to \$6 million, and possibly disclosure of the amount of the accrual. Note, however, that if the enterprise had assessed the verdict differently (e.g., that an unfavorable verdict was *not* probable but was only reasonably possible), condition (a) in paragraph 8 would not have been met and no amount of loss would be accrued but the disclosures in Statement 16x would still be required nature of the contingency and any amount of loss that is reasonably possible would be disclosed.~~

6. Assume that in the examples given in paragraphs 4 and 5 above condition (a) in paragraph 8 has been met and a reasonable estimate of loss is a range between \$3 million and \$9 million but a loss of \$4 million is a better estimate than any other amount in that range. In that situation, *FASB Statement No. 5* requires accrual of \$4 million, and the disclosures in Statement 16x are required disclosure of the nature of the contingency and the exposure to an additional amount of loss of up to \$5 million, and possibly disclosure of the amount of the accrual.

~~7. As a further example, assume that at December 31, 1976 an enterprise has an investment of \$1,000,000 in the securities of another enterprise that has declared bankruptcy, and there is no quoted market price for the securities. Condition (a) in paragraph 8 has been met because information available indicates that the value of the investment has been impaired, and a reasonable estimate of loss is a range between \$300,000 and \$600,000. No amount of loss in that range appears at the time to be a better estimate of loss than any other amount. *FASB Statement No. 5* requires accrual of the \$300,000 loss at December 31, 1976, disclosure of the nature of the contingency and the exposure to an additional amount of loss of up to \$300,000, and possibly disclosure of the amount of the accrual.~~

B9. EITF Issue No. 03-8, "Accounting for Claims-Made Insurance and Retroactive Insurance Contracts by the Insured Entity," is amended as follows:

a. Paragraph 26:

The Task Force discussed what disclosures would be appropriate when an enterprise changes from occurrence-based insurance to claims-made insurance or elects to significantly reduce or eliminate its insurance coverage. Members of the Task Force noted that paragraph 10 of Statement 5 requires disclosure if it is at least reasonably possible that a loss has been incurred. That paragraph also discusses disclosure with respect to unasserted claims. Statement 16x, which is effective for annual financial statements issued for fiscal years ending after December 15, 2008, and interim and annual periods in subsequent fiscal years, replaces the disclosure requirements in Statement 5 for loss contingencies that are (or would be, if the recognition criteria were met) recognized as liabilities in a statement of financial position. Upon adoption of Statement 16x, an entity

should disclose loss contingencies, whether insured or uninsured, in accordance with that Statement, rather than in accordance with Statement 5. [Note: See STATUS section.]

b. Paragraph 30:

No further EITF discussion is planned. Statement 16x, which is effective for annual financial statements issued for fiscal years ending after December 15, 200x, and interim and annual periods in subsequent fiscal years, replaces the disclosure requirements in Statement 5 for loss contingencies that are (or would be, if the recognition criteria were met) recognized as liabilities in a statement of financial position. Issue 5 addresses the disclosures that should be made by an entity that changes from occurrence-based to claims-made insurance or that elects to significantly reduce or eliminate its insurance coverage. Upon adoption of Statement 16x, an entity should disclose loss contingencies, whether insured or uninsured, in accordance with that Statement, rather than in accordance with Statement 5.

c. Paragraph 31 is added as follows:

No further EITF discussion is planned.

B10. AICPA Audit and Accounting Guide, *Federal Government Contractors*, is amended as follows:

a. Paragraph 3.43:

The rights of the contracting parties in a default termination of a fixed-price contract differ significantly from those in a convenience termination; consequently, the accounting must reflect these differences. Accordingly, contractors should record, in addition to normal contract liabilities, those liabilities arising from a default termination (for example, damages, excess procurement costs, and progress payments to be repaid). Termination for default may result in a reduction of previously recorded earnings. In such cases, adjustments of prior-period amounts are not appropriate. Instead, the resulting income effect should be included in the loss on termination of the contract in the current period as a change in an accounting estimate in conformity with FASB Statement No. 154. If material in amount, such loss should be reported as a separate item in the income statement or otherwise disclosed in the notes to the financial statements in conformity with FASB Statement No. ~~5~~16x, *Disclosure of Certain Loss Contingencies*.

