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November 30, 2012

Via email to [director@fasb.org](mailto:director@fasb.org)

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

RE: Invitation to Comment, *Disclosure Framework* (File Reference No. 2012-220)

Dear Ms. Cospers:

We are pleased to respond to the invitation to comment on the disclosure framework.

### *Scope and Introduction*

The objective of general purpose financial statements is to provide financial information that is useful for making investment and credit decisions, as described in the FASB's Conceptual Framework. Those decisions are based on an assessment of cash flows from the reporting entity that a user expects to receive through its investment, such as debt and equity contracts.

This has two important implications. First, a user would be expected to have an understanding of general economic and business conditions, as well as US GAAP and SEC financial reporting rules, because those factors influence a user's decision about whether to invest or lend to the reporting entity. Second, disclosures should supplement information that is not otherwise apparent in the primary financial statements. As such, a potential new disclosure requirement would need to pass both of those filters. To illustrate, a user would have an expectation that the reporting entity's revenue recognition policy complies with US GAAP, but wouldn't necessarily know whether the entity has elected to apply the milestone method for the receipt of additional consideration that wasn't fixed at the beginning of the contract. Therefore, a disclosure about the milestone method would be appropriate.

These two constraints mean there are limits to the information that can and should be provided in the financial statements. While the discussion paper acknowledges that limits exist, it does not address them directly. We believe this is an important omission, and that a disclosure boundary should be an explicit part of the final framework. Since financial statements report transactions and events that have occurred during the financial reporting period, disclosures should not substitute for the forward-looking financial analysis that users perform. Including a boundary in the framework would serve as a mechanism for the Board to incorporate the distinction between preparer and user roles in setting disclosures,



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something we acknowledge is more of an art than science. But a focus on factual information should be preferred over discussing potential future developments.<sup>1</sup> Disclosing factual information would include a discussion of the inputs reflected in fair value measurements on the balance sheet, as well as the nature of nonrecognized subsequent events. However, the footnotes would not provide analytical projections. Users would develop those based upon the information provided in the financial statements.

In addition, disclosures should focus on cash flows that the entity expects will be available to its financial statement users based on amounts recognized in the financial statements (we believe the definition of “cash flow” in the discussion paper is misleading in this regard—see comments below). Disclosures about “events and conditions that have not yet been represented in the financial statements but that are likely to affect assessment of prospects for future cash flows from the entity to its resource providers”<sup>2</sup> appears to go beyond the scope of general purpose financial statements. In other words, events and conditions which the Board has concluded should not be recognized or measured in the financial statements should be left to a user to assess. Generally, we do not believe it is helpful for preparers to speculate in the footnotes about how those uncertainties may affect a user’s assessment, although we agree the facts and circumstances regarding subsequent events should continue to be disclosed.

Crafting new disclosures with these principles in mind should also promote “auditability.” An auditor’s ability to test the reasonableness of financial statement assertions and disclosures is a source of substantial value for most users. An auditor’s opinion on a matter that hasn’t impacted the financial statements, such as the uncertainties mentioned in the preceding paragraph, may actually be counterproductive if a user perceives an independent confirmation of matters that are actually quite subjective.

Separately, we note the private company discussion paper contemplates disclosure differences between public and private companies. We believe the factors in Chapter 2 of that paper (paragraph 2.3 in particular) are appropriate and should also be considered by the FASB in its disclosure framework project, rather than limiting them to the private company initiative.

In the future, when the Board works through its disclosure framework to propose particular disclosures in an exposure draft, we recommend asking users to prioritize the relevance of individual potential disclosures. The same could be asked of users on a retrospective basis for standards that are currently effective in connection with a post-implementation review. The benefit of these questions would be to determine whether a consensus exists as to which of the proposed disclosures are most meaningful. In our experience, users do not generally oppose incremental proposed disclosures. However, they do criticize the effect of “disclosure overload.” By focusing on disclosures that are considered the most useful, the

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<sup>1</sup> Our comments assume the reporting entity is a going concern since the discussion paper does not address circumstances in which the entity’s going concern status is in doubt. It also assumes that it is not more likely than not that the entity will be unable to realize its assets and settle its liabilities in the ordinary course of business (as contemplated by the current FASB project on going concern).

