

To the Point

Financial reporting development

Some Board members see any issue with loss contingency disclosures as a compliance matter, not a standard-setting matter.

FASB drops loss contingencies disclosure project

What you need to know

- ▶ The FASB decided to discontinue its loss contingencies disclosure project, which would have significantly expanded quantitative and qualitative disclosures required for all loss contingencies.
- ▶ Compliance with existing loss contingency disclosure requirements continues to be an area of focus for the SEC staff.
- ▶ The FASB could revisit these disclosure requirements as part of its disclosure framework project.

Overview

The Financial Accounting Standards Board (FASB or Board) decided to discontinue its project to expand loss contingency disclosure requirements. The FASB started its loss contingencies disclosure project in 2007 because users of financial statements requested expanded disclosures to help them assess the likelihood, timing and amount of future cash flows related to loss contingencies, specifically those involving litigation.

In 2008 and 2010, the FASB issued exposure drafts that would have required expanded quantitative and qualitative loss contingency disclosures. Many constituents opposed both proposals.

In 2010, the FASB delayed deliberations so it could determine whether loss contingency disclosures improved after the Securities and Exchange Commission (SEC) staff renewed its focus on enforcing compliance with existing loss contingency disclosure requirements.¹ We expect the SEC staff to continue to focus on compliance with existing disclosure requirements.

Key considerations

At a recent meeting, the FASB staff commented that some constituents had observed an improvement in compliance with existing loss contingency disclosure requirements since 2010. In voting to discontinue the project, some Board members said that any issue with loss contingency disclosures is a compliance matter, not a standard-setting matter.

The FASB could revisit the appropriateness of existing loss contingency disclosure requirements as part of its disclosure framework project. The FASB issued an Invitation to Comment on the framework today.² In that project, the Board plans to establish an overarching framework to make financial statement disclosures more effective. The FASB then plans to reconsider existing requirements in light of the framework.

SEC staff focus areas

In reviewing registrants' filings, the SEC staff has increasingly commented on compliance with loss contingency disclosure requirements. The SEC staff has particularly focused on disclosures for reasonably possible losses, as well as the clarity and timeliness of loss contingency disclosures.

Reasonably possible losses

The SEC staff frequently challenges registrants for failing to make required footnote disclosures when losses are reasonably possible, or for failing to disclose the range of reasonably possible losses, including when there is a reasonable possibility of a loss in excess of the amount accrued. Through its comments, the SEC staff seeks to verify that a registrant has considered and disclosed an estimate of the amount or range of reasonably possible losses, or, if applicable, a statement that the amount of loss cannot be estimated.

The SEC staff generally has not objected when registrants comply with the loss contingency disclosure requirements for ranges of reasonably possible losses by disclosing either of the following:

- ▶ The amount or range of reasonably possible losses on an aggregate basis³
- ▶ The amount or range of reasonably possible losses in certain cases and a statement that the registrant cannot estimate an amount for other cases

The SEC staff consistently questions registrants about how they determine that an estimate or range of loss cannot be made in a reporting period. If an estimate cannot be made, the SEC staff expects the conclusion to be supported by a sufficient process.

More specifically, in situations in which a registrant is unable to estimate losses that are reasonably possible, the SEC staff asks for a specific and comprehensive explanation of why the registrant cannot make an estimate and what procedures the registrant has in place to attempt to determine such an estimate on a quarterly basis. The SEC staff has also looked for red flags (e.g., history with similar legal matters, age of the litigation) that might call into question whether a registrant cannot make an estimate. The SEC staff challenges disclosures that imply a need for precision in estimating the loss or range of loss because US GAAP does not require a level of certainty or confidence when estimating the range of loss.

The FASB could revisit the issue as part of its disclosure framework project.

Clarity and timeliness of loss contingency disclosures

The SEC staff requests that a registrant's disclosures be consistent with the language in the contingencies accounting guidance when discussing the likelihood of occurrence (i.e., probable, reasonably possible or remote) and the estimated reasonably possible loss (i.e., additional loss, range of loss, that an estimate cannot be made or that the estimated additional loss or range of loss is not material).

The SEC staff also expects management to evaluate its loss contingency disclosures (or lack thereof) each reporting period, and expects that the disclosures will evolve to include more quantitative information as the loss contingency progresses. The SEC staff sometimes issues comments on the same matter in subsequent annual and quarterly periods.

Further, the SEC staff frequently challenges the adequacy of historical disclosures when loss contingencies are settled. In particular, the SEC staff has reviewed prior-period disclosures and made inquiries to determine whether disclosures were appropriate in the past and whether an accrual was recognized in the appropriate period.

How we see it

We expect the SEC staff to continue to focus on compliance with loss contingency disclosure requirements. Companies should continue to challenge whether their loss contingency disclosures are appropriate, particularly for reasonably possible losses.

Endnotes:

- ¹ ASC 450, *Contingencies*.
- ² For additional information on the disclosure framework project, refer to our To the Point, *Now is the time to address disclosure overload* (SCORE No. BB2367).
- ³ While it is acceptable to aggregate the amount or range of all reasonably possible losses, the SEC staff has objected to the aggregation of all loss categories (i.e., it is not acceptable to disclose one estimate combining probable, reasonably possible and remote loss contingencies).

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