

Statement of Financial Accounting Concepts No. 8

As Amended

December 2021

Conceptual Framework for Financial Reporting

Chapter 8, *Notes to Financial Statements*

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Financial Accounting Standards Board

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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 notes to interim-period financial statements.

D2. There are limits to the information that can and should be provided in general purpose financial reporting. 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, measurement, and presentation requirements.¹ 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 content that Board members may consider.

D3. As with other aspects of the Conceptual Framework, the concepts and questions in this chapter may evolve. Additionally, none of the concepts can be considered in isolation. They are affected by the economic, legal, political, technological, and social environment in which financial reporting takes place and they also may change as new insights and new research results are obtained and understood. The concepts ought to change if new knowledge shows present judgments to be outdated. As this happens, the concepts and the decision questions in this chapter may need to be updated.

This Chapter's Ties to Other FASB Concepts Statements

Businesses

¹Definitions 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.

D4. 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 an entity.

D5. FASB Concepts Statement No. 5, *Recognition and Measurement in Financial Statements of Business Enterprises*,² identifies in general terms the purpose of notes to financial statements. Paragraph 7 states:

. . . 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.]

D6. According to paragraph 6 of Concepts Statement 5, 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.

D7. Thus, one of the purposes of notes to financial statements³ is to supplement 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.)⁴

D8. The objective of financial reporting is the starting point for identifying what information is needed to supplement or explain information in line items. That objective, as discussed in paragraph OB2 of Chapter 1, *The Objective of General*

²Although 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 also is applicable to not-for-profit organizations and employee benefit plans.

³In some cases, as indicated in the quote from Concepts Statement 5 in paragraph D5, an entity has 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.

⁴Line 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, but it simplifies sentence structures in this chapter while still conveying the intended meaning.

Purpose Financial Reporting, of FASB Concepts Statement No. 8, *Conceptual Framework for Financial Reporting*, 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.

D9. As indicated in paragraph OB3 of Chapter 1, investors and creditors allocate resources on the basis of 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 entities) are referred to throughout this chapter as users of financial statements (or users).

D10. 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 cash flows to the reporting entity. To make those assessments, a user 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.
- b. The nature of the specific investment or credit instrument issued by the reporting entity—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.

D11. While financial statements provide information that can assist users in making resource allocation decisions, financial statements are not the only source of information upon which users rely. Additionally, financial statements are not designed to show the value of an entity.

D12. To help achieve the objective of financial reporting set forth in paragraph D8, 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 been recognized that can affect an entity's cash flows.

D13. The following information might be suitable for the purposes described in paragraph D4, 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 attainable at little cost from other sources and readily available from other sources as long as a knowledgeable user should be aware of the need for the information and its availability.

Not-for-Profit Entities

D14. Paragraph OB28 of Chapter 1, *The Objective of General Purpose Financial Reporting*, of this Concepts Statement, states:

Existing and potential users of the information provided by financial reporting by a particular not-for-profit entity share a common interest in information about the services provided by the not-for-profit entity and its efficiency and effectiveness in providing those services as a basis for determining its ability to continue to provide those services.

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

D15. A contributor can use information about an entity's use of its resources to assess the services that have been provided and the entity's ability to provide services in the future. Because the assessments of the services that have been provided and the entity's ability to provide services can be aided, at least in part, through assessing past and future cash flows of the entity, this chapter can be used to identify information that would be useful to users of not-for-profit entities' financial statements.

D16. However, some disclosures that are relevant to investors, lenders, and other creditors may not be beneficial to contributors. Thus, the Board should consider contributors separately from the other types of users when using the concepts within this chapter and the decision questions in Appendix A. Considering contributors separately from other users may lead to a different assessment of the costs and benefits of disclosures. Said differently, a disclosure that is useful for assessing the prospects for cash inflows to a business entity may not be useful for assessing how efficiently and effectively a not-for-profit entity has provided services and the not-for-profit's ability to provide services in the future. Therefore, consideration of the differences may result in a different cost-and-benefit consideration.

