

## Heads Up

### In This Issue:

- Background
- Scope
- Threshold for Disclosure
- Qualitative Disclosures
- Quantitative Disclosures
- Tabular Reconciliation
- Prejudicial Exemption
- Effective Date and Transition
- Convergence With IFRSs
- Appendix

The proposed ASU addresses many but not all of the concerns raised by constituents in their comments on the 2008 ED.

## Raising the Volume on the Remote FASB Proposes Guidance on Expanded Disclosures for Certain Loss Contingencies

by Stuart Moss and Courtney Sachtleben, Deloitte & Touche LLP

Today, the FASB issued a [proposed Accounting Standards Update \(ASU\), \*Disclosure of Certain Loss Contingencies\*](#). The proposed guidance would (1) expand the scope of loss contingencies subject to disclosure to include certain *remote contingencies*; (2) increase the quantitative and qualitative disclosures entities must provide to enable users to assess “the nature, potential magnitude, and potential timing (if known)” of loss contingencies; and (3) for public entities, require a tabular reconciliation for changes in amounts recognized for loss contingencies. Comments on the proposed ASU are due by August 20, 2010.

**Editor’s Note:** On Wednesday, August 18, the FASB extended the comment period for the proposed ASU from August 20, 2010, to September 20, 2010. The extension came amid concerns from constituents that a 30-day comment period did not give companies enough time to respond.

### Background

In June 2008, the FASB issued an exposure draft, *Disclosure of Certain Loss Contingencies* (the “2008 ED”). The FASB undertook the project to address financial statement users’ concerns that Statement 5<sup>1</sup> (codified in ASC 450-20<sup>2</sup>) did not require entities to timely provide sufficient information about certain remote contingencies or loss contingencies in situations in which the loss amount could not be reasonably estimated. The 2008 ED would have significantly expanded the amount of information available to users by requiring entities to disclose certain remote loss contingencies and, for any loss contingency (including certain remote contingencies), the claim or assessment amount (or the entity’s best estimate of its maximum exposure to loss if there was no claim or assessment amount). Constituents expressed numerous concerns about the 2008 ED, including the difficulty preparers would have making reliable estimates of their exposure to loss, legal concerns about the prejudicial nature of the required disclosures, and auditors’ concerns about the reasonable level of assurance that could be obtained for some of the proposed disclosures.

The proposed ASU addresses many but not all of the concerns raised by constituents in their comments on the 2008 ED. The [appendix](#) of this *Heads Up* contains a table comparing the current guidance in ASC 450-20, the 2008 ED, and the proposed ASU.

<sup>1</sup> FASB Statement No. 5, *Accounting for Contingencies*.

<sup>2</sup> For titles of *FASB Accounting Standards Codification (ASC)* references, see Deloitte’s “Titles of Topics and Subtopics in the *FASB Accounting Standards Codification*.”

Certain *remote* contingencies would require disclosure if, because of their nature, potential magnitude, or potential timing (if known), disclosure would be “necessary to inform users about the entity’s vulnerability to a potential severe impact.”

## Scope

The proposed ASU would apply to all loss contingencies under ASC 450-20 and ASC 805. Unlike the 2008 ED, the proposed disclosure requirements would also apply to the following (to the extent that they relate to loss contingencies): (1) environmental obligations, (2) guarantees and product warranties, (3) troubled debt restructurings, (4) withdrawals from multiemployer plans, and (5) potential insurance expenses related to changes from occurrence-based insurance to claims-made insurance. In addition, the disclosure threshold for withdrawals from a multiemployer plan would be expanded to include certain remote contingencies that meet the new disclosure threshold in the proposed ASU.

## Threshold for Disclosure

The proposed ASU states that with regard to loss contingencies, an “entity shall disclose qualitative and quantitative information . . . to enable financial statement users to understand all of the following:

- a. **The nature of the loss contingencies**
- b. **Their potential magnitude**
- c. **Their potential timing (if known).”** [Emphasis added]

Accordingly, an entity’s disclosures about a contingency “should be more extensive as additional information about a potential unfavorable outcome becomes available” and as the contingency nears resolution. In addition, disclosures of similar contingencies may be aggregated so that disclosures are understandable and not too detailed.

