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July 14, 2014

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ATTN: Susan M. Cosper, Technical Director

Via Email to director@fasb.org

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Re: File Reference No. 2014-200

Dear Ms. Cosper:

Grant Thornton LLP appreciates the opportunity to comment on Proposed Statement of Financial Accounting Concepts, *Chapter 8: Notes to Financial Statements*. We strongly support the efforts of the FASB to continue with the updating of the conceptual framework and to address concerns about the relevance and extent of disclosure requirements and encourage the FASB to continue its efforts in this regard. However, we do not support issuing this document as a part of the conceptual framework. While it contributes to the conversation about disclosure issues, we do not believe that the ideas expressed in this document are sufficiently developed in a rigorous and systematic way that builds on and aligns with the previously issued chapters in the conceptual framework. We would support its issuance in another format.

There are several issues with the document that we believe require further discussion and refinement. We do not view disclosure as a discrete topic, but rather an integral part of the decision process that includes recognition, unit of account, classification, measurement, summarization, presentation, and disclosure. We believe it is important that a discussion about disclosure start from the *elements*, which are defined in the conceptual framework, rather than the *line item*, which is not a defined term. For example:

- Decisions by the Board about whether or not to recognize an element based on probability or other criteria could lead to disclosures about either a recognized or unrecognized transaction or event.

- Decisions about classification of elements whose value is realized in exchange or in use could lead to fundamentally different conclusions about measurement, presentation, and disclosure.

- Decisions about acceptable summarization and presentation for elements could lead to disclosures that disaggregate those summarizations in the notes.

Discussion of disclosure without consideration of those precedent issues is not likely to produce effective results, so we do not see the line item, itself a form of disclosure, as the

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starting point for a discussion on disclosure. We believe that the transaction and event, and the resulting elements, should be the starting point, with decision on how those elements are recognized, classified, summarized, and presented driving the disclosure conclusions. The recent Board discussion on grouping together information with similar characteristics into subtotals that provide more information on future cash flows is an example of concepts that should be developed further before making decisions on disclosure.

A second issue relates to the boundaries, and even the purpose, of financial reporting. Setting a primary objective for financial statements based on their usefulness for forecasting future cash flows, and specifying disclosure requirements in pursuit of that goal, yields diminishing returns and inevitably leads to disclosure overload because financial statements are not well-suited to that objective. The future cash flow objective overstates the value of financial statements as a forecasting tool and understates their real value and comparative advantages. Further, while the Board continues to assert the primacy of future cash flows as the objective of financial reporting, it is not clear that the market place has accepted that conclusion. A survey by Grant Thornton LLP in 2011 indicated that only 11% of private company CFOs and 15% of public company CFOs agreed with that objective.

We believe that financial statements should be viewed as one part of a much wider corporate reporting model and communication process. Financial statements that are prepared in accordance with high-quality and widely accepted accounting standards, and are subject to external audit, play an essential role in facilitating investment and capital allocation. While financial statements do not (and should not) aim to provide all of the information required for decision-making by investors and potential investors, their reliability and standardization represent key comparative advantages over other forms of communication. Audited financial statements thereby add discipline to the broader communication process. Describing the objective of financial reporting solely as a means of predicting future cash flows understates the value of the financial statements and diminishes their perceived importance when they, perhaps inevitably, fail to perform as promised. The financial statements therefore have a direct link to past transactions and events that have been recognized in the general ledger and to certain past transactions and events that for various reasons have not. The usefulness of that information goes beyond facilitating an assessment of future cash flows.

Even if the objective of financial reporting is confined to an “assessment of future cash flows,” arguably a euphemism for a financial forecast, the information required to prepare that assessment extends beyond the boundaries of the financial statements. Many of those inputs are user-provided, such as opinions about the likelihood of future events, including economic forecasts, technology forecasts, political forecasts, and other relevant externalities. Outside the financial statements, management can provide their own opinions about the future, but ultimately users must make their own assessments. Trying to incorporate those types of information into the financial statements can increase both complexity and disclosure without increasing the usefulness of the financial statements. Therefore, a discussion on disclosure should build on a discussion of the boundaries of the financial statements and the inherent limits of financial statements’ usefulness in preparing assessments of future cash flows.

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The focus of this exposure draft appears to be almost exclusively on line items in the statement of financial position. We believe that a conceptual discussion on disclosure should also include discussion of the role of income, especially income from operations, in assessing both performance and assessing future cash flows. Net income, other comprehensive income (OCI), and other measures derived from net income such as EBITDA and funds from operations (FFO), in combination with information about current cash flows, play an important role in evaluating the performance of management, the nature and quality of value creation, and the likely persistence of cash flows. The decision to classify revenues and expenses as operating or nonoperating items or as a component of net income or of OCI also has disclosure consequences. For example:

- Disclosures about revenue and expense derived from utilization of productive assets recognized at amortized cost could differ fundamentally from disclosures about net income derived from remeasurement or realization of treasury assets in exchange transactions.