b. Paragraph 3.44:

Generally, the effect of a contract termination should be reflected in the financial statements of the contractor in the period in which the termination occurs, or earlier if the termination is a subsequent event occurring prior to issuance of the financial statements and attributable to conditions that

existed at the date of the balance sheet. However, if sufficient information is not available to predict the effect of a very recent termination, then the best information available should be disclosed in the notes to financial statements in conformity with FASB Statement No. ~~5~~16x.

c. Paragraph 3.46:

Significant uncertainties may exist about the recoverability of costs in a termination claim, particularly in cases of termination for default. Such termination may create additional uncertainties regarding possible liabilities for damages or excess procurement costs. ~~As required by paragraphs 8 through 10 of FASB Statement No. 5, a~~A determination should be made about the probability that a loss has been incurred and whether an amount can be estimated. Based on this determination, such liabilities should be recorded as required by paragraph 8 of FASB Statement No. 5 and ~~or disclosed in accordance with FASB Statement 16x.~~

d. Paragraph 3.87:

Defective pricing. As discussed in Chapter 2, the Truth in Negotiations Act permits the government to make contract price reductions if a contractor fails to submit certified accurate, current, and complete cost or pricing data before award of certain negotiated contracts or contract amendments. When defective pricing exists, contract prices, including profit or fee, may be adjusted, and disclosure should be made if the amounts are material. Instances may occur when defective pricing may be alleged by the government but disputed by the contractor. In these cases, consideration of the circumstances (including consultation with legal counsel) and judgment is required. If the potential amounts involved are material, disclosure in the notes to financial statements should be made in accordance with FASB Statement No. ~~5~~16x.

B11. AICPA Statement of Position 90-7, *Financial Reporting by Entities in Reorganization Under the Bankruptcy Code*, is amended as follows:

a. Paragraph .24:

Prepetition liabilities, including claims that become known after a petition is filed, should be reported on the basis of the expected amount of the allowed claims in accordance with FASB Statement No. 5, *Accounting for Contingencies*, as opposed to the amounts for which those allowed claims may be settled. Claims not subject to reasonable estimation should be disclosed in the notes to the financial statements based on the provisions of FASB Statement No. ~~5~~16x, *Disclosure of Certain Loss Contingencies*. Once these claims satisfy the accrual provisions of FASB Statement No. 5, they should be recorded in the accounts in accordance with the first sentence of this paragraph.

B12. AICPA Statement of Position 94-5, *Disclosures of Certain Matters in the Financial Statements of Insurance Enterprises*, is amended as follows:

a. Paragraph .12:

If an insurance enterprise has recognized a liability for unpaid claims and claim adjustment expenses for difficult-to-estimate liabilities (such as for claims for toxic waste cleanup, asbestos-related illnesses, or other environmental remediation exposures), disclosure of the nature of the liability recognized, and in some circumstances the amount recognized, may be necessary so the financial statements are not misleading. If no liability has been recognized, or if an exposure to loss exists in excess of the amount recognized, disclosure of the contingent unpaid claims and claim adjustments shall be made when there is at least a reasonable possibility that a loss or an additional loss may have been incurred. The disclosure shall indicate the nature of the contingent unpaid claims or claim adjustments and shall give an estimate of the possible loss or range of loss or state that such an estimate cannot be made. Disclosure is not required of an unasserted claim when there has been no manifestation by a potential claimant of an awareness of a possible claim unless it is considered probable that a claim will be asserted and there is a reasonable possibility that the outcome will be unfavorable. In addition to ~~the~~ these disclosures and those required by FASB Statement No. 5 and other accounting pronouncements, insurance enterprises should disclose management's policies and methodologies for estimating the liability for unpaid claims and claim adjustment expenses for difficult-to-estimate liabilities, such as for claims for toxic waste cleanup, asbestos-related illnesses, or other environmental remediation exposures.

