FASB Interpretation No. 14

FIN14 Status Page

Reasonable Estimation of the Amount of a Loss

an interpretation of FASB Statement No. 5

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Financial Accounting Standards Board
of the Financial Accounting Foundation
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FIN 14: Reasonable Estimation of the Amount of a Loss an interpretation of FASB Statement No. 5

INTRODUCTION

1. The two conditions for accrual of an estimated loss from a loss contingency set forth in paragraph 8 of *FASB Statement No. 5*, "Accounting for Contingencies," are that "(a) information available prior to issuance of the financial statements indicates that it is probable that an asset had been impaired or a liability had been incurred at the date of the financial statements...." and "(b) the amount of loss can be reasonably estimated." In some situations in which condition (a) in paragraph 8 is met, a range of loss can be reasonably estimated but no single amount within the range appears at the time to be a better estimate than any other amount within the range. The Board has been asked to clarify whether, in those situations, condition (b) in paragraph 8 also is met and, if so, to explain what amount of loss should be accrued.

INTERPRETATION

2. As indicated in paragraph 59 of *FASB Statement No. 5*, the purpose of the two conditions in paragraph 8 of the Statement is "to require accrual of losses when they are reasonably estimable and relate to the current or a prior period." Condition (b) in paragraph 8, that "the amount of loss can be reasonably estimated," does not delay accrual of a loss until only a single amount can be reasonably estimated. To the contrary, when condition (a) in paragraph 8 is met, i.e., "it is probable that an asset had been impaired or a liability had been incurred," and information available indicates that the estimated amount of loss is within a range of amounts, it follows that some amount of loss has occurred and can be reasonably estimated.

3. When condition (a) in paragraph 8 is met with respect to a particular loss contingency and the reasonable estimate of the loss is a range, condition (b) in paragraph 8 is met and an amount shall be accrued for the loss. When some amount within the range appears at the time to be a better estimate than any other amount within the range, that amount shall be accrued. When no amount within the range is a better estimate than any other amount, however, the minimum amount in the range shall be accrued.[1] In addition, paragraph 9 of the Statement may require

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disclosure of the nature and, in some circumstances, the amount accrued, and paragraph 10 requires disclosure of the nature of the contingency and the additional exposure to loss if there is at least a reasonable possibility of loss in excess of the amount accrued.

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

5. The same answer would result under the example in paragraph 4 above if it is probable that a verdict will be unfavorable even though the trial has not been completed before the financial statements are issued. In that situation, condition (a) in paragraph 8 would be met because information available to the enterprise indicates that an unfavorable verdict is probable. An assessment that the range of loss is between $3 million and $9 million would meet condition (b) in paragraph 8. If no single amount in that range is a better estimate than any other amount, *FASB Statement No. 5* requires an accrual of $3 million at December 31, 1976, disclosure of the nature of the contingency and the exposure to an additional amount of loss of up to $6 million, and possibly disclosure of the amount of the accrual. Note, however, that if the enterprise had assessed the verdict differently (e.g., that an unfavorable verdict was not probable but was only reasonably possible), condition (a) in paragraph 8 would not have been met and no amount of loss would be accrued but the nature of the contingency and any amount of loss that is reasonably possible would be disclosed.

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

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

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nature of the contingency and the exposure to an additional amount of loss of up to $300,000, and possibly disclosure of the amount of the accrual.

EFFECTIVE DATE AND TRANSITION

8. The provisions of this Interpretation shall be effective for financial statements for annual and interim periods beginning after October 15, 1976. Earlier application is encouraged in financial statements for annual and interim periods beginning before October 15, 1976 that have not been previously issued. An accrual for a loss contingency or an adjustment of an established accrual for a loss contingency resulting from application of this Interpretation shall be accounted for as a change in estimate in accordance with the requirements of paragraph 31 of *APB Opinion No. 20*, "Accounting Changes." This Interpretation shall not be applied retroactively for previously issued annual and interim financial statements.

This Interpretation was adopted by the unanimous vote of the six members of the Financial Accounting Standards Board following submission to the members of the Financial Accounting Standards Advisory Council.

Marshall S. Armstrong, *Chairman*
Oscar S. Gellein
Donald J. Kirk
Arthur L. Litke
Robert E. Mays
Robert T. Sprouse

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Footnotes

FIN14, Footnote 1--Even though the minimum amount in the range is not necessarily the amount of loss that will be ultimately determined, it is not likely that the ultimate loss will be less than the minimum amount.

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