- Disclosures about amounts in OCI that do not reflect changes in future cash flows (e.g., remeasurement of in-use elements) could differ fundamentally from disclosures about amounts that would affect future cash flows (e.g., an amendment to a retirement plan).

- Disclosures about cash flows such as cash flows from customers in the ordinary course of business could differ fundamentally from disclosures about cash flows from the sale of a subsidiary.

In our view, the focus should be on how the information is used both to evaluate past performance and as part of an assessment of the prospects for future performance.

We believe that a discussion on disclosure should address whether the notes to the financial statements are to be viewed as a document to be read, akin to a digest or an analyst's report, as data to be analyzed and summarized by users, or both. If the notes are a digest, then the focus of disclosure should be on seeking out the most relevant and material information. If the notes are primarily viewed as a source for data for analysis using tools such as XBRL, then standardization, accessibility, and comparability are of more concern. Under either alternative, the focus should be on cost effectiveness and transparency. We would prefer that there would be a focus on disclosure that provides users with access to available data instead of disclosures that require preparers to generate data solely for the purpose of compliance.

Finally, there has been a long-standing consensus that while recognition and measurement should be the same for all types of entities, the disclosure requirements may differ (earning per share and segment reporting are examples). More recently, the consensus on recognition and measurement has been challenged. We believe that any discussion on disclosure should address the potential for differences in disclosure requirements. If the objective of financial reporting is to be defined in terms of future cash flows, then some of the entities referenced in the exposure draft, including benefit plans and not-for-profit organizations, may have a different objective of financial reporting, with more focus on stewardship or accountability and less on the ability of a user to assess a return of and on investment. If the Board decides to proceed with the current approach, then it may be better to limit the scope of the document to disclosures by companies with equity or debt instruments that are actively traded in capital markets.

On the issue of interim disclosure, we believe that the topic of interim financial statements would benefit from a comprehensive review. There appears to be differing opinions on the nature of interim financial statements and the type, volume, and precision of the information to be included that should be addressed and resolved, with potentially different answers for entities whose equity securities are actively traded and other types of entities. Broadly speaking, our view is that the focus of interim financial statements should be on timely communication of material changes since the annual financial statements, with less focus on routine remeasurement and an update on performance.

Until the broader issues are developed, therefore, we suggest that this document remain part of the conversation on developing a conceptual framework for disclosure, but not as the end product.

Responses to Invitation to Comment questions

Question 1: Should financial statements of employee benefit plans be excluded from the scope of this chapter of the conceptual framework?

We agree that employee benefit plans should be excluded from the scope of this document. We do not agree with the Board's conclusion in BC1.30 of the conceptual framework that external users of financial reporting have similar objectives, irrespective of the type of entities *in which they invest* (emphasis added), and that the objective of general purpose financial reports is therefore the same for all entities. We believe that entities such as employee benefit plans and not-for-profit organizations that do not have investors may have fundamentally different needs. In the absence of investors, the primary user of the financial statements of an employee benefit plan may be the plan participants.

Question 2: Do the concepts in this chapter related to not-for-profit entities address the informational needs of resource providers to those entities?

We believe that the needs of users of the financial statements of not-for-profit entities are of a different nature, with less focus on the assessment of future cash flows, remeasurement, and risks. Rather, they place more emphasis on stewardship, results of operations, compliance, and solvency.

The focus of the users of the financial statements of the average not-for-profit organization without significant debt is almost exclusively on stewardship and financial performance, including the use of funds, the extent of activities, and the results of fund-raising efforts. The need for information about future cash flows is more in the nature of whether the organization is a going concern and not the ability of the organization to generate returns to investors. The users of the financial statements of a not-for-profit organization with significant debt are also concerned about future cash flows but not for purposes of valuing the entity or the future cash flows to owners. Rather, the concern about future cash flows is about liquidity and solvency, and the organization's ability to meet current and longer-term commitments.

Both of these suggest that the objective of financial reporting, and hence for disclosure, for not-for-profit organizations is different than the objective for entities with actively traded shares. The Board acknowledged this by excluding not-for-profit entities from Chapter One of the Conceptual Framework, *The Objective of Financial Reporting*.

Question 3: Do the concepts in this chapter encompass the information appropriate for disclosure in notes to financial statements that would assist resource providers in their decision making? Are there concepts that should be added or removed?