<sup>2</sup> Paragraph 1.23



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Board may conclude other proposed items are less relevant and therefore unnecessary, in effect adopting a triage-approach to disclosure requirements.

We offer the preceding thoughts for purposes of future standard-setting. As the Board is aware, many constituents believe the volume of current disclosures is excessive. Part of that problem stems from similar, and in some cases the same, disclosure requirements in MD&A and the footnotes. We encourage the Board to work with the SEC staff on that particular issue. It could be addressed in a separate phase of the larger disclosure framework project in order to provide some amount of relief in the near term. We note the 2001 GAAP-SEC Disclosure Requirements report identifies specific areas of duplication between the SEC's rules and US GAAP.<sup>3</sup> The Final Report of the Advisory Committee on Improvements to Financial Reporting (CIFiR) acknowledged those findings and also recommended ongoing coordination between the SEC and the FASB. CIFiR proposed:

a process of coordination for the Commission and the FASB to regularly assess the continued relevance of disclosure guidance in both bodies of literature, particularly as new FASB standards are issued. *Existing guidance should be updated or removed, as appropriate* (emphasis added).

We believe many constituents would welcome a short-term project of this nature, while the rest of disclosure framework will likely be a longer effort.

We have provided additional thoughts in the Appendix on matters raised in the discussion paper.

\* \* \* \* \*

We would be pleased to discuss our comments with the FASB staff. Please direct questions to Lee Graul, National Director of Accounting at (312) 616-4667 or Adam Brown, Partner in the National Accounting Department at (214) 665-0673.

Very truly yours,

A handwritten signature in black ink that reads "BDO USA, LLP". The letters are written in a cursive, slightly slanted style.

BDO USA, LLP

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<sup>3</sup> Paragraph 1.38



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## Appendix

### *The Board's Decision Process*

We agree the Board should develop and use a decision process for establishing disclosure requirements. Historically, required disclosures have been developed on an ad-hoc basis, without the systematic approach that is implied by the discussion paper. Just as the Board has a conceptual framework that it uses to some extent for establishing recognition and measurement guidance, a similar framework outside of the Codification for disclosures would enhance the Board's standard-setting process.

We do not believe the decision questions contemplated in Chapter 2 are appropriate for reporting entities. They strike us as extraordinarily open-ended and inefficient for preparers to use on a regular basis. Rather, they appear better suited as factors for the Board to consider in its development of more specific, authoritative disclosure guidance in the Codification. However, even in the context of a single technical project (e.g., financial instruments or revenue recognition), the material in Chapter 2 is so broad we question whether board members and staff would be able to apply the current draft of this decision process in a reasonable amount of time (paragraph 2.3 acknowledges that evaluating all current US GAAP disclosure requirements in light of the discussion paper "would be an overwhelming task"). While it is still expected to undergo significant revisions, we suspect the final product will need to be substantially more succinct in order for it to be an effective tool for Board members to use in future standard setting.

As mentioned previously, we believe disclosures should focus on cash flows that the entity expects will be available to its financial statement users based on amounts recognized in the financial statements. In other words, disclosures should address inputs that entered into recognition and measurement decisions. We note the discussion paper states that the term "cash flows is intended to include flows of economic value other than cash and, unless specifically indicated otherwise in the context, refers to net inflows or outflows."<sup>4</sup> On its face, the term "cash flows" appears to be a misnomer if the concept is intended to be more expansive than actual cash flows. We also find it confusing because it is not clear what "flows of economic value" are. If this notion is intended to represent changes in fair value, it would be more constructive to describe it as such. But even then we are not certain all changes in fair value should potentially give rise to disclosures. To illustrate, the fair value of debt may change, without the entity's owners ever realizing the effect (positive or negative) of the fluctuation. Unless the entity was to prepay the debt and monetize the change in fair value, it would not give rise to actual cash flows that the entity would be able to pass on to its owners and creditors. Therefore, we recommend linking proposed disclosures to actual cash flows that are reflected in the carrying amount of assets and liabilities. This would include disclosures for amounts recognized at amortized cost, such as how the cash paid for property and equipment is allocated to subsequent reporting periods via depreciation. It would also give rise to disclosures about the expected future cash flows reflected in a current fair value measurement.