The proposed amendments would not change an entity’s requirement to recognize loss contingencies that are *probable* and to disclose loss contingencies that are at least *reasonably possible* (although the information actually disclosed would most likely change). However, certain *remote* contingencies would require disclosure if, because of their nature, potential magnitude, or potential timing (if known), disclosure would be “necessary to inform users about the entity’s vulnerability to a potential severe impact” (“special remote”). ASC 275-10-20 defines severe impact, in part, as a “significant financially disruptive effect on the normal functioning of an entity. Severe impact is a higher threshold than material. . . . The concept of severe impact, however, includes matters that are less than catastrophic.”

Entities must use significant judgment when determining whether a remote contingency should be disclosed. They must consider all relevant facts and circumstances, such as (1) the potential effect on the entity’s operations, (2) the cost for the entity to defend its contentions, and (3) the amount of time and energy that management may have to devote to resolve the contingency.

## Qualitative Disclosures

Entities would be required to disclose the following qualitative information about a loss contingency that meets the threshold for disclosure (i.e., probable, reasonably possible, or special remote) or classes (types) of similar contingencies:

- Information about the nature and risks of the loss contingency.
- For individually material contingencies, information that is sufficiently detailed to enable users to “obtain additional information from publicly available sources such as court records.” This could include the “name of the court or agency in which the proceedings are pending,” the “date instituted, the principal parties to the proceedings,” a “description of the factual basis alleged to underlie the proceeding,” and the “current status of the litigation contingency.”
- When applicable, the basis for aggregation and “information that would enable financial statement users to understand the nature, potential magnitude, and potential timing (if known) of loss.”

The proposed ASU would require public entities to present a table reconciling the total aggregate amount of contingencies recognized in the statement of financial position at the beginning and end of the period.

In addition, for asserted litigation contingencies, entities should make the following disclosures:

- During early stages, the contentions of the parties (i.e., the basis for the claim amount, the amount of damages claimed, the basis for the entity's defense or that the entity has not yet formulated its defense).
- More extensive disclosures as additional information about a potential unfavorable outcome becomes available (e.g., as progress is made toward resolution, or as the likelihood and magnitude of a loss increase).
- For individually material asserted litigation contingencies, the anticipated timing/next steps (if known).

## Quantitative Disclosures

Although qualitative and quantitative information about loss contingencies is required under existing U.S. GAAP, the proposed ASU would significantly enhance the disclosure requirements to enable users to better assess the "nature, potential magnitude, and potential timing (if known)" of the loss contingencies. Specifically, for **all loss contingencies that meet the threshold for disclosure** (i.e., probable, reasonably possible, or special remote), an entity would disclose:

- Publicly available quantitative information (e.g., the amount claimed by the plaintiff or damages indicated through expert witness testimony).
- Other nonprivileged information that would help users understand the potential magnitude of the possible loss.
- Information about potential recoveries from insurance and other sources, but only if (1) such information "has been provided to the plaintiff(s) in a litigation contingency" or "is discoverable by either the plaintiff or regulatory agency" or (2) a receivable has been recognized. "If the insurance company has denied, contested, or reserved its rights related to the entity's claim for recovery, an entity shall disclose that fact."

In addition, if a loss contingency is **probable or reasonably possible**, an entity would disclose an estimate of the possible loss or range of loss and the amount accrued (if any), unless an estimate cannot be made, in which case the entity would state that fact and explain its reasons. If an entity has insurance or other recoveries related to its loss contingencies, the potential recovery amounts are not netted (offset) against amounts accrued for loss contingencies.

