FASB EXPOSURE DRAFT

Proposed Statement of Financial Accounting Concepts

Issued: March 4, 2014
Comments Due: July 14, 2014

Conceptual Framework for Financial Reporting

Chapter 8: Notes to Financial Statements

This Exposure Draft of a proposed Statement of Financial Accounting Concepts is issued by the Board for public comment. Comments can be provided using the electronic feedback form available on the FASB website. Written comments should be addressed to:

Technical Director
File Reference No. 2014-200

Financial Accounting Standards Board

Notice to Recipients of This Exposure Draft of a Proposed Statement of Financial Accounting Concepts

The Board invites comments on all matters in this Exposure Draft and is requesting comments by July 14, 2014. Interested parties may submit comments in one of three ways:

- Using the electronic feedback form available on the FASB website at Exposure Documents Open for Comment
- Emailing a written letter to director@fasb.org, File Reference No. 2014-200
- Sending written comments to “Technical Director, File Reference No. 2014-200, FASB, 401 Merritt 7, PO Box 5116, Norwalk, CT 06856-5116.”

Do not send responses by fax.

All comments received are part of the FASB’s public file. The FASB will make all comments publicly available by posting them to the online public reference room portion of its website.

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FASB FINANCIAL ACCOUNTING STANDARDS BOARD

Proposed Statement of Financial Accounting Concepts

Conceptual Framework for Financial Reporting

Chapter 8: Notes to Financial Statements

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Preface

Background

P1. On July 8, 2009, the Board added the disclosure framework project to its technical agenda with the goal of establishing an overarching framework intended to make financial statement disclosures more effective and coordinated and less redundant. The project was added in response to requests and recommendations received from several stakeholders, including the Investors Advisory Committee (formerly the Investors Technical Advisory Committee) and the Securities and Exchange Commission (SEC) in its *Final Report of the Advisory Committee on Improvements to Financial Reporting* (Recommendations 1.2 and 1.3).

P2. In July 2012, the Board published for public comment an Invitation to Comment, *Disclosure Framework*. That Invitation to Comment contained a discussion of the Board's decision process for deciding on disclosures, flexible disclosure requirements, an entity's decision process related to those flexible requirements, and the organization and format of disclosures. The Invitation to Comment also included discussions related to interim reporting and accounting policies.

P3. The Board received 84 comment letters in response to the 2012 Invitation to Comment. This Exposure Draft represents the Board's views after considering respondents' comments and the views received through other outreach initiatives, as well as the Board's reasons for modifying some of the views in that Invitation to Comment.

Developing the Conceptual Framework

P4. The first Concepts Statement was issued in 1978, and a total of seven Concepts Statements were issued through the year 2000. In 2004, the International Accounting Standards Board (IASB) and the FASB began a joint project on the conceptual framework followed by the issuance in 2010 of FASB Concepts Statement No. 8, *Conceptual Framework for Financial Reporting—Chapter 1,* The Objective of General Purpose Financial Reporting, *and Chapter 3,* Qualitative Characteristics of Useful Financial Information. However, later in 2010, the Boards decided to postpone further action until after the completion of a number of key joint projects. The IASB eventually decided to reactivate the project as an IASB project on the basis of the results of its 2011 Agenda Consultation. In September 2012, the IASB recommenced discussions related to the project. One of the five key items that the IASB anticipated being addressed in its conceptual framework project was disclosure. The IASB concluded that the conceptual framework project should include only high-level principles related to presentation and disclosure. More detailed work on presentation and disclosure would be carried out in another project, the disclosure initiative. The IASB's conceptual framework project and the research phase of the disclosure initiative are intended to run concurrently with one another because of the complementary nature of the projects.

P5. The FASB concluded that a comprehensive reconsideration of all concepts would not be an efficient use of its resources. Many aspects of the IASB's *Framework for the Preparation and Presentation of Financial Statements* and the FASB's *Statements of Financial Accounting Concepts* are consistent with each other and do not seem to need fundamental revision. Instead, the FASB adopted an approach that focuses on the improvement of the existing framework, giving priority to issues that are likely to yield standard-setting benefits in the near term. In January 2014, the FASB decided to reactivate work on the conceptual framework.

P6. In this Exposure Draft, the Board is considering conceptual matters relating to notes to financial statements. The Board intends to use the concepts developed as part of this project as a basis for establishing disclosure requirements in the future as well as evaluating existing disclosure requirements.

P7. The disclosure framework project also includes a separate component related to the decisions that reporting entities make when evaluating disclosure requirements. While this chapter would promote consistent decisions about disclosure requirements by the Board, the entity's decision process would promote the appropriate exercise of discretion by reporting entities in meeting those requirements. The entity's decision process for complying with disclosure requirements will not be part of the conceptual framework and will be exposed separately in a proposed Accounting Standards Update.

P8. On December 20, 2013, the SEC issued a staff report to Congress on its disclosure rules for U.S. public companies, *Report on Review of Disclosure Requirements in Regulation S-K*. The report was mandated by Section 108 of the 2012 Jumpstart Our Business Startups (JOBS) Act and required the SEC staff to conduct a review of Regulation S-K to determine how the requirements therein can be updated to modernize and simplify the registration process for emerging growth companies.[1] The Report offers an overview of the SEC's Regulation S-K as well as the SEC staff's preliminary conclusions and recommendations. The Board expects to continue to work in a coordinated manner with the SEC staff to

[1]The Securities and Exchange Act of 1933 defines the term *emerging growth company* as:

> . . . an issuer that had total annual gross revenues of less than $1,000,000,000 (as such amount is indexed for inflation every 5 years by the Commission to reflect the change in the Consumer Price Index for All Urban Consumers published by the Bureau of Labor Statistics, setting the threshold to the nearest 1,000,000) during its most recently completed fiscal year.

identify ways to improve the efficiency and effectiveness of disclosures, including ways to reduce overlapping disclosures.

Authoritative Status of the Framework

P9. This Exposure Draft is intended to become a chapter in Concepts Statement 8. FASB Concepts Statements do not override authoritative standards, even though some standards may be inconsistent with them.

P10. Paragraph 105-10-05-03 of the *FASB Accounting Standards Codification*® states that FASB Concepts Statements are nonauthoritative. If guidance for a transaction or event is not specified within a source of authoritative generally accepted accounting principles (GAAP) for that entity, the entity first must consider accounting principles for similar transactions or events within authoritative GAAP and then consider nonauthoritative guidance from other sources (including Concepts Statements).

P11. In preparing responses to this Exposure Draft, respondents should consider the differences in status of the FASB Concepts Statements and the Accounting Standards Codification, as well as the possibility that FASB Concepts Statements could be elevated to authoritative status in the future.

How This Chapter of the Framework Would Be Used

P12. This chapter of Concepts Statement 8 is similar to the rest of the framework in that it would establish concepts that the Board will use in developing standards of financial accounting and reporting. In particular, this chapter would provide the Board with a framework for identifying information that could be appropriate for inclusion in notes to financial statements and relevant to the users of those statements.

P13. This chapter of the framework would identify, by design, a broad range of possibilities for the Board to consider when deciding on the disclosures related to a particular topic that is required under U.S. GAAP. From that intentionally broad set, the Board would identify a more narrow (and, in many cases, a far more narrow) set of disclosures about that topic to be required.