As noted in our general comments, in our view this document would better serve constituents outside the conceptual framework. We would hope that a chapter within the conceptual framework would address additional issues, including:

a. <u>The roles of net income and current cash flows</u>
There is little or no consideration of the role of net income or current cash flows in assessing future cash flows. Net income and cash flow from operations, especially amounts based on recognition of revenues and costs, are important indicators of the ability of the entity to generate future cash flows.

b. <u>The objective of financial reporting on the efficiency and effectiveness of management</u>
We do not agree with the Board's description of the relationship between the objective of financial reporting and the information in the financial statements. Paragraph D6a, for example, states that in making an assessment of prospects for net cash inflows to the reporting entity, a resource provider "needs information about the resources of the entity, claims against the entity, and how efficiently and effectively the entity's management and governing board have discharged their responsibilities in using the resources of the entity." We do not agree that the role of the financial statements is to provide information about the efficiency and effectiveness of management. The efficiency and effectiveness of management are user judgments, not preparer judgments. Users should make their own appraisal of the efficiency and effectiveness of management, whether or not as part of an assessment of future cash flows, based on information provided in the financial statements about the resources of the entity, claims against the entity, changes in those resources, the results of operations, and current cash flows.

c. <u>The role of disclosure</u>
We do not agree with the description in paragraph D32 that the role of disclosure is to provide additional information about line items or information that can affect future cash flows. We do not see a distinction between presentation and disclosure, and note that presentation of a line item is in itself a disclosure decision. Information that can affect future cash flows also lacks a direct connection to financial reporting. We would restate paragraph D32 to align more closely with the rest of the conceptual framework, so that the general types of information would include information such as

- Information about the reporting entity
- Additional information about resources, claims, the results of operations, and current cash flows as presented in the financial statements

- Information about other past events and current conditions and circumstances that could give rise to additional resources or claims against the entity, impair current resources, or eliminate existing claims

d. The relationship between the type of claim, resource, income, or cash flow and disclosure
We would agree with the sentiment in paragraph D36 that "the nature of additional information about line items that is relevant for a resource provider's decision making depends on what the line item represents" if the term "line items" were replaced with the words "resources, claims, the results of operations, and current cash flows as presented in the financial statements." However, we believe that this concept needs to be developed further, especially with regard to income and cash flows. For example, operating assets and treasury assets are fundamentally different in nature, as the entity realized the value of one in use and the other in exchange. Income resulting from remeasurement or from the disposition of operating assets may be fundamentally different from income from transactions with customers. We suggest that those relationships be further discussed and clarified in the conceptual framework.

e. The boundaries of the financial statements
As noted in our general comments, we believe that the best way to exert discipline into the disclosure process is by clarification of the boundaries of financial reporting. For example, paragraph D38 discusses disclosure of the potential effects of changes in general legal and economic conditions, accounting methods, market factors, and factors specific to the entity or sector such as social perceptions or initiatives, imminent obsolescence, supply chain concerns, new regulations, availability of trained workers, management turnover, or environmental hazards. We believe that there needs to be a robust conversation about whether these types of disclosures should be part of the financial statements, in unaudited supplementary materials, or information that the user should provide or obtain from other sources. Due to the judgmental nature of the information, we suggest that users of the financial statements should be responsible for making their own assessments even if management provides their views outside of the financial statements.

Question 4: Are there additional concepts needed to identify information that is unsuitable for requirement by the Board in notes to financial statements even though that information would be consistent with the purpose of the notes?

As noted in our general comments, we believe that the best way to exert discipline into the disclosure process is by clarification of the boundaries of financial reporting. For example, paragraph D38 discusses disclosure of the potential effects of changes in general legal and economic conditions, accounting methods, market factors, and factors specific to the entity or sector such as social perceptions or initiatives, imminent obsolescence, supply chain concerns, new regulations, availability of trained workers, management turnover, or environmental hazards. We believe that there needs to be a robust conversation about whether these types of disclosures should be included in the audited financial statements, in unaudited supplementary materials, or considered to be information that the user should provide or obtain from other sources.

In our view, the financial statements are just one input to an assessment of future cash flows or management performance. For example, an economic forecast, industry outlook, or a technology review/forecast would be valuable inputs to that process. That information is best provided by the user or obtained from independent third-party providers. While management may provide their interpretation of economic or technological developments, both voluntarily or in MD&A, that interpretation will of necessity be their opinion and would not meet the standard normally expected of audited information. We believe that a conceptual framework for disclosure therefore should discuss what inputs to an assessment of future cash flows or management performance would or would not be included within the audited financial statements.

Question 5: Do the decision questions in Appendix A identify the information appropriate for the Board to consider requiring for disclosure when setting standards related to line items and other past events and current circumstances and conditions that can assist resource providers in their decision making?

As noted in our general comments, we do not consider the line item to be an appropriate starting point for a discussion about disclosure. A line item is the culmination of a series of decisions that involve identification, recognition, measurement, classification, and summarization. Decisions made along that chain are factors or even determinants in disclosures and presentation on the financial statements, which in some cases may be alternatives. The decision to summarize accounts into a line item is both a presentation and a disclosure issue. We believe it makes more sense conceptually to discuss classification and summarization or aggregation instead of disaggregation. Many of the determinants of disclosure will be found at the level of the element (e.g., financial vs. nonfinancial assets), classifications of elements (e.g., operating vs. treasury assets), summarizations (e.g., line items), or groups of line items (e.g., financial statement). We would expect a conceptual framework on disclosures to start at the level of the element and to discuss classification, including the types of disclosures that might be expected for particular classes of elements, and summarization, including when classified elements should or should not be aggregated and when different classes of elements can be aggregated in the financial statements only if disaggregated in the notes.