## Tabular Reconciliation

The proposed ASU would also require **public entities** to present a table reconciling the total aggregate amount of contingencies recognized in the statement of financial position at the beginning and end of the period. The FASB believes this information will "provide users with valuable information about significant estimates and changes in those estimates that are subject to significant measurement judgment." Presentation of the table would be required for each period for which an income statement is presented. Although they would be included in the reconciliation, contingencies recorded in a business combination would be shown separately from other contingencies if they have a different measurement attribute (i.e., fair value versus probable loss amount). Likewise, the reconciliation should be presented **separately for each class of contingencies** so that dissimilar contingencies are not aggregated.

In addition to the beginning and ending balances, the table would show the following:

- Increases in amount accrued for new loss contingencies recognized.
- Increases for changes in estimates for amounts previously recognized.
- Decreases for changes in estimates for amounts previously recognized.
- Decreases for cash payments or other forms of settlement.

Further, an entity would be required to provide a qualitative description of any significant activity included in the table. The entity would also need to disclose which line item in the statement of financial position contains the loss contingency amounts. An entity need not disclose contingencies that arise and are resolved in the same period (except those recognized in a business combination).

### Prejudicial Exemption

The 2008 ED included a limited exemption under which an entity would not be required to provide detailed information that might be prejudicial (e.g., in the context of pending or threatened litigation in which disclosure could affect the outcome of the contingency itself). However, the FASB did not include this exemption in the proposed ASU because it believes it eliminated many of the speculative/predictive disclosures required under the 2008 ED.

### Effective Date and Transition

For public entities, the proposed amendments would be effective for fiscal years ending after December 15, 2010, and interim and annual periods in subsequent fiscal years. For nonpublic entities, the proposed amendments would be effective for the first annual period beginning after December 15, 2010, and for interim periods of fiscal years after the first annual period. Early adoption would be permitted. Comparative disclosures would only be required for periods ending after initial adoption.

### Convergence With IFRSs

The proposed ASU is not part of the FASB's and IASB's current efforts to converge U.S. GAAP and IFRSs, as outlined in the boards' *Memorandum of Understanding*. However, the disclosures that would be required under the proposed ASU are similar to those required under IAS 37.<sup>3</sup> The IASB is currently deliberating amendments to IAS 37 that would, among other things, improve the guidance on identifying, recognizing, and measuring liabilities. While such amendments would reduce the differences between IAS 37 and U.S. GAAP, they are significantly broader in scope than those in the FASB's proposed ASU. See Deloitte Touche Tomatsu's *January 2010 IAS Plus Update* on the IASB's re-exposure of certain amendments to IAS 37.

The disclosures that would be required under the proposed ASU are similar to those required under IAS 37.

<sup>3</sup> IAS 37, *Provisions, Contingent Liabilities and Contingent Assets*.

## Appendix

The table below compares the current guidance in ASC 450-20, the 2008 ED, and the proposed ASU.