P14. This chapter of the framework would not specify how the Board should accomplish that narrowing of disclosures. That can best be done in the context of individual standard-setting projects. The Board would have to assess the potential benefits of entities providing specific information and justify the costs of providing and using that information. Paragraph QC39 in Chapter 3 of Concepts Statement 8 states the following:

> Because of the inherent subjectivity, different individuals' assessments of the costs and benefits of reporting particular items of financial information will vary. Therefore, the Board seeks to consider costs and benefits in relation to financial reporting generally, and not just in relation to individual reporting entities. That does not mean that

assessments of costs and benefits always justify the same reporting requirements for all entities. Differences may be appropriate because of different sizes of entities, different ways of raising capital (publicly or privately), different users' needs, or other factors.

In addition, the Board would consider the consequences that may come from an entity providing particular information in notes.

P15. Because this chapter eventually would be contained within Concepts Statement 8, many of the concepts that the Board uses when setting standards are not repeated in this Exposure Draft.

Summary and Questions for Respondents

Summary

Introduction to the Framework

S1. Concepts Statement 8 establishes the concepts that underlie financial reporting. The framework is a coherent system of concepts that flow from an objective. The objective of financial reporting is the foundation of the framework. The other concepts provide guidance to varying degrees on identifying the boundaries of financial reporting: selecting the transactions, events, and circumstances to be represented; how those items should be recognized, measured, and disclosed; and how they should be summarized and presented in financial reports.

Notes to Financial Statements

S2. The primary purpose of notes to financial statements is to supplement or further explain the information on the face of financial statements by providing financial information relevant to existing and potential investors, lenders, and other creditors for making decisions about providing resources to the entity.

S3. Decisions about whether to provide resources depend, at least in part, on resource providers' assessments of cash flows that they ultimately would receive. Financial statements provide information that does both of the following:

a. Assists resource providers in the assessments of prospects for net cash inflows to the reporting entity, which are based on the resources of and claims against the entity and the efficiency and effectiveness of the entity's management and governing board in discharging their responsibilities.
b. Explains the nature of the specific investment or credit instrument, the rights to cash flows that the entity conveys to its holder, and its relationship to other claims against the entity.

S4. To help make the decisions in the previous paragraph, the notes should contain information about the following matters:

a. Financial statement line items
b. The reporting entity
c. Past events and current conditions and circumstances that have not met the criteria for recognition that can affect an entity's cash flows.

S5. The following information might be suitable for the purposes described in paragraph S3, but generally should not be required by the Board in the notes:

a. Assumptions and expectations about uncertain future events that are not reflected in financial statements
b. Information about matters that are not specific to the entity and are common knowledge or readily and cost effectively available from other sources as long as a knowledgeable resource provider should be aware of the need for the information and its availability.

Questions for Respondents

S6. The Board invites individuals and organizations to comment on all matters in this Exposure Draft, particularly on the issues and questions below. Comments are requested from those who agree with the proposed concepts as well as from those who do not agree. Comments are most helpful if they identify and clearly explain the issue or question to which they relate. Those who disagree with the proposed concepts are asked to describe their suggested alternatives, supported by specific reasoning.

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

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

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?

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?

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?

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?

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?

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?

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?

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?

Conceptual Framework for Financial Reporting

Chapter 8: Notes to Financial Statements

Introduction

D1. This chapter discusses the information that should be considered for inclusion in notes to financial statements. It also addresses considerations specific to interim period financial statements.

D2. There are limits to the information that can and should be provided in a set of general purpose financial statements, including the notes. Information that should be depicted in words and numbers on the face of financial statements is determined by the definitions of assets, liabilities, equity, revenues and expenses, gains and losses, and the related recognition and measurement requirements.[2] This chapter explains what information should be considered for inclusion in notes. It first describes the purpose of notes and general limitations and then more directly addresses the nature of the appropriate content in detail.

Background from Other FASB Concepts Statements

Businesses

D3. FASB Concepts Statement No. 5, *Recognition and Measurement in Financial Statements of Business Enterprises,*[3] identifies in general terms the purpose of notes to financial statements. Paragraph 7 makes the following statements:

> . . . some useful information is better provided by financial statements and some is better provided, or can only be provided, by notes to financial statements or by supplementary information. . . .
>
> a. Information disclosed in notes or parenthetically on the face of financial statements . . . amplifies or explains information recognized in the financial statements. [Footnote references omitted.]

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[2]Definitions of elements and recognition criteria are in FASB Concepts Statements No. 6, *Elements of Financial Statements*, and No. 5, *Recognition and Measurement in Financial Statements of Business Enterprises*, respectively.

[3]Although the recognition criteria and measurement attributes discussed in Concepts Statement 5 are intended to apply specifically to business enterprises, the general discussion of financial statements and notes is equally applicable to not-for-profit organizations and employee benefit plans.

According to paragraph 6 of that same Concepts Statement, recognition is defined as:

> . . . the process of formally recording or incorporating an item into the financial statements of an entity as an asset, liability, revenue, expense, or the like. Recognition includes depiction of an item in both words and numbers, with the amount included in the totals of the financial statements.

D4. Thus, one of the purposes of notes to financial statements[4] is to amplify or explain information depicted in words and numbers on the face of, and included in totals of, financial statements. (This chapter refers to that information as financial statement line items or, simply, line items.)[5]

D5. The objective of financial reporting is the starting point for identifying which information is needed to amplify or explain information in line items. That objective, as discussed in paragraph OB2 of Chapter 1 of Concepts Statement 8, is:

> . . . to provide financial information about the reporting entity that is useful to existing and potential investors, lenders, and other creditors in making decisions about. . . . buying, selling, or holding equity and debt instruments and providing or settling loans and other forms of credit.

According to paragraph OB3, investors' and creditors' decisions are based on their expectations about returns from their investments, loans, or other forms of credit. The parties noted in paragraph OB2 (along with contributors to not-for-profit organizations) are referred to throughout this chapter as resource providers.

D6. Ultimately, expectations about returns from investments, loans, and other forms of credit depend directly or indirectly on the following factors:

a. An assessment of prospects for net cash inflows to the reporting entity. To make those assessments, 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.

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[4]In some cases, as indicated in the quote from Concepts Statement 5 in paragraph D3, entities have a choice of providing information in notes or parenthetically on the face of financial statements. For convenience and ease of reading, this chapter specifically refers only to notes, but the concepts discussed also apply to information disclosed parenthetically.

[5]Line items are discussed in this chapter as if each represents only one phenomenon. That ignores the fact that nearly every financial statement line item represents an aggregation of items, and it simplifies sentence structures in this chapter while still conveying the intended meaning.

b. The nature of the specific investment or credit instrument—the rights to cash flows that an investment or claim conveys to its holder and its relationship to other claims against the entity. That includes the level of subordination or seniority, collateral, if any, the interest rate, and any other relevant terms of the right to distributions from the entity. The assessments of those factors lead investors or creditors to an assessment of prospects for cash flows to themselves.

D7. Of course, financial statements are not the only source of information that can be useful to a resource provider's decision making and are not designed to show the value of an entity. Financial statements provide information that can assist resource providers in making their decisions.

Not-for-Profit Entities

D8. Paragraph 30 of FASB Concepts Statement No. 4, *Objectives of Financial Reporting by Nonbusiness Organizations*, states the following:

> Present and potential users of the information provided by financial reporting by a particular nonbusiness organization share a common interest in information about the services provided by the nonbusiness organization, its efficiency and effectiveness in providing those services, and its ability to continue to provide those services.

Those users are different from the current and potential lenders or other creditors because lenders and other creditors are generally most interested in assessing cash flows to themselves.