b. Paragraph .15, subparagraph A-4:

The following is an illustration of an insurance enterprise disclosure designed to meet the requirements of paragraph .12 of this SOP to disclose management's policies and methodologies for estimating the liability for unpaid claims and claim adjustment expenses for difficult-to-estimate liabilities. (Additional disclosures about the liabilities for unpaid claims and claim adjustment expenses may be required under paragraph .12 of this SOP, FASB Statement No. 5, FASB Interpretation 14, *Reasonable Estimation of the Amount of a Loss*, AICPA SOP 94-6, and SEC requirements.)

[For ease of use, the note, which is unaffected by this Statement, has been omitted.]

B13. AICPA Statement of Position 94-6, *Disclosure of Certain Significant Risks and Uncertainties*, is amended as follows:

a. Paragraph .05:

The disclosure requirements of this SOP in many circumstances are similar to or overlap the disclosure requirements in certain pronouncements of the Financial Accounting Standards Board (FASB), such as FASB Statement of Financial Accounting Standards No. 5, *Accounting for Contingencies*, FASB Statement No. 16x, *Disclosure of Certain Loss Contingencies*, and, for public business enterprises, FASB Statement No. 14, *Financial Reporting for Segments of a Business Enterprise*.^{*} The disclosure requirements of this SOP in many circumstances also are similar to or overlap the disclosure requirements in certain pronouncements of the Securities and Exchange Commission (SEC). This SOP does not alter the requirements of any FASB or SEC pronouncement.

b. Paragraph .12:

Various accounting pronouncements require disclosures about uncertainties addressed by those pronouncements. In particular, paragraphs 9 through ~~11~~¹², and 17b, and footnote 6 of FASB Statement No. 5, and paragraphs 4 through 11 of FASB Statement No. 16x, *Disclosure of Certain Loss Contingencies*, specify disclosures to be made about contingencies⁶ that exist at the date of the financial statements. The disclosure requirements of ~~paragraphs 9 through 12 of Statement No. 5 and Statement No. 16x~~ are further clarified in FASB Interpretation No. 14, *Reasonable Estimation of the Amount of a Loss*. In addition to disclosures required by FASB Statement No. 5, FASB Statement No. 16x, and other accounting pronouncements, this SOP requires disclosures regarding estimates used in the determination of the carrying amounts of assets or liabilities or in disclosure of gain or loss contingencies, as described below.

c. Paragraph .14:

The disclosure should indicate the nature of the uncertainty and include an indication that it is at least reasonably possible⁸ that a change in the estimate will occur in the near term.⁹ ~~If the estimate involves a loss contingency covered by FASB Statement No. 5, the disclosure also should include an estimate of the possible loss or range of loss, or state that such an estimate cannot be made.~~ Disclosure of the factors that cause the estimate to be sensitive to change is encouraged but not required.

d. Paragraph .16:

This SOP's disclosure requirements are separate from and do not change in any way the disclosure requirements or criteria of FASB Statement No. 5 or

FASB Statement No. 16x; rather, the disclosures required under this SOP supplement the disclosures required under those Statements~~Statement No. 5~~ as follows:

- If an estimate (including estimates that involve contingencies recognized in accordance with ~~covered by~~ FASB Statement No. 5 or disclosed in accordance with either FASB Statement No. 5 or FASB Statement No. 16x) meets the criteria for disclosure under paragraph .13 of this SOP, this SOP requires disclosure of an indication that it is at least reasonably possible that a change in the estimate will occur in the near term; FASB Statement No. 5 does not distinguish between near-term and long-term contingencies.
 - An estimate that does not involve a contingency covered by Statement No. 5 or Statement No. 16x, such as estimates associated with long-term operating assets and amounts reported under profitable long-term contracts, may meet the criteria in paragraph .13. This SOP requires disclosure of the nature of the estimate and an indication that it is at least reasonably possible that a change in the estimate will occur in the near term.
- e. The note under the heading “Certain Significant Estimates” in paragraph .27 (between subparagraphs A-10 and A-11) of Appendix A:

Note: Some of the following disclosures contain certain information that is already required to be disclosed under FASB Statement No. 5 and FASB Statement No. 16x; in those cases, the following disclosures illustrate that the FASB Statement No. 5 and FASB Statement No. 16x disclosure requirements are supplemented by an indication that it is at least reasonably possible that a change in an estimate will occur in the near term. They are not intended to illustrate all of the disclosure requirements of FASB Statement No. 5 and FASB Statement No. 16x. Others may not be covered by FASB Statement No. 5 or FASB Statement No. 16x.

- f. Paragraph .28, subparagraph B-23:

FASB Statement No. 5 requires reporting entities to disclose certain loss contingencies, as follows:

~~If no accrual is made for a loss contingency because one or both of the conditions in paragraph 8 are not met, or if an exposure to loss exists in excess of the amount accrued pursuant to the provisions of paragraph 8, disclosure of the contingency shall be made when there is at least a reasonable possibility that a loss or an additional loss may have been incurred.⁶ The disclosure shall indicate the nature of the contingency and shall give an estimate of the possible loss or range of loss or state that such an estimate cannot be made. [Emphasis added.] [FASB Statement No. 5, paragraph 10]~~

Footnote 6 to Statement No. 5 states:

~~For example, disclosure shall be made of any loss contingency that meets the condition in paragraph 8(a) but that is not accrued because the amount of loss cannot be reasonably estimated (paragraph 8(b)). Disclosure is also required of some loss contingencies that do not meet the condition in paragraph 8(a)—namely, those contingencies for which there is a *reasonable possibility* that a loss may have been incurred even though information may not indicate that it is *probable* that an asset has been impaired or a liability had been incurred at the date of the financial statements. [Emphasis in original.]~~

FASB Statement No. 5 defines loss contingencies as:

~~an existing condition, situation, or set of circumstances involving uncertainty as to possible . . . loss . . . to an enterprise that will ultimately be resolved when one or more future events occur or fail to occur. Resolution of the uncertainty may confirm the acquisition of an asset or the reduction of a liability or the loss or impairment of an asset or the incurrence of a liability. [paragraph 1]~~

~~The recognition and disclosure requirements of Statement No. 5 are further clarified in FASB Interpretation No. 14, *Reasonable Estimation of the Amount of a Loss*. This SOP does not change the requirements of FASB Statement No. 5 or FASB Interpretation No. 14; the requirements of this SOP supplement those requirements. For example, ~~if~~ if a loss contingency meets the criteria for disclosure under ~~both either~~ either Statement No. 5 or Statement No. 16x and paragraph .13 of this SOP, this SOP requires disclosure that it is at least reasonably possible that future events confirming the fact of the loss or the change in the estimated amount of the loss will occur in the near term.~~

B14. AICPA Statement of Position 96-1, *Environmental Remediation Liabilities*, is amended as follows:

a. Paragraph .123:

Two kinds of costs that may be involved in environmental remediation situations are not discussed in this chapter. These costs—natural resource damages and toxic torts—are identified in paragraphs .21 and .48 through .50 in chapter 2 of this SOP. Concepts and practices with respect to natural resource damages are still evolving, and third-party suits are too case-specific for general guidance. The accounting guidance with respect to litigation [FASB Statement No. 5, especially paragraphs 33 through 39, and FASB Statement No. 16x, *Disclosure of Certain Loss Contingencies*] should be considered in accounting for and the disclosure of such costs.

b. Paragraphs .155 and .156:

.155 FASB Statement No. ~~5~~16x provides the primary guidance applicable to disclosures of environmental remediation loss contingencies. ~~Paragraphs 9 and 10 of FASB Statement No. 5 state:~~

~~9. Disclosure of the nature of an accrual made pursuant to the provisions of paragraph 8 [of Statement No. 5], and in some circumstances the amount accrued, may be necessary for the financial statements not to be misleading.~~