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<sup>4</sup> Paragraph 2.9.



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In connection with cash flows, we recommend incorporating income tax and estate tax considerations to the framework. We agree with the observations in the private company discussion paper, suggesting they're also relevant to disclosure matters, particularly for private companies:

DF8. The capital structure and capital funding of private companies vary from that of public companies, in part because of the strong focus by private companies on income taxes, estate taxes, succession planning, restrictions on who can hold their stock and the transferability of that stock, and limiting their exposure to personal liability and loss. A large number of private companies are structured as pass-through entities (that is, entities that are not subject to income tax; rather, the entity's owners are individually taxed on the entity's earnings). Common private company ownership structures include S-corporations; limited liability companies; general, limited, limited liability, or family limited partnerships; sole proprietorships; and trusts, such as employee stock ownership plans. Many private companies have multiple entities under common ownership, which often results in transactions with affiliates and other related parties, as well as guarantees and cross-collateral arrangements with lenders. In contrast, the most common form of public company structure is the C-corporation, which is more likely to feature some sophisticated equity instruments.

#### *Implications*

DF9. The typical types of ownership and capital structures of private companies versus public companies should be considered in evaluating the applicability and the consequences of some accounting guidance. For example, certain guidance related to income taxes, consolidation policy, and equity (including financial instruments with characteristics of equity) may have different relevance and consequences for users of private company financial statements than for users of public company financial statements, which may warrant a difference in recognition, measurement, disclosure, or display requirements.

In addition, a focus on cash flows related to amounts recognized in the primary statements suggests limits on disclosing alternative accounting policies that were not selected by the reporting entity. These same limits are implied by the familiarity a user is presumed to have with general business conditions and financial reporting standards. For example, FIFO and LIFO are both acceptable inventory policies. Similarly, a company may or may not elect hedge accounting for an interest rate swap. Both options affect the timing and amount of reported cash flows in the financial statements, something a user would already know. Therefore, we believe disclosures should supplement accounting policies that are in place, rather than discussing policies that were not adopted. Otherwise, a requirement to disclose alternative accounting policies could be irrelevant and quite expensive. For example, reconstructing LIFO liquidation layers or the effect of documenting and applying hedge accounting when it hasn't been elected would impose significant costs on preparers and auditors.

With respect to future accounting pronouncements that have not yet been adopted, we agree general disclosure about their anticipated effect is useful, similar to disclosures currently provided under SAB Topic 11M.<sup>5</sup> However, the discussion paper contemplates

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<sup>5</sup> Disclosure Of The Impact That Recently Issued Accounting Standards Will Have On The Financial Statements Of The Registrant When Adopted In A Future Period



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disclosing “the pro forma effect on current-year financial statements”<sup>6</sup> of new standards that are not yet effective. The phrase “pro forma effect” implies a much higher degree of precision than disclosures about new pronouncements under current practice. Without further clarification it could be construed to, in effect, require companies to early-adopt a new standard prior to its actual effective date. If that is the intent, we do not agree it would provide enough incremental benefits compared to current practice to justify the related costs.

As it relates to information about other events and conditions that can affect an entity’s prospects for future cash flows,<sup>7</sup> we urge the Board to be judicious in this area. Recent experience related to accounting and disclosures for contingent liabilities, including litigation, has highlighted the difficulty of imposing additional requirements. Beyond litigation, we observed in our comments to you on the liquidity and interest-rate risk exposure draft that the SEC considered similar issues related to future uncertainties in connection with Releases 33-8144<sup>8</sup> and 33-8182.<sup>9</sup> For example, the SEC’s rule specifically stated off-balance sheet obligations should only be disclosed if they are “reasonably likely” to have a current or future effect. Given the uncertainty of such exposures, the Board may consider a similar threshold or limit potential disclosures to a narrative discussion as the SEC did, rather than quantifying these matters in detailed terms.