D9. A contributor can use information about an entity's use of its resources to assess the services that have been provided and the potential to provide services in the future. Because the assessments of services and the ability to provide services can be aided, at least in part, through assessing the past and future cash flows of the entity, this chapter of Concepts Statement 8 can be used to identify information that would be useful to users of not-for-profit financial statements.

D10. However, some disclosures may not be beneficial to both contributors and investors, lenders, and other creditors. Thus, the Board should consider the contributor in addition to the other types of resource providers when using the concepts within this chapter and the decision questions within Appendix A.

Employee Benefit Plans

D11. Currently, there is no explicit mention within the Concepts Statements of matters specific to employee benefit plan financial statements. An employee benefit plan's financial statements and their users are sufficiently different from business entities and not-for-profit entities to warrant potentially different considerations in reporting. Therefore, this chapter is not designed to be used by the Board when making disclosure decisions relative to employee benefit plans.

Types of Information in Notes to Financial Statements

D12. The information provided by the recognized amounts and related descriptions in the financial statements is fundamental to a resource provider's decision making, but the information that can be provided in that form is inherently limited. Information not discernable from line items or from readily available sources of information other than the entity could significantly affect a resource provider's decisions. Consequently, notes to financial statements provide types of relevant information that cannot be or is not provided on the face of the financial statements. The resulting disclosures can be categorized as information about financial statement line items, the reporting entity, and past events and current conditions and circumstances that have not met the criteria for recognition that can affect an entity's cash flows.

D13. First, notes provide information about specific line items either to amplify or to explain information on the face of the financial statements. The information conveyed by the amount and description of a line item does not always give users enough information to assist in their decisions about whether to provide resources to the entity. The nature, terms, or quality of an asset, whether it is on the basis of physical conditions, contractual terms, the ability of the counterparty to perform, or other factors, often will not be apparent from the amount and description of a line item or related line items. Similarly, important information about the nature, terms, or other features of a liability or equity instrument may not be discernable simply from the amount and description of a line item. Finally, the nature of revenues, expenses, gains and losses, and the reasons why they occurred may not be readily apparent from line items but may be important to assist the user, including assessing the probability that similar or related phenomena will occur in the future.

D14. Second, notes provide general information about the nature of the entity, its activities, any special restrictions or privileges that apply to it, and other advantages and disadvantages relative to other entities. That might include unusual or unique regulatory or legal factors that apply to the entity or it might be the nature of the entity's activities.[6] Resource providers require appropriate context or background to assess the potential effect of financial statement line items on prospective future cash flows to and from the entity because, among other things, an identical asset held or a liability owed by two different entities can have very different implications for a resource provider's decisions. For example, a resource provider would have a very different assessment of prospects for cash flows if one entity acquires subsidiaries to hold for a period of time and sell versus another entity that acquires subsidiaries and operates as a conglomerate. As another example, two entities may have identical performance obligations, but one may be required by law to hire licensed contractors to fulfill

[6]As discussed in paragraph S5, it is not necessary for a reporting entity to provide information if users can be presumed to be aware of the information because it is readily available from sources other than the entity at little or no cost.

the obligation and the other may not operate under that restriction. Not all of that information will be apparent from the entity's name or the descriptions of the line items or otherwise readily available from sources other than the entity.

D15. Third, notes provide information about other past events and current circumstances and conditions that will or may affect an entity's future cash flows but that have not affected a line item. The effects of events, circumstances, or conditions of that type may not be recognized because they have not (or the entity cannot determine whether they have) created resources of the entity or claims against the entity or caused changes to existing resources or claims. They also may not be recognized because the creation of, or changes in, resources or claims have not met the criteria for recognition or the Board has decided to prohibit or not to require recognition.

Limitations on Information in Notes to Financial Statements

D16. Advancements in technology enable some users of financial statements to consume more and more data and, thus, the demand for more data follows. However, the Board must be sensitive to the possibilities that excessive disclosure may cause users to overlook important information and that it may be burdensome to reporting entities. With that in mind, requirements to provide information in notes to financial statements are limited in at least three ways.

D17. First, the Board should only require information that is relevant to providers of resources to a significant number of the entities to which it applies. Second, the cost constraint applies; that is, the benefits of providing the information should justify the cost of providing as described in paragraphs QC35–QC39 in Chapter 3 of Concepts Statement 8. Third, including some types of future-oriented information in notes may have negative effects on the cash flow prospects of the reporting entity and its investors and creditors. Those negative consequences should be avoided if possible.

Relevance

D18. The Board's judgments about whether to establish disclosure requirements necessarily are based on broad general considerations of relevance rather than on materiality, which is entity specific. Ideally, disclosure requirements would be made applicable only to the specific entities to which they are most important. However, most types of disclosures have the potential to apply to a broad range of entities, and that range may change from year to year. Therefore, materiality decisions must be made by each individual entity, and the Board should establish requirements that are not so prescriptive that they preclude reporting entities from making materiality judgments.

The Cost Constraint

D19. Notes to financial statements are subject to the same cost constraint that applies to financial reporting in general. One implication is that the cost of a requirement to provide information in notes normally is not justified by the benefits if (a) that information is not specific to the individual entity and is readily and cost effectively available from sources other than the entity and (b) knowledgeable users should be aware of the need for the information and its availability. Generally, entities should not be required to provide in notes information about general economic, political, and social conditions, events, and circumstances that are common knowledge and not specific to the entity.[7]

D20. Resource providers would be expected to be aware of and have access to information about things such as the Accounting Standards Codification and common accounting practices, frequently used pricing models, and the SEC's rules and regulations or other regulations. Disclosure of accounting methods is important only if (a) alternatives are permitted, (b) the methods are not otherwise apparent, or (c) the methods have changed. Disclosure of mechanics of frequently used mathematical models is seldom if ever important.

D21. The Board attempts to avoid requiring information in notes that entities are otherwise required to provide, for example, in SEC filings or other regulatory reports. However, there are valid reasons why the Board at times considers requiring disclosure of information in notes when the entity provides similar or identical information in other forms of communication. For example, some entities whose resource providers would find the information useful may not be subject to the requirement to provide it in any other form of communication. Also, the form of communication in which the information is provided may not be required every period or may not be as timely as the financial statements and notes. Finally, the information provided in that other form of communication may not be as complete or subject to the same degree of scrutiny and verification as information in financial statements.

Future-Oriented Information

D22. Making decisions about providing resources involves, in part, assessing prospects for the entity's future cash flows. Resource providers make estimates and assumptions about future events and conditions and might benefit from receiving such future-oriented information in notes to financial statements, at least for use in comparison with their own predictions or assessments. The cost constraint would not always preclude requiring entities to provide that kind of information. Some entities prepare forecasts or budgets or both, or set detailed

[7]That does not mean that economic, social, or political information should never be required. For example, economic, social, or political matters specific to lesser known foreign jurisdictions in which the entity operates may not be generally available. Also, in times of significant economic, social, or political change, an entity may need to inform users about matters affecting the entity because the entity is in a better position to evaluate those effects.

numerical goals and objectives, and, in those cases, the incremental direct costs of preparing future-oriented information may not be particularly significant.[8]

D23. However, there sometimes are potentially significant negative consequences to issuers of financial statements (and ultimately to their investors and creditors) of providing some future-oriented information. Predictions, projections, forecasts, or similar assertions about uncertain or unknown future events that are beyond management's control cause the most concern because some of that information may turn out to be materially different from the actual future events or conditions when they occur. Some potential consequences are litigation or threat of litigation and loss of credibility.