~~10. If no accrual is made for a loss contingency because one or both of the conditions in paragraph 8 are not met, or if an exposure to loss exists in excess of the amount accrued pursuant to the provisions of paragraph 8, disclosure of the contingency shall be made when there is at least a reasonable possibility that a loss or an additional loss may have been incurred. The disclosure shall indicate the nature of the contingency and shall give an estimate of the possible loss or range of loss or state that such an estimate cannot be made. Disclosure is not required of a loss contingency involving an unasserted claim or assessment when there has been no manifestation by a potential claimant of an awareness of a possible claim or assessment unless it is considered probable that a claim will be asserted and there is a reasonable possibility that the outcome will be unfavorable. [footnotes omitted]~~

.156 The disclosure requirements of SOP 94-6, *Disclosure of Certain Significant Risks and Uncertainties*, also apply to environmental remediation liabilities. SOP 94-6, paragraphs 12 through 14 state in part:

12. In addition to disclosures required by FASB Statement No. 5, FASB Statement No. 16x, and other accounting pronouncements, this SOP requires disclosures regarding estimates used in the determination of the carrying amounts of assets or liabilities or disclosure of gain or loss contingencies, as described below.

13. Disclosure regarding an estimate should be made when known information available prior to issuance of the financial statements indicates that *both* of the following criteria are met:

- It is at least reasonably possible that the estimate of the effect on the financial statements of a condition, situation, or set of circumstances that existed at the date of the financial statements will change in the near term due to one or more future confirming events.
- The effect of the change would be material to the financial statements.

14. The disclosure should indicate the nature of the uncertainty and include an indication that it is at least reasonably possible that a change in the estimate will occur in the near term. ~~If the estimate involves a loss contingency covered by FASB Statement No. 5, the disclosure also should include an estimate of the possible loss or range of loss or state that such an estimate cannot be made.~~ Disclosure of the factors that cause the estimate to be sensitive to change is encouraged but not required.

- c. Footnote 15 to paragraph .158:

Nothing in this SOP eliminates disclosures that are required by FASB Statement No. ~~5~~¹⁶ or SOP 94-6.

- d. Paragraph .159:

~~Paragraphs 9 and 10 of FASB Statement No. 5 provide for disclosures related to three different aspects of loss contingencies: (a) recognized losses and reasonably possible (additional) loss exposures, (b) probable but not reasonably estimable losses, and (c) unasserted claims. Following are the disclosures that are required or encouraged by Statement No. 5, SOP 94-6, and this SOP for each aspect.~~

- e. Paragraph .160 and its related footnote 16:

~~If the FASB Statement No. 5 criteria of remote, reasonably possible, and probable were mapped onto a range of likelihood of the existence of a loss spanning from zero to 100 percent, the reasonably possible portion would span a significant breadth of the range starting from remote and ending with probable. The potential outcomes of environmental remediation loss contingencies often span a range of possibilities. If a loss is deemed probable and it is reasonably estimable, it is recognized; however, beyond the recognized losses, there may be additional exposure to loss that is reasonably possible. This often happens in situations in which a range of possible outcomes is identified and, in accordance with FASB Interpretation No. 14, the entity records either a best estimate within the range or the minimum amount in the range, thus leaving unrecorded amounts of additional possible loss for the higher cost outcomes.¹⁶ In other situations, no loss may be probable, but a loss is reasonably possible. There may also be situations where a loss is probable, but no amount that would be material to the entity is reasonably estimable (see the subsequent section entitled “Probable But Not Reasonably Estimable Losses” in paragraphs .165 through .167).~~

¹⁶~~When an overall liability is estimated by combining estimates of various components of the liability, additional possible losses present in the component estimates must be considered in determining an overall additional possible loss.~~

f. Paragraphs .161–.164:

~~.161 With respect to recorded accruals for environmental remediation loss contingencies and assets for third-party recoveries related to environmental remediation obligations, in addition to the disclosures required by FASB Statement No. 16x, financial statements should disclose the following:~~