	ASC 450-20	2008 ED	Proposed ASU
Scope	Affects all entities; however, does not apply to the initial recognition of liability arising from loss contingencies recognized at fair value on the acquisition date in a business combination under ASC 805-20.	Would have affected all entities. In addition, loss contingencies assumed in a business combination under ASC 805 were within the scope of the proposed guidance.	Same scope as 2008 ED; however, the tabular reconciliation requirement (see below) only applies to public entities. “[O]bligations that may result from withdrawal from a multiemployer plan” would also be included in the scope of ASC 450-20.
Scope exceptions	<p>The following transactions are excluded from the scope of ASC 450-20:</p> <ul style="list-style-type: none"> <li>• Stock issued to employees (ASC 718).</li> <li>• Employment-related costs (i.e., deferred compensation contracts — see ASC 710, 712, 718); however, certain postemployment benefits are included through application of ASC 712-10-25-4 and 25-5.</li> <li>• Uncertainty in income taxes (ASC 740-10-25).</li> <li>• Accounting and reporting by insurance entities (ASC 944).</li> </ul>	<p>In addition to the scope exceptions in the current guidance, contingencies arising from the following would have also been excluded:</p> <ul style="list-style-type: none"> <li>• Asset impairments (i.e., allowance for uncollectible accounts receivable, impairment of loans).</li> <li>• Guarantees.</li> <li>• Unpaid claim costs related to insurance contracts.</li> <li>• Employment-related costs, including pensions and other postemployment benefits.</li> </ul>	Scope exceptions are consistent with current guidance (the scope exceptions in the 2008 ED were not included).
Threshold for recording a loss contingency	<p>Accrual should be made if:</p> <ul style="list-style-type: none"> <li>• It is <b>probable</b> that an asset has been impaired or a liability incurred.</li> <li>• The amount can be reasonably <b>estimated</b>.</li> </ul>	No change.	No change.
Unasserted claims or assessment in which “there has been no manifestation by a potential claimant of an awareness of a possible claim or assessment”	<p>Disclosure is not required unless both of the following apply:</p> <ul style="list-style-type: none"> <li>• It is probable that the claim will be asserted.</li> <li>• An unfavorable outcome is reasonably possible.</li> </ul>	No change.	No change. However, additional implementation guidance is included.
Disclosure of remote contingencies	Disclosure not required.	<p>Remote contingencies would have been subject to the disclosure requirements if both of the following conditions were met:</p> <ul style="list-style-type: none"> <li>• Resolution was expected in the near term.</li> <li>• A “severe impact on the entity’s financial position, cash flows, or results of operations” was possible.</li> </ul>	<p>Remote contingencies should be disclosed if, because of the “nature, potential magnitude, or potential timing (if known),” disclosure is “necessary to inform users about the entity’s vulnerability to a potential severe impact.” Entities will need to exercise judgment and consider all facts and circumstances.</p>

	ASC 450-20	2008 ED	Proposed ASU
Quantitative disclosures	<p>Quantitative disclosures include:</p> <ul style="list-style-type: none"> <li>For probable loss contingencies, the amount accrued, if necessary for the financial statements to not be misleading.</li> <li>For reasonably possible loss contingencies, an estimate of the possible loss or range of a loss, or a statement that an estimate cannot be made.</li> </ul>	<p>For probable loss contingencies, the amount accrued (excluding possible recoveries).</p> <p>In addition, for all loss contingencies requiring disclosure (probable, reasonably possible, certain remote loss contingencies), either of the following:</p> <ul style="list-style-type: none"> <li>The amount of the claim or assessment against the entity.</li> <li>The entity's estimate of the <b>maximum exposure to loss</b> if there is no claim or assessment amount.</li> </ul> <p>Entities that did not believe the maximum exposure to loss was representative of their actual exposure would have also been permitted to disclose their best estimate of the possible loss or range of loss.</p>	<p>For all loss contingencies requiring disclosure (probable, reasonably possible, special remote):</p> <ul style="list-style-type: none"> <li>Publicly available quantitative information (e.g., amount claimed by plaintiff or damages indicated through expert witness testimony).</li> <li>Other relevant, nonprivileged information that enables users "to understand the potential magnitude of the possible loss."</li> <li>Certain information about possible recoveries from insurance (see further discussion below).</li> </ul> <p>For loss contingencies that are probable or reasonably possible, in addition to the disclosures above, disclosure of an estimate of the possible loss or range of loss and amount accrued, if any (or if amount cannot be estimated, a statement to this effect).</p>
Qualitative disclosures	<p>Disclose the nature of the contingency.</p>	<p>Disclosures "sufficient to enable users to understand the risks posed to the entity," including the following:</p> <ul style="list-style-type: none"> <li>Description of the contingency (how it arose, legal or contractual basis, current status, timing of resolution).</li> <li>Description of factors that were likely to affect the ultimate outcome and potential effect on the outcome.</li> <li>Entity's qualitative assessment of the most likely outcome.</li> <li>Significant assumptions used in estimating the quantitative disclosures and in assessing the most likely outcome.</li> </ul>	<p>For all contingencies that meet the disclosure threshold (for "a loss contingency or classes (types) of similar loss contingencies"), disclose information that enables users to understand the nature and risk of the contingency.</p> <p>For asserted litigation contingencies:</p> <ul style="list-style-type: none"> <li>During early stages, the contentions of the parties.</li> <li>"[M]ore extensive [disclosures] as additional information about a potential unfavorable outcome becomes available" (e.g., as progress is made toward resolution, or as likelihood and magnitude of loss increase).</li> <li>For individually material asserted litigation contingencies, the anticipated timing/next steps (if known).</li> </ul> <p>If the contingency is individually material, sufficient detail to enable users to obtain additional publicly available information, such as court records.</p> <p>For aggregated disclosures, the basis for aggregation and information that helps "users to understand the nature, potential magnitude, and potential timing (if known) of loss."</p>
Possible recoveries from insurance	<p>Disclosure of noninsured or underinsured risks is not required but would not be discouraged in appropriate circumstances.</p> <p>Silent about other insurance/recovery disclosures.</p>	<p>Potential recoveries from insurance or other arrangements would not have been offset against amounts accrued for loss contingencies.</p> <p>Disclosure would have been required of a qualitative and quantitative description of any insurance or indemnification arrangements that could have resulted in a recovery of some or all of the loss.</p> <p>The quantitative disclosures and the amounts in the tabular reconciliation would have excluded the effect of possible recoveries.</p>	<p>Potential recoveries from insurance or other arrangements should not be offset against amounts accrued for loss contingencies.</p> <p>Quantitative disclosures are required about possible recoveries from insurance and other sources, but only to the extent that (1) information has been provided to the plaintiff in a litigation contingency or is discoverable by the plaintiff or regulatory agency or (2) a receivable has been recorded for the recovery.</p> <p>Disclosure should also be made if an insurance claim has been denied, contested, or reserved.</p>