Our responses to the individual questions are included in an Appendix.

Question 6: Does the discussion in paragraphs D43–D50 identify the information appropriate for the Board to consider when setting standards related to information about the reporting entity?

We generally agree with the concepts in this section with the following comments.

1. “Restrictions, Privileges, Advantages, and Disadvantages”

   This section could benefit from a discussion of the differences that may be inherent in different legal environments. For example, property rights, rights in bankruptcy, and the rights of employers or employees can differ significantly from jurisdiction to jurisdiction and significantly affect the economic substance of transactions.

   Also, some business models are highly dependent on tax subsidies, monopoly, or government forbearance. The nature of the subsidy or program and the extent to which the entity's profits rely on those programs would be relevant to a user of the financial statements.

2. "Information about Related Parties and Related Party Transactions"

   In addition to information about interrelationships and their effects on conditions, circumstances, transactions, or events, the extent of intercompany transactions and whether those transactions are conducted at market terms are both important factors. Also, management should be considered a related party.

   Other candidates for information about the entity might be identification of the economies where the entity primarily does business, including the location of its suppliers, processing facilities, customers, where it pays taxes, where it employs personnel, and how many personnel it employs.,.

Question 7: Will the concepts related to future-oriented information (paragraphs D22–D31) result in disclosures that are appropriate for the notes? If not, what types of information should be included in or excluded from consideration for disclosure in the notes?

In regards to information about estimates and assumptions used as inputs to measurements, many of which are future oriented and internally developed, we believe that the most important information about fair value is disclosure of the fact that the measurement is based on market participant estimates and assumptions developed by management when fair value is not based on

- A market transaction with an independent third party, or
- A price in an active market for an identical asset or similar asset

The current focus on providing detailed information about estimates, assumptions, and the effects of changes in those assumptions, is a major driver behind complaints about the amount of disclosure and the expense of preparing and auditing disclosures. We suggest that the Board consider alternatives to the current disclosure structure. For example, rather than providing disclosures about forward-looking assumptions and the effects of changes in those assumptions, it may be less expensive and more useful to provide disclosure of a range of values when a reasonable change in judgment could lead to a material difference in the financial statements. Alternatively, a general disclosure on the assumptions used in preparing the financial statements may provide the most relevant and accessible information to a user of the financial statements as opposed to disclosures located throughout the notes.

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In regards to information about existing plans and strategies related to matters under management's control, strictly speaking, existing plans are not a future event. Existing plans and strategies are a current event which can affect

- The ability of the reporting entity to recover the costs of the asset as its future value will now be realized from an exchange transaction rather than in use. That reclassification is a current event that should be reflected in the financial statements.
- The persistence of income.

Therefore, an intent to sell a division, to institute or terminate a benefit plan, or to expand capacity could be a useful disclosure. However, premature disclosure of intent to purchase or sell assets can adversely affect operations or the ability of the entity to secure the best price in an orderly transaction. Current GAAP requires that there be a commitment to sale, i.e., the information is already public. We agree with the provisions of current GAAP that require the financial statements to reflect this information once there is a firm commitment, not at the planning stage. For acquisitions, it would most likely be inappropriate to disclose information prior to the decision to make an offer. In both cases, it is not the plan that would drive disclosure, it is the commitment.

In regards to paragraph D29 and information about the effect of specified future changes in existing conditions on specific line items or on the entity as a whole, we believe that there should be a discussion and debate about whether and when "what if" disclosures should be provided. In the example provided, the effect of a 100-point basis change in interest rates, that information may only be relevant if the reporting entity has variable-rate financial instruments or debt. Even then, the information may only be relevant if a change is likely and would have a material effect on income or cash flows.

Question 8: Do the concepts in this chapter appropriately distinguish the types of information that are appropriate for the notes from the analysis management provides in other communications?

As noted in our general comments and elsewhere, we believe that there needs to be a more robust discussion around the boundaries of the financial statements. Because an assessment of future cash flows is in substance a forecast based in part on the financial statements, it may be useful to discuss what inputs a user would be expected to provide or obtain in addition to a discussion about management's contribution to the assessment of future cash flows outside of the financial statements.

Question 9: Are the concepts related to disclosure requirements for interim periods (paragraphs D60–D71) appropriate? If not, are there concepts that should be added or removed?

We suggest that the topic of interim financial statements be reconsidered in-depth. The current requirements are focused almost exclusively on the needs of the users of financial statements of actively traded entities and effectively preclude other companies from issuing interim financial statements without incurring unreasonable costs. Also, we believe that the primary objective of interim financial statements is to provide timely updates on the annual report instead of comprehensive current information. Interim financial statements should focus on significant new information or other changes rather than repeating the disclosures from the annual report. Activities that require active input and significant cost, such as remeasurement, should only be required when there has been a material change. Therefore:

- We agree with the principle in paragraph D61that interim financial statements should be considered an integral part of the financial statements for annual periods.