#### *Making Disclosure Requirements Flexible*

The discussion paper describes a spectrum of approaches to facilitate disclosure “selectivity.” On one end, the Board would establish detailed and prescriptive disclosure requirements, leaving little room for preparer discretion. While at the other end, the Board might require preparers to develop disclosures based on the questions that the FASB would otherwise use in its own decision process, as described in Chapter 2. Each approach has pros and cons, with tradeoffs between comparability and relevance.

Somewhere in between these extremes, our initial preference is for the approach described in paragraph 3.11(c):

The Board could set a minimum disclosure or set of disclosures and an expanded set of disclosures. Reporting entities would make their own judgments about whether to provide the minimum disclosures or whether some or all of the expanded disclosures are relevant to their financial statements.

In our view, relevance is more important than comparability, if a choice has to be made. The existing disclosure regime has historically promoted consistency through detailed requirements, and yet virtually all constituents agree change is needed.

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<sup>6</sup> Question L13, page 27

<sup>7</sup> Paragraphs 2.18 and 2.19

<sup>8</sup> *Disclosure in Management’s Discussion and Analysis About Off-Balance Sheet Arrangements, Contractual Obligations and Contingent Liabilities and Commitments*

<sup>9</sup> *Disclosure in Management’s Discussion and Analysis about Off-Balance Sheet Arrangements and Aggregate Obligations*



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By adopting a flexible disclosure approach, the “tone” of accounting standards would change. This is important because it provides a clear, authoritative basis on which preparers could decide a disclosure isn’t necessary. To some extent, that should mitigate the path of least resistance to maximize disclosures and improve the visibility of more meaningful information that would still be disclosed.

We are less optimistic a tiered approach with three or more levels of potential disclosures would be effective. The process for defining multiple categories would be inevitably arbitrary. While the same could be said of our recommendation to establish minimum disclosures, leaving preparers to decide on the rest, the problem is compounded as the number of categories increases. Therefore, we prefer limiting required disclosures to those that “seem basic to the overall effect”<sup>10</sup> of an accounting standard. And as discussed previously, we would articulate a “seems basic” principle in terms of disclosures about cash flows that the entity expects will be available to users based on amounts that are recognized in the financial statements.

#### *Reporting Entities’ Decisions About Disclosure Relevance*

We agree with the observation that:

Many reporting entities have a reasonable understanding of the key ratios and other metrics that users of their financial information consider to be most relevant. If that is the case, those metrics may be a good tool for thinking about relevance of disclosures to users.<sup>11</sup>

In fact, we have difficulty envisioning a reporting entity that doesn’t have such an understanding. Public entities usually discuss key metrics in press releases and earnings calls, while private entities report key performance indicators to their owners and lenders, including covenant calculations.

It is also our experience that most reporting entities have a process, whether formal or informal, for identifying key financial reporting issues during the period based on the metrics described above. For example, management will often develop a brief summary of points for discussion with the disclosure committee, audit committee and/or board of directors each period. These are usually documented in internal reporting packages or other summary forms of information, such as a letter from the president.

For these reasons, we do not believe the Board needs to expend significant resources to define the notion of relevance or to provide detailed implementation guidance along these lines. Management has a vested interest in identifying and communicating relevant information to users, regardless of any action taken by a regulator or standard-setter. If there are scenarios in which users desire more information than is available in the footnotes, other avenues such as press releases or conversations with management may suffice. Otherwise, users will factor the lack of information into their resource allocation decisions,

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<sup>10</sup> Paragraph 3.19

<sup>11</sup> Paragraph 4.20



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such as increasing the interest rate in a lending arrangement or even declining to extend credit.

If the Board decides to pursue this element of the disclosure framework to a greater extent, we recommend that it be considered a lower priority than building a decision framework for establishing new disclosure requirements (Chapter 2) or making disclosures flexible (Chapter 3). We suspect a standard-setting project to define matters of materiality and relevance for the reporting entity will take substantial time and effort that would significantly delay the rest of the disclosure framework initiative.

With respect to disclosures from prior periods, we recommend providing an option for preparers to determine whether they are relevant and should be retained in the current period. We believe an option would be more cost-beneficial than a requirement to evaluate prior periods each time a current set of financial statements is prepared.