- ~~a. The nature of the accruals, if such disclosure is necessary for the financial statements not to be misleading, and, in situations where disclosure of the nature of the accruals is necessary, the total amount accrued for the remediation obligation, if such disclosure is also necessary for the financial statements not to be misleading~~
- ~~b. If any portion of the accrued obligation is discounted, the undiscounted amount of the obligation and the discount rate used in the present-value determinations, if any portion of the accrued obligation is discounted~~
- ~~c. If the criteria of SOP 94-6 are met with respect to the accrued obligation or to any recognized asset for third party recoveries, an indication that it is at least reasonably possible that a change in the estimate of the obligation or of the asset will occur in the near term~~

~~.162 With respect to reasonably possible loss contingencies, including reasonably possible loss exposures in excess of the amount accrued, financial statements should disclose the following:~~

- ~~a. The nature of the reasonably possible loss contingency, that is, a description of the reasonably possible remediation obligation, and an estimate of the possible loss exposure or the fact that such an estimate cannot be made~~
- ~~b. If the criteria of SOP 94-6 are met with respect to estimated loss (or gain) contingencies, an indication that it is at least reasonably possible that a change in the estimate will occur in the near term~~

~~.163 Entities also are encouraged, but not required, to disclose the following:~~

- ~~a. The estimated time frame of disbursements for recorded amounts if expenditures are expected to continue over the long term~~
- ~~b. The estimated time frame for realization of recognized probable recoveries, if realization is not expected in the near term~~
- ~~c. If the criteria of SOP 94-6 are met with respect to the accrued obligation, to any recognized asset for third party recoveries, or to reasonably possible loss exposures or disclosed gain contingencies, the factors that cause the estimate to be sensitive to change~~
- ~~d. If an estimate of the probable or reasonably possible loss or range of loss cannot be made, the reasons why it cannot be made~~

- e. If information about the ~~reasonably~~ possible loss or the recognized and additional ~~unrecognized~~ ~~reasonably~~ possible loss for an environmental remediation obligation related to an individual site is relevant to an understanding of the financial position, cash flows, or results of operations of the entity, the following with respect to the site:
- The total amount accrued for the site
 - ~~The nature of any reasonably possible loss contingency or additional loss, and an estimate of the possible loss or the fact that an estimate cannot be made and the reasons why it cannot be made~~
 - Whether other PRPs are involved and the entity's estimated share of the obligation
 - ~~The status of regulatory proceedings~~
 - ~~The estimated time frame for resolution of the contingency~~

~~.164~~ The following is an illustration of disclosure for a situation in which —

- ~~a. An entity is involved in a single environmental site at which a number of potential outcomes may occur.~~
- ~~b. There is a probable, reasonably estimable recovery from a third party.~~
- ~~c. The entity has accrued for the most likely outcome within a range of possible outcomes for each component.~~
- ~~d. The nature of the amounts accrued for remediation and the related probable recovery are necessary to be disclosed in order for the financial statements not to be misleading.~~
- ~~e. There is a reasonably possible loss exposure in excess of the amount accrued that is material and it is reasonably possible that a change in estimate that would be material to the financial statements will occur in the near term.~~

Information that is not required is italicized and enclosed in brackets.

~~Enterprise A has been notified by the United States Environmental Protection Agency (EPA) that it is a potentially responsible party (PRP) under Superfund legislation [with respect to XYZ site in Sometown, USA, a disposal site previously used in its chemical fertilizer business. The EPA has also identified ten other PRPs for XYZ. A remedial investigation and feasibility study has been completed, and the results of that study have been forwarded to the EPA. The study indicates a range of viable remedial approaches, but agreement has not yet been reached with the EPA on the final remediation approach. The PRP group has preliminarily agreed to an allocation that sets Enterprise A's share of the cost of remediating XYZ site at 6 percent.] Enterprise A has accrued its best estimate of its obligation with respect to the site at December 31,~~