- We agree with the principle in paragraph D62 that interim financial statements are about significant changes. We would add that users should not expect the same level of precision in the interim financial statements because the focus is on significant changes and the timeliness of the information rather than its precision.

- We agree in part with the principle in paragraph D63. A change in accounting principle, change in estimate, or change in accounting policy from the annual report would be a change that should be highlighted in an interim report. Also, a temporary departure or change in the pattern of seasonality would be relevant.

- We disagree somewhat with paragraphs D65 and D66. We believe that aggregation is a disclosure issue itself and should be discussed in this chapter or elsewhere. How transactions and events are classified and aggregated should affect both presentation and disclosure and therefore the two issues should be discussed together. If different aggregation principles apply to interim reports, that should be discussed along the related disclosure issues.

- As previously noted, we do not agree with the principle in paragraphs D67 or D70 relating to remeasurement, in particular to disclosure or routine changes in fair values of items measured and recognized at amortized cost. The cost should be weighed against the benefits and the likelihood of a significant unexpected change since the last annual statement. In our view, the general principle should be that only significant changes since the last annual statement should be disclosed rather than repeating the annual financial statements. We note that this is an area where the line between the annual and interim financial statement has become blurred in recent years.

- We also disagree with the importance of the assessment of future cash flows in paragraph D69 because that principle differs from the principles of interim reporting in D63. Instead of looking at changes since the most recent annual statements or the relationship between the interim and annual statements, it introduces a new criterion: importance to the assessment of cash flows. The principle of importance to the assessment of future cash flows could lead back to preparation of a full set of financial statements in interim periods. If importance to the assessment of future cash flows is meant to evoke materiality, we would prefer the use of the latter term.

- The text in D70 also is a restatement of the general principle in D63 and not necessary. Further, the example provided is at a level of detail that is contrary to the intent of financial reporting to provide timely updates of significant changes. Earlier paragraphs describe the effects of significant changes in highly aggregated line items, not at the level of an individual instrument. Under the general principles, only a change that would have a significant impact on a line item would trigger an interim disclosure.

We also suggest that the Board consider separate interim guidelines that would be oriented towards not-for-profit organizations or entities other than those whose equity securities trade in active markets. The current interim reporting requirements preclude many entities from providing information other than informal updates to the users of their financial statements.

Question 10: If no disclosure guidance for a transaction, event, or line item is specified in U.S. GAAP, how will an entity consider the nonauthoritative guidance in this chapter?

In our view, the principles in this chapter are not sufficiently developed to serve effectively as a proxy for authoritative guidance. Ideally, the Board would develop principles around different types of resources, claims, income, and cash flows that could serve that role.

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We would be pleased to discuss our comments with you. If you have any questions, please contact John Hepp, Partner, Accounting Principles Consultation Group, 312-602-8050 or john.hepp@us.gt.com

Sincerely,

/s/ Grant Thornton LLP

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Appendix

Comments on the decision questions in Appendix A

In our view, a conceptual framework of presentation and disclosure would ideally start from a discussion of the objectives of financial reporting and the elements of the financial statements, as well as how that information is classified, summarized, presented, disclosed, and explained. While analysis of the financial statements may begin with the line item, we don't view that as the conceptual starting point. The task of the preparer, regulator, and analyst all will be easier if there is a common understanding of how the financial statements are assembled.

Our comments on the individual questions follow.

Question L1: Is there information about the nature or quality of the phenomenon or phenomena represented by the line item (for example, the underlying rights, obligations, or transactions) that can affect assessments of cash flow prospects and that is not adequately conveyed by the line item's description?

We prefer the term "affect representational faithfulness" rather than "affect assessments of cash flow prospects" because representational faithfulness is a financial reporting characteristic while the assessment of future cash flows goes beyond the boundaries of financial reporting. Also, this may be a place to interject the concept of materiality explicitly.

Question L2: Does the line item represent any of the following:
a. Financial instruments issued or held by the entity
b. Other contracts or legally binding documents
c. Other binding arrangements?

This question is a good start in the direction that we would follow on this project. We would develop the notion of the type of element further to consider whether an element or class of elements is an in-exchange asset, an in-use asset, intellectual property or similar right, a short-term liability, revenue, expense, etc., and go on to discuss how the type of element could commonly affect disclosure.

Question L3: Could the existence or ownership of the rights and obligations underlying the line item be uncertain?
This question is different from the uncertainty question related to measurement (see Question L9) in that it does not relate to uncertainty about outcomes, but to uncertainty about whether an asset or liability exists or is owned or owed by the entity.