D24. SEC registrants are required to provide "forward-looking"[9] information with respect to certain disclosures in portions of certain registrants' regulatory filings that are outside of audited financial statements, and they are encouraged to provide forward-looking information where doing so would be useful to investors.[10] Federal securities laws and SEC rules provide a "safe harbor" for some forward-looking information.[11] The safe harbor does not extend to audited financial statements, whether or not the reporting entity is an SEC registrant.

D25. The objective of financial reporting does not require a reporting entity's management to assess the entity's prospects for future cash flows, but to provide information to assist investors and creditors in making their own assessments. Therefore, it is not necessary for the Board to require that entities disclose in notes to financial statements the types of future-oriented information with the greatest potential for negative consequences to a reporting entity.

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[8]The cost and difficulty of auditing that information might, at least in some cases, change the judgment about whether costs are justified by benefits.

[9]SEC rules provide a safe harbor for "forward-looking" information, as defined in those rules, which is provided outside of audited financial statements. To avoid any confusion over possible differences in definition or scope, the term *forward looking* is not used elsewhere in this chapter.

[10]See, for example, SEC Securities Act of 1933 Release No. 33-8350, *Commission Guidance Regarding Management's Discussion and Analysis of Financial Condition and Results of Operations* (effective date: December 29, 2003):

> In addressing prospective financial condition and operating performance, there are circumstances, particularly regarding known material trends and uncertainties, where forward-looking information is required to be disclosed. We also encourage companies to discuss prospective matters and include forward-looking information in circumstances where that information may not be required, but will provide useful material information for investors that promotes understanding.

[11]See, for example, Section 27A(C) of the Securities Act of 1933, *Application of Safe Harbor for Forward-Looking Statements;* Section 21E of the Securities Exchange Act of 1934, *Application of Safe Harbor for Forward-Looking Statements,* on Safe Harbor; Securities Act Rule No. 175, *Liability for Certain Statements by Issuers;* and Exchange Act Rule 3b-6, *Liability for Certain Statements by Issuers.*

D26. However, there are at least three other types of future-oriented information that may be useful disclosures for the Board to consider in some cases and that would not be expected to have the same type of negative consequences as those discussed in paragraph D23.

D27. The first is information about estimates and assumptions used as inputs to measurements, many of which are future oriented and internally developed. Information about those inputs often is an important part of a faithful representation of a line item and does not create the same degree of risk of negative consequences as do projections or predictions about future events that are not within a line item in the financial statements. Many such inputs relate to fair value measurements (which are estimates of current market prices). Those inputs reflect a market perspective instead of the entity's own perspective and are required specifically to be based on existing conditions and currently available information. In addition, they are either probability weighted or discounted at a rate that allows for risk and uncertainty. Even the results of entity-specific measurement inputs are purported to represent the way the entity views an item at the reporting date on the basis of existing conditions, and are not purported to be predictions. However, some entity-specific measurements also include projections or predictions about future events (for example, salvage value, useful lives, and bad-debt percentages) that are important to faithful representation of the line item. Because that information explains amounts included in financial statement line items, it would be appropriate for the Board to consider requiring disclosure of these inputs. In contrast, estimates of future revenues related to future sales transactions or the timing of those revenues would not be related to past events or current conditions or circumstances. Therefore, that information would be inappropriate for the notes unless it was an input to a current measure of an asset or a liability.

D28. The second is information about existing plans and strategies related to matters under management's control. The disclosure of some types of plans may in some cases render those plans less effective and, therefore, adversely affect the reporting entity. That adverse consequence is different from those adverse consequences discussed in paragraph D23 and should be considered by the Board. Plans also are rarely required to be disclosed because a plan seldom supplements or explains amounts recognized in financial statements. For those reasons, it is likely that plans and strategies are not generally disclosed in notes to financial statements. However, there are exceptions, for example, plans as of the reporting date for the sale of a long-lived asset. That kind of future-oriented information does not involve an assertion about uncertain events beyond management's control nor does it represent promises by management, but it does represent management's current plans. That sort of disclosure is unlikely to result in a negative consequence to the entity as far as rendering the plan less effective, and it does help to further explain an amount that is currently recognized. However, an entity's plan and the entity's anticipated outcomes related to the plan, which are subject to external factors outside of the entity's control, would not be appropriate for requirement in the notes.

D29. The third is information about the effect of specified future changes in existing conditions on specific line items or on the entity as a whole. In some cases, it is difficult to discern the potential effects on cash flows of a particular line item (or of an entity) without some indication of the way that possible future changes in economic conditions would affect the line item (or an entity).

D30. One way to provide that information is by quantifying the effects of a specified change in economic conditions, for example, a 100-basis-point change in market interest rates. The Board might require that information in some circumstances if the information reflects the results of changing the inputs to a mathematical model and it is clearly explained that the effect (a) is specified in a standard and (b) does not represent a prediction by management. That sort of disclosure is different from a disclosure that requires an entity to predict changes in inputs, which are outside of its control and quantify those effects.

D31. In summary, the Board generally does not require disclosures of expectations and assumptions about the future that are not inputs to current measures in financial statements or notes.

Information Content of Notes to Financial Statements

D32. As previously discussed, the general types of information to be included in notes to financial statements are:

a. Additional information about line items
b. Information about the reporting entity
c. Information about other past events and current conditions and circumstances that can affect an entity's cash flows.

D33. Those descriptions are very general and might include a wide range of information. However, because of the limitations discussed in paragraphs D16–D31, it is not necessary that notes include all of the information that might fit those descriptions.

Additional Information about Line Items

D34. Resource providers can adequately understand some line items with little to no explanation or additional information in notes, for example, a noninterest-bearing-demand deposit in an entity's local currency that is not subject to any restrictions and that does not result in a concentration of risk. However, there are many line items about which users might need more information than is conveyed by the amount and description in addition to what users can gather cost effectively from readily available sources other than from the entity itself.

D35. The volume of information that would be required to adequately understand different line items varies greatly depending on many factors. Some assets and liabilities are easy to understand. In many cases, understanding trade accounts payable and receivable or plant and equipment would require only a little more information than what is conveyed by the amounts and descriptions of the line items. Similarly, some revenues and expenses result from routine transactions, and nearly all of the information users need may be conveyed by the amounts and descriptions of the line item. In contrast, complex financial instruments or gains or losses arising from complex transactions may require significantly more explanation and elaboration.

D36. 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. For example, assets may be physical, contractual or statutory, or intangible. Similarly, liabilities may result from contracts, statutes, or court actions, and revenues, expenses, and gains and losses may be routine or unusual and may result from cash transactions, accruals, or estimation processes. In each case, the set of information that should be provided is potentially different.

D37. Ultimately, each line item should be explained in enough detail for a user to understand the nature of the underlying phenomenon and significant uncertainties, if any, about ownership, obligation, or other matters that the entity considered in determining whether to recognize the item. Some other information that is useful for almost any kind of line item includes how the amounts were determined if that is not specified by U.S. GAAP, for example, measurement methods, measurement uncertainties, amortization or accretion methods, and any other relevant information about the accounting and, if applicable, why the amounts or descriptions changed from previous reporting periods or dates. If that information is not otherwise available or apparent, providing that information in notes would be appropriate.