~~199X, [which is \$10 million and which is included in long-term liabilities and is expected to be disbursed over the next ten years. If certain of the PRPs are ultimately not able to fund their allocated shares or the EPA insists on a more expensive remediation approach,] Enterprise A could incur additional obligations of up to \$7 million. It is reasonably possible that Enterprise A's recorded estimate of its obligation may change in the near term.~~

~~With respect to the environmental obligation discussed above, the site was acquired in 1982, and, in connection with that acquisition, the former owner partially indemnified Enterprise A for environmental impacts occurring prior to the acquisition. [Based on existing documentation indicating the years in which the business shipped wastes to XYZ and the terms of the indemnification in the acquisition agreement,] Enterprise A [believes it is probable that it will recover from the prior owners 50 percent of its allocated remediation costs for XYZ and, accordingly,] has recorded a receivable of \$5 million at December 31, 199X.~~

g. Paragraphs .166–.168:

.166 Even though an entity may not be able to establish a reasonable estimate of a material loss or a range of reasonably estimable material loss exposure that must be recorded, in many cases it can determine early in the investigation whether the costs of environmental remediation, in fact, may be material (that is, the upper end of the range of the reasonable estimate of the loss is material). If an entity's probable but not reasonably estimable environmental remediation obligations may be material, the financial statements should disclose the nature of the probable contingency information about the loss contingency in accordance with FASB Statement No. 16x, that is, a description of the remediation obligation, and the fact that a reasonable estimate cannot currently be made. Entities also are encouraged, but not required, to disclose the estimated time frame for resolution of the uncertainty as to the amount of the loss.

~~.167—An illustration of disclosure of a probable but not yet reasonably estimable environmental remediation loss contingency follows (information that is italicized and enclosed in brackets is not required):~~

~~Enterprise A has been notified by the U.S. Environmental Protection Agency (EPA) that it is a potentially responsible party (PRP) with respect to environmental impacts [identified at the XYZ site in Sometown, USA. Several meetings have been held with the EPA and the other identified PRPs, and a remedial investigation has recently commenced.] Although a loss is probable, it is not possible at this time to reasonably estimate the amount of any obligation for remediation [of XYZ site] that would be material to Enterprise A's financial statements [because the extent of environmental impact, allocation among the PRPs, remediation~~

~~alternatives (which could involve no or minimal efforts), and concurrence of the regulatory authorities have not yet advanced to the stage where a reasonable estimate of any loss that would be material to the enterprise can be made]. [A reasonable estimate of a material obligation, if any, is expected to be possible in 199X.]~~

Unasserted Claims

.168 Whether notification by regulatory authorities in relation to particular environmental laws and regulations constitutes the assertion of a claim is a matter of legal determination. If an entity concludes that it has no current legal obligation to remediate a situation of probable or possible environmental impact, then in accordance with ~~paragraph 10 of FASB Statement No. 5~~16x, no disclosure is required. Similarly, future actions of an entity, when they occur, may create a legal obligation to perform environmental remediation; however, no obligation exists currently (for example, if the obligation arises only when and if an entity ceases to operate a facility).¹⁷ However, if an entity is required by existing laws and regulations to report the release of hazardous substances and to begin a remediation study or if assertion of a claim is deemed probable, the matter would represent a loss contingency subject to the disclosure provisions of Statement No. ~~5, paragraph 10~~5, paragraph 1016x, regardless of a lack of involvement by a regulatory agency.

h. Paragraph .171:

Financial statements may include a *contingency conclusion* that addresses the estimated total unrecognized exposure to environmental remediation and other loss contingencies. Such contingency conclusions may state, for example, that “management believes that the outcome of these uncertainties should not have (or “may have”) a material adverse effect on the financial condition, cash flows, or operating results of the enterprise.” Alternatively, the disclosure may indicate that the adverse effect could be material to a particular financial statement or to results and cash flows of a quarterly or annual reporting period. Although potentially useful information, these conclusions are not a substitute for the required disclosures of this SOP and of FASB Statement No. ~~5~~16x, ~~such as their requirement to disclose the amounts of material reasonably possible additional losses or to state that such an estimate cannot be made.~~ Also, the assertion that the outcome should not have a material adverse effect must be supportable. If the entity is unable to estimate the maximum end of the range of possible outcomes, it may be difficult to support an assertion that the outcome should not have a material adverse effect.