#### *Format and Organization*

We believe this is another area that does not merit a high degree of consideration from the Board. Holding all else constant, such as the current content and volume of disclosures, we do not believe reorganizing the notes to the financial statements will meaningfully improve the information that users receive. There are very few users who read an entire set of financial statements from front to back, and even fewer who read an entire Form 10-K. We are aware that some sophisticated users employ data mining software applications to perform key word searches, with any "hits" being flagged for further review by an individual. In addition, the advent of XBRL diminishes the likelihood of a complete, sequential review of a financial reporting document, given its ability to select only particular portions of a document to analyze.

Apart from the methods that users employ to consume financial information, preparers may develop best practices for formatting and presenting disclosures, particularly within industries. As such, we generally believe format and organization is more of a practice issue than a matter for standard-setting. However, we would be supportive of guidance for preparers to place the most important disclosures for the period in the beginning of the footnotes. This would be similar to the recommendation we made to the PCAOB in response to its concept release on the auditor's report regarding the use of an emphasis of matters paragraph to highlight issues that the auditor believes are most significant.<sup>12</sup>

#### *Disclosures for Interim Financial Statements*

Topic 270 currently states that the objective of interim reporting is "to provide guidance on accounting and disclosure issues *peculiar* to interim reporting..."<sup>13</sup> In addition, interim financial statements are generally prepared on an assumption that a user has access to the most recent set of annual financial statements. Therefore, interim reports focus on "peculiarities" in the period, in other words, significant developments and changes since the last annual date. We believe this longstanding principle is appropriate and should be

<sup>12</sup> See <http://pcaobus.org/Rules/Rulemaking/Docket034/102.pdf>, page 8.

<sup>13</sup> ASC 270-10-10-1



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maintained. Consequently, we do not believe a separate framework is necessary to establish interim disclosure requirements. Any guidance for interim periods should affirm that disclosures should be provided to the extent they enhance a user's understanding of the interim period, rather than merely repeating information that has not changed since the last year-end. This implies that the volume of interim disclosures should generally be substantially less than those related to the financial statements for an annual period.

However, if a user of the interim financial statements does not have access to the most recent set of annual financial statements, we believe all of the annual disclosures should be provided in the interim statements. For example, while annual financial statements are generally available to the public for SEC registrants, it is possible a user of interim statements for a private company may not have the same access. But in most cases, we wouldn't expect the notion of user access to be onerous on private companies since they typically control the distribution of their financial statements and are therefore in a position to know whether a user received the last set of annual statements.

Lastly, we note Chapter 6 of the discussion paper introduces the subject of interim financial statements in terms of SEC registrants. Specifically, it states that the discussion:

applies to SEC registrants that are required to file Form 10-Q, which includes a set of condensed financial statements with abbreviated notes. The discussion also would apply to private companies if they issue interim financial statements in accordance with the requirements for Form 10-Q.

This language could be interpreted in at least two ways. It could be read to imply that private companies should look to the SEC's rules and regulations, rather than Topic 270 for guidance related to interim financial statements. In that scenario, we do not understand the basis for this assumption. If there are particular elements of the SEC's rules that the Board or FASB staff believe should apply to private companies, they should be more clearly highlighted in the discussion paper. The language could also be read to establish two distinct classes of private company preparers: those who comply with Form 10-Q requirements and those who don't. Under that view, there would be no specific guidance for the second category of private companies, and inconsistent disclosures would result between the two types of private companies. This would not be a desirable outcome.

In any event, we recommend clarifying that all preparers should look to Topic 270 for purposes of US GAAP, while public companies would also consider any other incremental requirements imposed by regulators.

#### *Other Matters for Discussion*

We believe it would be problematic to move the summary of accounting policies out of the financial statements, for instance, onto a company's website. We are concerned there would be questions of professional liability, such as an auditor's association with the company's website, and perhaps logistical challenges of clearly identifying the accounting policies that were in effect for particular reporting periods, but not others. While these issues could be addressed satisfactorily, the costs of resolving them to the satisfaction of all



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stakeholders would seem to outweigh the marginal benefit of relocating the text from the financial statements to a website or other repository.