D38. The following additional types of information will be useful for some line items in some circumstances:

a. Information about the nature, quality, location, and other factors affecting the utility of an asset, how the asset can or will generate future cash flows, how the asset relates to other line items (hedging relationships, liens, contractual restrictions on use, sale, and settlement), and any significant contractual, statutory, regulatory, or judicial restrictions on the asset's use or disposition
b. For assets or liabilities resulting from financial instruments or other contracts or legal documents:
    (1) Contractual or legal terms, such as the amount and timing of receipts or disbursements and the form of settlement (for example, by delivering cash or other assets, issuing equity or debt instruments, or performing services)
    (2) Degree of credit or nonperformance risk
    (3) Potential effect of the counterparty's or the entity's inability to pay or perform

   (4) Some indication of the method of determining and the amounts and timing of uncertain future flows (such as probability-weighted estimates, ranges of possibilities, or most positive outcomes or most negative outcomes) that are either one of the following:
      (a) Contractually required, but whose amounts and timing are not contractually specified
      (b) Not contractually specified, but that are anticipated or otherwise probable

c. The terms or conditions of equity instruments issued by the entity
d. 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
e. Breakdowns of line items that are aggregations of phenomena with significantly different descriptions, effects on cash flow prospects of the entity, risks, or accounting methods
f. Alternative measurements and information to support those measurements
g. How the line item relates to other line items in the financial statements.

Decision Questions to Be Considered in Establishing Disclosure Requirements

D39. Each time the Board sets new accounting standards or updates existing standards that affect specific line items or that require new line items, it considers what information should be provided about those particular line items. Appendix A would aid in that process by expanding on the types of information discussed in paragraphs D37 and D38. Appendix A is organized as a series of questions about the nature of line items being considered that, if answered positively, indicate the Board should consider requiring disclosures. It also provides a list of types of disclosures to consider. Obviously, because line items differ, a "yes" answer to a question does not automatically mean the Board should require disclosures. Judgments will be necessary in each circumstance.

D40. Two matters about line items are not included in Appendix A because they do not arise when establishing or updating standards about particular line items.

D41. First, although the Accounting Standards Codification addresses most phenomena that an entity will need to account for, there are or may still be gaps or new phenomena that may arise or be created. If an entity must determine on its own, by analogy or otherwise, how to account for a significant phenomenon not addressed in the Accounting Standards Codification, users almost certainly would need information about the method of accounting that the entity has used and possibly even why the entity decided to use that method.

D42. Second, disclosure about the correction of an error is a more detailed explanation of a change in a line item. Users most likely would be interested in understanding that an apparent change in the reported financial position of an entity occurred because of the correction of an error versus normal and routine transactions.

Information about the Reporting Entity

D43. There is a variety of general information about an entity that if unknown to resource providers could impair their ability to make informed resource allocation decisions. The general information that different entities should provide in notes to financial statements can vary greatly in both type and volume depending on the nature of the entity and its activities and the availability of information from other sources.

Information about the Entity and Its Activities

D44. The nature of many entities' primary activities is readily apparent or otherwise well known to the average person and need not be detailed in notes to financial statements. However, some entities are not very well known, even to investors or creditors who are well informed about the types of activities in which those entities engage. Also, some well-known entities' routine and recurring activities are more complex or varied than observers can be presumed to be aware of, and other entities engage in ancillary or occasional activities that would have a potentially significant effect on resource allocation decisions.

Restrictions, Privileges, Advantages, and Disadvantages

D45. Some entities operate with relatively few restrictions or privileges other than statutes that apply to every entity (for example, taxes and land use restrictions). Others are subject to restrictions or are granted privileges (or both) because of regulations. Others have significant contractual, statutory, or judicial restrictions or advantages. Still others have a business that depends heavily on government subsidies or on one or very few customers, suppliers, or financing sources. Information about any of those matters that have had, will have, or can have significant effects on resource allocation decisions is a candidate for disclosure.

Information about Related Parties and Related Party Transactions

D46. Most entities have interrelationships with their owners, managers, parents, subsidiaries, entities under common control, or other entities in which they have significant investments. Information about those matters can significantly affect resource allocation decisions if the interrelationships result in conditions, circumstances, transactions, or events that are different from what otherwise informed observers would have expected if they were uninformed about those interrelationships. Therefore, such interrelationships and their effects on conditions, circumstances, transactions, or events are candidates for disclosure.

Disaggregation of Legal Entities and Segments

D47. Disaggregation at the entity level (as opposed to the line item level) is a possible reason for providing information in notes. That information may be about disaggregation of consolidated entities or disaggregation of different activities, geographic areas, or other units managed separately.

D48. Consolidated financial statements tend to make a group of entities appear to an outside observer to be a single entity. Even though the observer may be aware (and in most cases should be aware) that a more complex structure exists, the potential to affect cash flows to resource providers may not be discernable unless the entity provides additional information in notes about its structure. In some cases, an entity may make a decision about whether to include a subsidiary or variable interest entity in consolidated financial statements under conditions of uncertainty. Information about such decisions and the related uncertainties is a candidate for disclosure.

D49. Many business entities provide significantly different products or services, otherwise engage in varied activities such as operating in different geographic areas with different effects on prospects for cash flows to resource providers, or may manage different portions of the consolidated entity separately or differently. Similarly, some not-for-profit organizations provide more than one type of service or otherwise engage in more than one type of activity. Information such as a description of each of those portions (for example, segments) and some indication of assets, liabilities, and results of operations is a candidate for disclosure.

Decision Questions to Be Considered in Establishing Disclosure Requirements

D50. Disclosures to provide additional information about the reporting entity typically are not considered when the Board sets standards about individual line items. In the past they have been, and almost certainly will be in the future, the subjects of separate standards (separate Topics in the Accounting Standards Codification). For example, the requirements for disclosures about segments, related party transactions, and consolidation were all established as separate standards. Therefore, there are no questions addressing those matters in Appendix A. However, the concepts contained in this chapter would be used when the Board undertakes any such projects.

Information about Other Past Events and Current Conditions and Circumstances That Can Affect an Entity's Cash Flows

D51. There are a number of types of events, conditions, and circumstances that can affect the amounts or timings of an entity's future cash flows but that have not yet affected a line item. The Board should consider requiring information about such events, conditions, and circumstances subject to the cost constraint and other limitations on information to be provided in notes. (See paragraphs D16–D31 for a discussion of limitations.)

Events

D52. Some types of events that are candidates for disclosure are:

a. Existing or potential litigation (because of specific matters instead of general business risk) against the entity or by the entity against another entity or entities
b. Suspected or known violations by the entity of statutes, judicial requirements, regulations, or contractual terms and violations by other entities of the reporting entity's rights under statutes, judicial requirements, regulations, or contracts
c. Existing commitments that have not been recognized but that are expected to be recognized in future periods (for example, contracts to deliver goods, provide services, permit use of assets, or extend credit that are not yet required by standards to be recognized)
d. Events that have not created recognizable assets, liabilities, equity, revenues, expenses, gains, or losses but about which there was significant uncertainty in the entity's decision not to recognize (for example, disputed rights and obligations)
e. Events that have occurred after the reporting date but before the financial statements are issued.

D53. In most cases, resource providers are likely to want as much information as possible about the potential effects of those events on the entity. Some of the information resource providers would want is obvious and is not likely to be difficult to provide. However, some events may require an entity to make difficult estimates or judgments or may subject the entity to a potential disadvantage (or a loss of advantage) to competitors, litigants, or others. The Board's decisions about such matters are made on a case-by-case basis. This chapter identifies the possible types of information but does not imply that all types identified should always be disclosed.