We agree that this category of elements or near-elements could have unique disclosure issues. It could be expanded to include a number of items that could meet the definition of an element but are not recognized, such as executory contracts, patents, and research and development.

Question L4: Does the line item include components of different natures that could affect prospects for net cash flows differently?

Again, we disagree with using the term “prospects for future cash flows” as being too broad, preferring the qualitative characteristic “representational faithfulness.” We believe that the focus should be on the relationship between aggregation and disclosure, i.e., when is it inappropriate to aggregate unlike elements and when would it be appropriate to provide additional disclosure when unlike elements are summarized into a single measure on the financial statements?

Question L5: Are the cash flows related to the line item subject to change as a result of changes in general economic conditions or market factors? If so, are the specific conditions or factors or the nature of their effects not apparent from the description of the line item?

As a general matter, we view the effects of possible changes in general economic conditions as being beyond the boundaries of the financial statements. Information about general economic conditions and market factors are user-provided inputs to the assessment/forecast, even when management provides their own views. Also, the term “future” has been omitted from the description, but it appears that this question is in regards to future cash flows. We believe that this reflects a general bias toward the statement of financial position within the document. The statement of cash flows and the statement of comprehensive income are not concerned with future cash flows, at least not directly, yet there should be disclosure objectives around those financial statements as well. Therefore, this question is too narrow in scope and perhaps poorly worded.

If the question is intended to focus on the volatility of the measure, we believe that volatility could be a useful indicator when classifying and summarizing elements into the financial statements and could be one of the determinants of disclosure. Other characteristics could be the persistence of cash flows, revenues, or expenses. For example, the framework could include a discussion of discontinued operations, expired patents, introduction of new technology, etc., as part of a general discussion on the persistence of earnings and how that could affect disclosures.

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Question L6: Are the prospects for cash flows related to the line item affected by changes in entity-specific factors or sector-specific factors, particularly those that can be expected to change frequently or significantly, and would a user not be expected to be aware of the factors or their potential effects?
Examples include volatile demand for the entity's products or services, social factors affecting the sector or entity, imminent obsolescence, supply chain concerns, new laws and regulations, availability of trained workers, management turnover, and environmental hazards.

Please refer to our comments on Question L5 as many of the issues are the same. In particular, we consider "prospects for future cash flows" to be too broad a term because an assessment of future cash flows requires information besides that included within the financial statements. We prefer the term "representational faithfulness." In terms of the boundaries of financial reporting, possible changes in sector-specific factors are likely to be both forward looking and speculative and are probably better addressed in MD&A. Newly enacted laws and regulations, existing supply chain issues, environmental sustainability issues, and similar items that have a current impact on existing assets or liabilities or the persistence of earnings would, however, be appropriate disclosure topics.

Question L7: Are the causes of the changes in an entity's line item of an asset, liability, or equity instrument not easily understood?
Information to Be Considered for Disclosure
a. The causes of changes from the prior period (such as major inflows and outflows summarized by type or a detailed roll forward). It would be important to separate routine changes from nonroutine changes and changes in reported amounts caused by changes in accounting, changes in economic conditions, changes in the composition of the entity, and changes in contractual obligations or rights.

This question does look at the elements of the financial statements but at too high a level. In our view, there are fundamental differences between operating assets and nonoperating elements, elements whose value is realized in exchange and those whose value is realized in use, and various types of liabilities and equity. In addition, Question L7 is focused exclusively on the statement of financial position. We think the framework could also benefit from a discussion on changes in an element on the statement of comprehensive income or the statement of cash flows due to, for example, discontinued operations, acquisitions, or nonrecurring activities.

Question L8: Could the quality or utility of a nonfinancial asset have changed?
That disclosure is related to measurement but is not strictly a measurement issue. Some productive assets are carried at amounts that are not closely related to their current values and they do not change in relation to those values. For example, a building with a carrying amount that is being depreciated may actually be appreciating in value and its cash-flow generating potential may be increasing.
Information to Be Considered for Disclosure
a. A description of the nature of the change and how that change could affect prospects for cash flows of the entity. The objective of this disclosure would be to provide

information not signaled or indicated by accounting and reporting. For example, the carrying amounts of depreciable assets may systematically decline in a way that masks a change in utility or value. The asset may have been depreciated at a rate that exceeds the rate at which its economic value has declined. Therefore, a technological change that causes it to become significantly less valuable in a single year may not require an impairment write-down. That change in economic value is the kind of information to be provided by this disclosure.

This question is a good start toward a discussion on the classification and related disclosure around operating assets whose value is realized in use. A change in utility, for example, could result in a nonfinancial asset being reclassified from an in-use asset to an asset whose value will be realized by disposition (in exchange) or abandonment, changing the measurement basis of the asset, and creating both presentation and disclosure issues in order to preserve representational faithfulness. However, in our view, the current discussion is overly focused on the statement of financial position, neglecting the importance of net income and measures derived from net income and current cash flows. A change in the quality or utility of an in-use asset could result in a nonrecurring impairment charge and create a divergence between current income and cash flows. When an asset will continue to be utilized in operations, an impairment also may change the evaluation of earnings in both the current and future periods by accelerating recognition of future operating losses. In our view, those issues and others would be discussed when differentiating assets whose value is realized in use from assets whose value is realized in exchange.