- i. Paragraph .173, subparagraph A-5:

~~Paragraphs 9 and 10 of FASB Statement No. 5 state the following:~~

~~9. Disclosure of the nature of an accrual [*footnote omitted*] made pursuant to the provisions of paragraph 8, and in some circumstances the amount accrued, may be necessary for the financial statements not to be misleading.~~

~~10. If no accrual is made for a loss contingency because one or both of the conditions in paragraph 8 are not met, or if an exposure to loss exists in excess of the amount accrued pursuant to the provisions of paragraph 8, disclosure of the contingency shall be made when there is at least a reasonable possibility that a loss or an additional loss may have been incurred.⁶ The disclosure shall indicate the nature of the contingency and shall give an estimate of the possible loss or range of loss or state that such an estimate cannot be made. Disclosure is not required of a loss contingency involving an unasserted claim or assessment when there has been no manifestation by a potential claimant of an awareness of a possible claim or assessment unless it is considered probable that a claim will be asserted and there is a reasonable possibility that the outcome will be unfavorable.~~

~~The disclosure requirements of FASB Statement No. 5 are emphasized in FASB Interpretation No. 14.~~

⁶For example, disclosure shall be made of any loss contingency that meets the condition in paragraph 8(a) but that is not accrued because the amount of loss cannot be reasonably estimated (paragraph 8(b)). Disclosure is also required of some loss contingencies that do not meet the condition in paragraph 8(a) — namely, those contingencies for which there is a *reasonable possibility* that a loss may have been incurred even though information may not indicate that it is *probable* that an asset had been impaired or a liability had been incurred at the date of the financial statements.

- j. In paragraph .174, subparagraph B-1 of Appendix B, the following footnote is added to the end of the second paragraph after the heading *Discussion of Case*:

^{18a}The disclosure requirements of FASB Statement No. 16x apply to loss contingencies that are (or would be, if the recognition criteria were met) recognized as liabilities in a statement of financial position for annual financial statements issued for fiscal years ending after December 15, 2008, and interim and annual periods in subsequent fiscal years.

B15. AICPA Statement of Position 97-3, *Accounting by Insurance and Other Enterprises for Insurance-Related Assessments*, is amended as follows:

a. Paragraph .27:

If an entity has recognized a liability for assessments covered by this SOP, disclosure of the nature of the liability recognized, and in some circumstances the amount recognized, may be necessary for the financial statements not to be misleading. If no liability has been recognized, or if an exposure to loss exists in excess of the amount recognized, disclosure of the contingent assessment shall be made when there is at least a reasonable possibility that a loss or an additional loss may have been incurred. The disclosure shall indicate the nature of the contingent assessment and shall give an estimate of the possible loss or range of loss or state that such an estimate cannot be made. Disclosure is not required of an unasserted assessment when there has been no manifestation by a potential claimant of an awareness of a possible assessment unless it is considered probable that an assessment will be asserted and there is a reasonable possibility that the outcome will be unfavorable. FASB Statement No. 5, FASB Interpretation No. 14, and SOP 94-6, *Disclosure of Certain Significant Risks and Uncertainties*, address disclosures related to loss contingencies. That guidanceThe guidance in SOP 94-6, *Disclosure of Certain Significant Risks and Uncertainties*, also is applicable to assessments covered by this SOP. Additionally, if amounts have been discounted, the entity should disclose in the financial statements the undiscounted amounts of the liability and any related asset for premium tax offsets or policy surcharges as well as the discount rate used. If amounts have not been discounted, the entity should disclose in the financial statements the amounts of the liability, any related asset for premium tax offsets or policy surcharges, the periods over which the assessments are expected to be paid, and the period over which the recorded premium tax offsets or policy surcharges are expected to be realized.