D54. The information about those events that are relevant for resource allocation decisions begins with the fact that an event has occurred, then a description of that event, and possibly which other entities or groups were involved; for example, a lawsuit was filed against the entity by a group of customers to recover $1 billion in overcharges and punitive damages or the entity signed a contract to provide services to a customer for $500 million.

D55. Two other things resource providers are likely to consider important are whether an event is unique, infrequent, unusual, or routine and whether it could have a continuing effect on routine and frequent business activities. Resource providers also are likely to be interested in the entity's judgment about the probability that an event such as threatened litigation or a claimed statutory violation ultimately will significantly affect that entity and, if there is an effect, a current measure of that possible effect.

D56. Finally, if the entity assessed uncertainties in concluding that the effects of an event should not be recognized under existing standards, users may need at least a general indication of what those uncertainties were to facilitate comparisons with other entities that have experienced similar events.

Conditions and Circumstances

D57. Some current conditions and circumstances that do not necessarily affect line items but that are candidates for disclosure are:

a. Dependency of the entity for its continued profitability (or existence) on one or a few customers or suppliers
b. Volatility or other uncertainty in volumes or prices in the markets for the entity's inputs or outputs that would have a significant effect on the entity's future cash flows
c. Uncertainty in an entity's access to the markets for its inputs or outputs (whether resolution of the uncertainty would result in increased or decreased access)
d. Uncertainty about an entity's ability to maintain a qualified work force and suitable physical facilities
e. Sensitivity of the entity as a whole to future changes in the following (if it is not apparent from information about line items):
    (1) Interest rates
    (2) The entity's ability to obtain financing
    (3) Foreign currency exchange rates
    (4) Commodity prices (whether exchange traded or not) or volumes
    (5) Stock market prices or volumes
    (6) Other financial market prices or market conditions
f. Other uncertainties specific to the entity (that is, not ordinary business risks) that create significant risk that an entity will not be able to continue to operate (that is, that call into question the "going concern" presumption).

D58. The following are the types of information about the conditions and circumstances in the previous paragraph that might be decision useful (not all would apply in every case):[12]

a. The existence and description including, if applicable, the causes and the nature of the effects of any uncertainties
b. If possible, the probabilities that the conditions or circumstances will affect future cash flows of the entity and at least a general indication of

[12] The considerations of potential disadvantage or loss of advantage to the entity discussed in paragraph D53 as well as the limitations discussed in paragraphs D22–D31 would be applied when considering these disclosures.

the amount and timing of the effects (for example, the worst-case scenario or the best-case scenario or some other general indication of potential significance of the potential effect) and the factors that affect the occurrence or nonoccurrence and the amount and timing

c. An explanation of actions that the entity has taken to mitigate potential effects of the conditions or circumstances.

Decision Questions to Be Considered in Establishing Disclosure Requirements

D59. Appendix A includes three questions about events and circumstances that will or may affect the amounts or timings of an entity's future cash flows but that have not yet affected a line item. Such events are sometimes associated with line items that are addressed in standard-setting projects, and requiring disclosure may be judged to be appropriate. Two examples are potential litigation or suspected violation of laws.

Considerations Specific to Financial Statements for Interim Periods

D60. Financial statements for interim periods generally are provided for different reasons from the reasons for providing annual financial statements and, therefore, have unique characteristics and limitations. Those characteristics and limitations affect the nature and volume of information to be provided in notes.

D61. The interim periods for which financial statements are prepared should be viewed primarily as an integral part of annual periods.[13] In addition, the financial statements for interim periods generally are not designed to be full sets of general purpose financial statements as are annual financial statements, primarily due to the increased timeliness of the information and the costs that would be incurred. Therefore, some of the information needed to understand interim-period financial statements must be obtained from the most recent set of annual financial statements.

D62. Because financial statements for interim periods are essentially an update of the information in the most recent annual statements, notes are intended to convey new information or information about significant changes to matters discussed in notes to the most recent annual financial statements.

[13]Paragraph 270-10-45-1 of the Accounting Standards Codification states the following:

> Interim financial information is essential to provide investors and others with timely information as to the progress of the entity. The usefulness of such information rests on the relationship that it has to the annual results of operations. Accordingly, each interim period should be viewed primarily as an integral part of an annual period.

Information Specific to Interim Reporting

D63. Because interim-period financial statements are not discrete, the notes should provide two specific types of information that would not be relevant in notes to annual financial statements. First, they should describe differences from the most recent annual financial statements in recognition, measurement, or presentation of line items. Some examples are accounting policies that differ from those applied in the most recent annual financial statements and methods of determining the amounts and expenses that are deferred or accelerated to reflect a portion of the anticipated annual amount. Second, they should explain how the financial position and results of operations for the interim period relate to the entire year, for example, the effect of seasonal variations in revenues.

D64. Financial statements for interim periods generally are aggregated to a greater degree than full sets of general purpose annual financial statements. Therefore, they are not necessarily as informative. If there are significant changes in financial position since the most recent annual financial statements or significant differences in results of operations that are unclear from the line items, the changes or differences should be explained in notes.

Information to Be Provided in both Interim-Period and Annual Financial Statements

D65. Interim-period financial statements are not designed to be as complete as a set of annual financial statements. Normally, relevant information that can be obtained from the most recent annual financial statements and has not changed is not provided in interim-period financial statements. That applies to most descriptions in notes and much of the explanatory information, such as accounting policies.

D66. Numerical information in notes to financial statements tends to change at least slightly from period to period, but that does not automatically mean that all notes including numerical information should be included in interim-period financial statements. For example, notes to annual financial statements include disaggregated information about some line items. Interim-period financial statements generally are designed to be more highly aggregated than annual financial statements and emphasize information about changes from the most recent annual financial statements. Providing all of the same disaggregated information in interim-period financial statements that is provided in annual financial statements would be inconsistent with that design. However, disaggregated information about line items would not be inconsistent with that design if the composition changed significantly in ways that users would have no reason to expect.

D67. If the direction and amount of the change during an interim period cannot be readily estimated or are otherwise not discernable from other information in the interim period and most recent annual financial statements, the new information should be included in notes. Fair values change in inherently less predictable ways and information about fair values of material items may be necessary at interim periods. Contingent liabilities or potential liabilities may have highly uncertain outcomes or otherwise may be so unpredictable that the most recent available information should be provided.

D68. In contrast, some annual disclosures relate to matters that are peripheral to the activities of most entities to whom they apply and are not likely to give important information for interim-period financial statements. For example, annual disclosure of capitalized costs may be relevant but peripheral to most businesses.

D69. Information may need to be included in notes to interim-period financial statements even if it can be estimated or is discernable from other information if it is especially important to the assessment of cash flow prospects. A key example is detailed information about revenues such as disaggregation, contract terms, and related balances.

D70. Some notes to annual financial statements provide information about changes since the end of the previous annual period. Similar information may be important to notes to interim-period financial statements. One example is a financial instrument measured at fair value for which there was an observed market price at the end of one period but no observable market price at the end of the next period.

D71. Finally, notes to interim-period financial statements should tend to be more highly aggregated than similar notes to annual financial statements.

Appendix A: Decision Questions to Be Considered in Establishing Disclosure Requirements

Introduction

DQ1. The decision questions in this appendix are a tool to be used by the Board and its staff when applying the concepts in this chapter. The questions will help the Board decide when to consider whether a disclosure should be required and to identify the nature of the disclosure.