Question L9: Does the line item include individual items (or groups) that are measured differently?
That information is not the same as the information addressed by Question L4 because differences in measurement may exist for very similar or identical items. Two items measured the same way may have different responses to changes in market conditions.

We agree that this is a disclosure issue but would approach this from the perspective of classification and summarization. The question is whether elements with different measurement attributes can be aggregated and, if so, whether they should then be disaggregated in the notes.

Question L10: Are there acceptable alternative accounting policies or methods provided under U.S. GAAP that might have been applied to this line item?
Information to Be Considered for Disclosure
a. The accounting policy or method applied
b. The magnitude of the effect if the accounting method is unusual, if results produced are counter to what a reader might otherwise expect (for example, last-in, first-out [LIFO] inventory costing), or if the method otherwise dramatically affects the financial statements (full cost versus successful efforts)

We agree that alternative accounting policies are a driver of disclosure policies. However, in light of issues arising from the application of principles-based standards, we would expand this discussion to include common or uncommon interpretations of principles-based GAAP and judgments made when there is no specific GAAP, combining this question with Question L13. In addition, the policy for classifying and summarizing financial information, whether into multiple line items or separate line items with disclosure, could be discussed.

Question L11: Has the accounting policy or method used for this line item changed because of adoption of or transition to newly issued guidance or because the previous method was determined to no longer be proper?
This raises two related but different topics: transition guidance and accounting changes.

We agree that transition is an issue that could present unique disclosure issues. However, those issues could affect multiple line items, so the line item is not necessarily the best starting point for that analysis. Because many standards address specific elements, the element would probably be the best starting point, with disclosure determined at least in part by the nature of the element. In recent standards, the disclosure requirements have tended to flow in the other direction, from the overall impact to the line item and not the reverse.

While a conceptual framework could discuss general principles about transition disclosures, discretionary accounting changes, and error correction, three very different issues that merit separate discussion, the details are better addressed at the standards level.

Question L12: Will this line item be affected in future years by transition to an accounting standard that has been issued but that is not yet effective or not fully effective?
Information to Be Considered for Disclosure
a. When the transition will occur
b. A description of the anticipated effect on future financial statements
c. If readily available, the pro forma effect on current-year financial statements.

This also is a component of transition guidance and should be incorporated into the issues raised in Question L11. It may also be useful to discuss these disclosures in terms of the boundaries of the financial statements. These disclosures could duplicate the requirements in Staff Accounting Bulletin 74 on transition. The framework could also benefit from a discussion about expectations as to the precision of anticipated effects since detailed information about the effect of a change in the accounting for an element may not be available prior to implementation. For those reasons, it may be better to leave those disclosures outside the audited financial statements.

Question L13: Is the method for determining the amount of the line item uncommon, not apparent from the description, or otherwise hard to discern?
Information to Be Considered for Disclosure
a. An explanation of how the amount of the line item was determined (for example, an option pricing model, a matrix pricing technique, or an internally developed technique). However, if the computation is unique or unusual but prescribed in an accounting standard (such as the way of determining deferred taxes or uncertain tax

positions), disclosure might be unnecessary if the line-item description is adequate to indicate the accounting requirement that is applied.

See our comment on Question L10. Again, there may be two separate issues here: the accounting for an element and the policy for classification and summarization.

Question L14: Is the carrying amount of the line item an estimate that requires assumptions, judgments, or other internal inputs that could reasonably have been different?
This question is not limited to fair value or other estimates of current value. At times, accumulations of costs involve uncertainties (about which costs to include, for example), and impairment allowances not based on quoted market prices are nearly always subject to significant uncertainties. Information about how changes between periods for significant estimates, assumptions, judgments, or other internal inputs that have affected a line item also would be potentially relevant.
Information to Be Considered for Disclosure
a. Disclosure of enough detail about the significant estimates, assumptions, judgments, or other internal inputs to provide a general understanding of (1) how the carrying amount was determined, (2) the level of uncertainty inherent in the amount, and (3) how significantly the number might have changed if the inputs had been different.

This question may be addressing some of the principle drivers about complaints about disclosure. This raises issues about classification, measurement, and, especially, summarization. Virtually every line item on the financial statement reflects estimates and assumptions including the materiality of individual transactions or elements, value in use, value in exchange in real or hypothetical markets, recoverability of costs, possible outcomes of legal actions, the timing of recognition, and even the continued existence of the entity. The role of financial reporting is to summarize those estimates and judgments into line items, subtotals, and articulated financial statements. Just as it could be inappropriate to publish the general ledger as a financial statement, it could also be inappropriate to include detailed information about the measurement of every transaction or element.