ASC 450-20		2008 ED	Proposed ASU
Aggregation	Silent.	<p>Quantitative and qualitative disclosures “may [have been] aggregated by the nature of the loss contingency (for example, product liability or antitrust matters).”</p> <p>The Board believed many preparers already aggregated disclosures in a meaningful way; thus, option was not likely to result in a significant change.</p>	<p>“[D]isclosures about similar contingencies (for example, by class or type) [may be aggregated] so that disclosures are understandable and not too detailed.” The basis of aggregation should be disclosed.</p> <p>Use of judgment is required (i.e., assessing whether contingencies are sufficiently similar to be included in one class, finding the “right balance” to help users understand the “nature, potential magnitude, and potential timing (if known”).</p>
Tabular reconciliation of recognized loss contingencies	Not required.	<p>Would have applied to <b>all entities</b>.</p> <p>For each period presented, a tabular reconciliation would have been required of the total amount recognized in the aggregate at the beginning and end of the period, detailing increases for new contingencies, increases/decreases from a change in estimate, derecognition of amounts previously recognized, and decreases from cash payments or other forms of settlement.</p> <p>Contingencies under ASC 805 and ASC 450-20 would have been shown separately.</p> <p>Qualitative description would have been required of significant activity in reconciliation and disclosure of line item in statement of financial position in which accrual was included.</p> <p>All loss contingencies recognized in a business combination would have been included; however, other contingencies whose cause and settlement occurred in the same period would have been excluded.</p> <p>Disclosure would have been required of the amounts of any recoveries from insurance or indemnification arrangements related to contingencies included in rollforward.</p>	<p>Substantially the same as the 2008 ED except for a clarification that the tabular reconciliation should be presented separately for each class of contingencies so that dissimilar contingencies are not aggregated. Further, requirement would only apply to <b>public entities</b>.</p>
Prejudicial exemption	None.	<p>Limited exemption — entity would not have been required to provide detailed information that might have been prejudicial (e.g., in the context of pending or threatened litigation in which disclosure could have affected the outcome of the contingency itself). However, entity would still have been required in all circumstances to disclose (1) the amount of the claims or assessments against it (or its estimate of maximum exposure to loss), (2) a description of the loss contingency, and (3) a description of the factors likely to affect the contingency’s outcome.</p>	<p>Does not include a prejudicial exemption — the FASB believes it eliminated many of the speculative/predictive disclosures required under the 2008 ED.</p>

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