DQ2. A "yes" answer to a question indicates that the Board should consider requiring information that should be provided in notes. However, a "yes" answer does not necessarily mean that the Board should require note disclosure or the amount of disclosure that would be necessary. Those decisions can be reached only by considering the Topic that is under consideration and would be subject to all of the constraints listed in paragraphs D16–D31.

DQ3. When the decision questions reference cash flows, and because the decision questions would be used by the Board and staff in standard-setting projects, the cash flows being referred to relate to the cash flows of the entity from the particular line item, transaction, phenomenon, event, circumstance, or condition being addressed. Ultimately, the prospects of cash flows to the entity can affect the cash flows to the resource providers.

Information about Line Items

DQ4. The following group of questions relate to information about line items in financial statements that can affect a resource provider's decisions.

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?

Information to Be Considered for Disclosure

a. Enough information (normally qualitative instead of quantitative) about the phenomenon or phenomena so that a user may access reference materials or other sources of information to understand the phenomenon or phenomena.
b. If a user could not reasonably be expected to find adequate information from other sources, an explanation of the nature of the phenomenon or phenomena in enough detail to provide an understanding of how the item might affect prospects for cash flows.

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?

Information to Be Considered for Disclosure

a. Terms (obligations and rights) needed for the assessment of prospects for cash flows. Some examples are amounts and timing of payments and receipts, interest rates, and the nature and timing of other required performance, call or put options, and penalty or bonus clauses.
b. If the item is an asset, the risk of counterparty nonperformance (credit risk or failure to deliver other assets or services) at the date of the financial statements.
c. The potential effect on the financial statements of the reporting entity of counterparty nonperformance.
d. The potential effect on the financial statements of the reporting entity of the entity's nonperformance.
e. The estimated amounts and timing of future cash flows that are contractually required, but whose amounts and/or timing are not contractually specified.
f. The estimated amounts and timing of future cash flows that are not contractually specified but that are anticipated or otherwise probable (for example, on the basis of past history or economic incentives).
g. Terms needed for assessment of prospects for cash flows of claims against the entity related to equity instruments issued by the entity. Some examples are the number of shares outstanding, the number of share options outstanding, dividend and liquidation preferences, conversion or exercise prices, participation rights, and unusual voting rights.

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.

Information to Be Considered for Disclosure

a. A description of the uncertainty or uncertainties about the existence and ownership of the item
b. An explanation of how future cash flows would change if the uncertainty is resolved in a manner that is different from what the entity expects.

Question L4

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

There are many examples of line items that contain different components, and not all of those components would necessarily affect prospects for cash flows in the same manner. Some examples include the following:

a. A portfolio of financial instruments of different types
b. Inventories of different types of products or of raw materials, work in process, or finished goods
c. Revenues from different products or services whose sales are not correlated
d. Real estate that includes apartment buildings, malls, and office buildings
e. Revenue related to a business acquired through a business combination
f. Property, plant, and equipment acquired in exchange for debt.

The following are examples of indications that components affect prospects for cash flows differently:

a. Different frequency or timing of occurrence
b. Different probabilities of repeating
c. Responses to different variables or different responses to the same variables
d. Different rates of return expected.

Information to Be Considered for Disclosure

a. The amounts and natures of the different components of the line item
b. Unusual or infrequent items.

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?

Information to Be Considered for Disclosure

a. A description of the types of changes in future economic conditions or market factors that could be expected to cause frequent or significant changes (for example, changes in interest rates, stock prices, and foreign currency rates and housing starts, unemployment, and inflation)
b. An indication of how changes in those factors would affect the prospects for cash flows arising from the line item (that is, sensitivity analysis)[14]
c. A general description of the policies, practices, and strategies that could mitigate the effects of the changes in conditions or factors
d. An indication of the past effectiveness of the policies, practices, and strategies.

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.

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[14]Sensitivity analyses would be subject to the constraints in paragraphs D22–D31 of this chapter. Disclosure of management's predictions of the most likely scenario would be inappropriate. However, it would be appropriate for the Board to consider prescribing the change (for example, a 100-basis-point move in rate) and require the sensitivity to that change in condition.

Information to Be Considered for Disclosure

a. A description of the entity-specific factors or sector-specific factors that could be expected to cause frequent or significant changes
b. An indication of the effects on the line item of changes in those factors[15]
c. A general description of the policies, practices, and strategies that could mitigate the effects of the changes in conditions or factors
d. An indication of the past effectiveness of the policies, practices, and strategies.

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.

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

[15]Possible effects would be subject to the constraints in paragraphs D22–D31 of this chapter.

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.

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.

Information to Be Considered for Disclosure

a. Descriptions, carrying amounts, and measurement methods of the items or groups that are measured differently.

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).

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?

Information to Be Considered for Disclosure

a. The fact that a change has occurred
b. The reason(s) for the change
c. How the change would have affected previous years or, if that is not feasible, how the previous method would have produced different information this year.

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[16]
c. If readily available, the pro forma effect on current-year 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.

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?

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[16] If the data are available without undue effort.

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.

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).

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.

Information about Other Past Events and Current Conditions and Circumstances That Can Affect an Entity's Cash Flows

DQ5. The following group of questions relate to information about other past events and current conditions and circumstances (the effects of which have not yet been reflected in financial statements) that can affect a resource provider's decisions.

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?

Information to Be Considered for Disclosure

a. The existence and description of the event or condition
b. Whether the effect of the event or condition would involve the entity's routine and frequent business activities or would have an infrequent or one-time effect on an entity's cash flows
c. Whether the event or condition itself is unique or infrequent or is routine or frequent
d. A current measure of the possible effect of the event or condition on an entity's future cash flows
e. The entity's judgment about the probability that the event or condition will affect the entity's future cash flows.

If the entity has plans that it believes may minimize decreases or maximize increases in net cash inflows, it may describe those actions and should explain whether the amounts disclosed as possible effects on future cash flows assume that the planned actions will be effective. In other words, if the disclosure assumes that the entity will be able to minimize a probable loss or maximize a probable gain, disclose that fact. Unless the entity has prior experience in successfully minimizing that type of loss or maximizing that type of gain, the more pessimistic amount also should be disclosed (assuming the minimizing or maximizing plans fail).

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))?

Information to Be Considered for Disclosure

a. The existence and description of the event or condition
b. Uncertainties that were assessed in deciding not to recognize an asset or liability and gain or loss (income or expense) and the reason for that decision
c. Whether events or conditions of the same type are routine and frequent or would have an infrequent or one-time effect on cash flows
d. Whether the event or condition itself is unique or infrequent or is routine or frequent
e. A current measurement of the possible effect of the event or condition on future cash flows
f. The entity's judgment of the probability that the event or condition will affect future cash flows.

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.

Appendix B: Basis for Conclusions

Introduction

BC1. The following summarizes the Board's considerations in reaching the conclusions in this chapter. It includes reasons for accepting some alternatives and rejecting others. Individual Board members gave greater weight to some factors than to others.

BC2. In July 2012, the Board published for public comment an Invitation to Comment on disclosure framework and received 84 comment letters in response to that document. Additional outreach included individual stakeholder meetings, forums with individuals from all parts of the financial reporting system, and meetings with the FASB's various advisory groups. This Exposure Draft sets out the FASB's views after considering all of the above outreach efforts.