In our view, many of the current disclosure requirements at the level of the individual contract or transaction may be better addressed at a level consistent with the summarization inherent in the financial statements. Therefore, we would like to see a discussion in the conceptual framework about the uncertainty inherent in the financial statements and how that uncertainty should be communicated to the users of the financial statements. We suggest that the Board investigate alternatives to the current disclosure model that could include a general disclosure about key assumptions at the level of the financial statements or significant subtotals, such as net income, with due consideration of materiality, rather than pursuing a disclosure regime that looks at the significant estimates and uncertainty at the transaction or contract level. We do not agree with a disclosure regime that would require detailed disclosures about assumptions and uncertainty at the contract level, unless that contract is individually material.

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We also question the utility of "what if" disclosures based on alternative assumptions, presumably ones that were rejected. Those alternative measures should be factored into the level of uncertainty inherent in the amount. Requiring disclosure of alternative measures based on differences in assumptions, including the interaction effects that change could have on other assumptions, could be redundant with disclosures on uncertainty at best and misleading at worst if the disclosures present an improbable scenario or fail to take into consideration the effect on the financial statements as a whole.

We encourage the Board therefore to consider additional discussion of this topic, with the objective of increasing the usefulness of the financial statements through better consideration of summarization and materiality.

Question L15: Is there an alternative measure or way of applying a measurement that clearly would be useful in assessing prospects for cash flows?
An alternative measure might be considered for an asset or a liability. One example is the fair value of a financial instrument reported at a cost-based amount. Another example is disclosing inventory using the first in-first out (FIFO) inventory costing method for inventory carried using the LIFO inventory costing method.
Information to Be Considered for Disclosure
a. Identification of the alternative measurement or method of application
b. An indication of the magnitude of the difference between the reported measurement and the alternative measurement (or the amount of the alternative measurement).

We agree that alternative measures are an important part of the overall disclosure picture and should be discussed within the framework. We would like to see a discussion at the level of the element (e.g., when is disclosure of fair value appropriate for an operating asset or asset whose value is realized both in use and in exchange), and at the level of the financial statement (e.g., disclosure when the values of elements that are not measured on the same basis are linked).

Question L16: Does a line item have a direct relationship to another line item(s) in another statement that is not otherwise apparent?
Information to Be Considered for Disclosure
a. A description of the relationship(s) between line items when the relationship or relationships are otherwise not apparent
b. The effects that a change in a particular item has on another item
c. A reconciliation of the relationship(s) between line items on various statements.

We agree with the principle that linkages are a driver of disclosure. As per our response to Question L15, linkages could affect how an element is summarized or presented in the financial statements (e.g., net or gross presentation) and disclosed in the financial statements and whether an alternative measure might be appropriate.

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Question O1: Can any of the following events or conditions create a possibility that a user's assessment of an entity's future cash flows would be significantly different (lower or higher):
a. Potential litigation against the entity or by the entity against another entity or entities (because of specific matters instead of general business risk)
b. Existing litigation against the entity or by the entity against another entity or entities, the outcome of which is still uncertain
c. Suspected or known violations by the entity of laws, regulations, or contractual terms or violations of the entity's rights under statutes, regulations, or contracts
d. Other uncertain conditions?

We agree that litigation and other potential legal liabilities that may require the assessment of an attorney are a special type of element. While the nature of all types of element and some general discussion should be included within the conceptual framework, the details should be left to the standards level.

There are potential boundary issues within this area as well, both between the financial statements and MD&A and also in the type of disclosures feasible in an adversarial legal system. While disclosure about existing litigation and probable or likely litigation would affect recognized or near-recognized elements, disclosures about other risks may be better addressed in MD&A, with discussion of other factors that could affect future cash flows but are not part of the financial statements.

Question O2: Are there other events or circumstances that are not represented by an asset or a liability and a gain or loss (or income or expense) in an entity's financial statements but for which there is uncertainty in the decision about whether it should be recognized (that would include items other than the contingencies discussed in Questions O1(a) and O1(b))?

We think we agree with the general principle here but would like to have seen an example. If this is meant to be a reference to a threshold for recognition, the framework could benefit from a more extensive discussion of when events that do not qualify for recognition should be disclosed.

There is also a potential boundary issue as other events and circumstances that can affect future cash flows may be outside the boundaries of the financial statements.

Question O3: Are there contractual rights or obligations arising from past transactions and events or current conditions and circumstances that are expected to meet the criteria for recognition by the entity in the future?
Information to Be Considered for Disclosure
a. Unrecognized obligations
b. Future payments related to unrecognized obligations.

In our view, there are several types of resources or claims that do not currently qualify for recognition (such as unrecognized intellectual property, research and development, licenses, executory contracts, and internally generated goodwill) and other items that do qualify for recognition (such as customer relationships) that may raise similar disclosure issues. We believe that the conceptual framework would benefit from a discussion of such items and the related disclosure issues.