Notes to Financial Statements

Purpose and Boundary of the Notes

BC3. The 2012 Invitation to Comment stated that the decision questions created a de facto boundary for the notes. Many respondents to that Invitation to Comment said that the decision questions alone were not adequate to describe the purpose or create a boundary for notes to financial statements. Therefore, paragraphs S2–S5 were added to this chapter to describe, at a high level, the purpose of notes to financial statements and the types of information that would be considered appropriate and not appropriate for inclusion in the notes.

Collaboration with the SEC and Disclosure Overlap

BC4. Many respondents commented that the disclosure framework should be developed in coordination with the SEC and that the coordinated effort should address issues such as overlapping disclosure requirements.

BC5. The SEC staff and the FASB have been in contact throughout the course of the project. Additionally, forums cosponsored by the FASB and the Center for Audit Quality were held. The forums were attended by various stakeholders within the financial reporting system, including an SEC staff member. The Board acknowledges that there are ways in which it and the SEC could work together to improve existing or potential disclosure requirements and intends to pursue every reasonable opportunity to do so.

BC6. Some of the duplication or overlap in SEC rules and FASB standards exists because FASB standards apply to reporting entities that are not SEC registrants. In addition, there are situations in which the Board concludes that information may not be as complete or subject to the same degree of scrutiny unless the information is required in the financial statements.

Alternative Measures

BC7. The 2012 Invitation to Comment stated that the Board should consider requiring disclosure in certain circumstances of alternative measures of line items. Many respondents stated that disclosure of alternative measures should never be required. They added that alternative measures can challenge the measurement used in the financial statements as well as confuse the user.

BC8. The Board decided that alternative measures were useful and appropriate in certain circumstances for the notes. Users have different needs and different ways of analyzing the financial position and performance of an entity. Therefore, at times, users may differ on which measure is best suited to their needs. Furthermore, alternative measures can provide additional information that complements reported amounts (for example, the fair value of a financial instrument measured at historical cost).

Not-for-Profit Entities

BC9. Initially, the decision questions in the 2012 Invitation to Comment were developed with business enterprises in mind. Investors and creditors of those entities' financial statements are interested in disclosures that assist in the assessment of future cash flows to the investors and creditors. Creditors of not-for-profit entities also are interested in assessing cash flows to themselves; therefore, the decision questions also are useful in identifying relevant disclosures in not-for-profit financial statements.

BC10. The 2012 Invitation to Comment asked whether the decision questions and the indicated disclosures could be used to identify disclosures relevant to donors even though donors and contributors do not expect cash flows to themselves. Respondents said that the questions could be used as long as the Board considers the donor's purpose for using the financial statements when assessing the relevance of potential disclosures. That purpose is to assess how an entity used its resources to provide services and the entity's efficiency and effectiveness in providing those services as well as the entity's ability to continue to provide those services.

Employee Benefit Plans

BC11. Respondents to the 2012 Invitation to Comment stated that there are issues unique to disclosures in financial statements of employee benefit plans that were not addressed by the decision questions in that document (see Appendix A for a revised version). After additional research and analysis, the Board agreed with those respondents. The Board considered modifying the decision questions in that Invitation to Comment or adding additional questions to address employee benefit plan issues but decided not to do so. Many of the disclosures unique to employee benefit plans (some of which are the result of legal or regulatory requirements) are included in a single Topic in the Accounting Standards Codification. The concerns expressed by stakeholders did not relate to those specific disclosures. Therefore, modifying the decision questions to address those disclosures would not have addressed stakeholders' concerns.

BC12. The concerns that stakeholders expressed were about disclosures that were intended to apply broadly to all types of entities but that seemed to have less relevance for analyzing financial statements of employee benefit plans. Consequently, the Board decided that the appropriate course of action was to establish a policy of giving separate consideration to employee benefit plans when proposing to add any new disclosure requirements or modify existing requirements. The more general concepts in this chapter apply to employee benefit plans, but the discussion of specific types of information that might be disclosed was developed with other types of entities in mind and may not apply or may apply differently to employee benefit plans. Therefore, the Board decided to exclude employee benefit plans from the scope of this chapter. Disclosure requirements will be set by the Board for those entities to meet the objective of financial reporting.

Decision Questions

BC13. The decision questions in Appendix A are not the same as those in the 2012 Invitation to Comment because of the comments of respondents and additional consideration by the Board.

Future-Oriented Information

BC14. Some respondents to the Invitation to Comment said that the notes should include only information of a historical nature because the financial statements themselves represent the accounting for the entity's current financial position and past financial results.

BC15. Currently, a number of disclosures discuss matters related to the future (such as maturity schedules or plans of the entity), but that information is based on existing circumstances and conditions. Those disclosures relate to the entity's current financial position and are not highly subjective.

BC16. The Board concluded that although disclosures may be oriented toward the future, the information in those disclosures is appropriate if it is either dictated by a current known condition or embedded within a current measurement used within the financial statements. Furthermore, the Board concluded that expectations and assumptions about the future that were not within a current measurement would generally not be appropriate for requirement in notes.

Private Company Considerations

BC17. This chapter applies to all business entities, whether they are public or private. If there are factors unique to private companies that affect disclosure requirements, they are addressed separately by the Board's and the Private Company Council's *Private Company Decision-Making Framework: A Guide for Evaluating Financial Accounting and Reporting for Private Companies* (private company framework). Procedurally, the private company framework is applied after the Board has established general applicability of disclosure requirements to all entities.

Notes to Financial Statements at Interim Periods

BC18. A number of respondents suggested that the Board should not have a role in setting disclosure requirements for interim reporting but, rather, should include within U.S. GAAP a principle that places the burden on preparers to determine where changes have occurred and whether updates of disclosures are needed. That principle would be similar to SEC Regulation S-X, Rule 10-01, *Interim Financial Statements*, which states that "disclosure shall be provided where events subsequent to the end of the most recent fiscal year have occurred which have a material impact on the registrant."

BC19. However, users expressed concern with allowing decisions about what to disclose at interim periods to rest solely with the reporting entity. The Board concluded that it is appropriate for it to require at least some level of disclosure for interim financial reporting.

BC20. The Board concluded that some disclosure requirements should be considered for interim periods because of the differences in the accounting methods that exist at those periods and because the interim period results may not faithfully represent the portion of the year in which they are a part.

BC21. The Board decided that there are some types of disclosures required in annual periods that also might be suitable for requirement at interim periods. However, there has been an expansion of this subset of disclosures in recent years, which has placed a strain on the ability of preparers to provide the information within tighter reporting deadlines. Therefore, this chapter contains a number of indicators that would assist the Board in evaluating whether an annual disclosure would be both useful and appropriate for disclosure at interim periods.

BC22. The use of those indicators is intended to limit the number of disclosures required for interim periods while still requiring information that is necessary for users to receive a meaningful and timely update of the financial results of the reporting entity.

BC23. It also is possible that the Accounting Standards Codification could incorporate something similar to (or exactly like) the guidance in Rule 10-01 (see paragraph BC18). However, such a modification would be most appropriately considered as part of the reporting entity's decision process within the disclosure framework rather than the development of this chapter.

BC24. Stakeholders suggested and the Board considered whether the Board's decision process should include the targeting of disclosures in interim reports on the basis of size, ratios, types of business in which a company engages, or other factors. During deliberations, the Board expressed mixed views on that issue. Some Board members noted that the entity's decision process could provide entities with sufficient tools to exercise further discretion at the entity-specific level and alleviate the need for such targeted interim disclosures at the standard-setting level. Some Board members also were concerned about the Board's ability to set appropriate thresholds for disclosure on the basis of the previously mentioned factors.