Employee Benefit Plans

D17. Currently, there is no explicit mention in 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 financial statements of business entities and not-for-profit entities and their respective users and 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

D18. The information provided by the recognized amounts and related descriptions in the financial statements is fundamental to a user'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 other than the entity could significantly affect a user's decisions. Consequently, notes to financial statements provide types of relevant information that is not provided on the face of the financial statements. The resulting disclosures can be categorized as information about (a) financial statement line items, (b) the reporting entity, and (c) past events and current conditions and circumstances that have not been recognized that can affect an entity's cash flows.

D19. Notes provide information that explains specific line items 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 an entity. The nature, terms, or quality of an asset, whether based on 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. Also, 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 in assisting the user, including assessing the probability that similar or related phenomena will occur in the future.

D20. Notes also provide general information about the nature of an entity, its activities, any special restrictions or privileges that apply to it, and its 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.⁵ Users 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 an identical asset held or a liability owed by two different entities can have very different implications on a user's decisions as could similar exposures and circumstances of the entity. For example, one entity acquires subsidiaries to hold for a period of time and sell versus another entity that acquires subsidiaries and integrates them into its operations. As another example,

⁵As discussed in paragraph D13(b), it is not necessary for the Board to require disclosure of unique regulatory or legal factors if users can be presumed to be aware of the information because such information is readily available from sources other than the entity at little or no cost.

two entities may have identical performance obligations, but one may be required by law to hire licensed contractors to fulfill the obligation and the other may not operate under that restriction. In both of these examples, additional context would be relevant for a user's assessment of prospects for future cash flows.

D21. Additionally, notes provide information about past events and current circumstances and conditions that have not been recognized but will or may affect an entity's future cash flows. The effects of those types of events, circumstances, or conditions may not be recognized because they have not (or the entity cannot determine whether they have) created resources for the entity or claims against the entity or caused changes to the entity's 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

D22. Requirements to provide information in notes to financial statements are limited in at least four ways:

- a. The Board should only require information that is relevant to existing and potential users of the financial statements of a broad range of entities (or to a broad range of entities within an identified subset of entities).
- b. The cost constraint applies; that is, the benefits of providing the information should justify the costs of providing and consuming it, as described in paragraphs QC35–QC39 in Chapter 3, *Qualitative Characteristics of Useful Financial Information*, of this Concepts Statement.
- c. The Board considers potential unintended adverse consequences that may arise from requiring certain information in notes.
- d. 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, lenders, and other creditors.

Relevance

D23. The Board's judgments about whether to establish disclosure requirements are based on broad general considerations of relevance rather than on entity-specific judgments about materiality. Ideally, disclosure requirements would be made applicable only to the specific entities to which they are most important. However, disclosures should have the potential to apply to a broad range of entities (or to a broad range of entities within an identified subset of entities). For example, disclosures may be relevant to a broad range of not-for-profit entities while not being relevant to for profit entities, although that range may not stay constant. While disclosures have relevance to a broad range of entities, they may not be material to all entities to which they may apply. Materiality decisions must be made

by each individual entity. As such, the Board should establish requirements that are not so prescriptive that they preclude reporting entities from making materiality judgments.

The Cost Constraint

D24. Notes to financial statements are subject to the same cost constraint that applies to financial reporting. Entities generally 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, even if that information can be provided at a low cost.⁶

D25. Users would be expected to be aware of and have access to information about things such as the *FASB Accounting Standards Codification*[®] and common accounting practices, frequently used pricing models, or other regulations, and for public entities the U.S. Securities and Exchange Commission's (SEC) rules and regulations. Disclosure of accounting methods is important if (a) alternatives are permitted, (b) the methods are not otherwise apparent, or (c) the methods have changed. Disclosure of the details of frequently used mathematical models is seldom if ever important. However, certain key assumptions within those models may be important.

D26. The FASB establishes financial accounting and reporting standards for public and private companies and not-for-profit entities that follow generally accepted accounting principles (GAAP). Subsets of these entities might be required to include a full set of financial statements and notes in SEC filings or other regulatory reports. 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 may be valid reasons why the Board at times considers requiring disclosure of information in notes when an entity provides similar or identical information in other forms of communication. For example, some entities whose users 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.

D27. Technology's effect on the cost constraint is twofold. First, technology increases the ability of a user to consume data. That increased ability translates

⁶That 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 an 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.

to increased demand for more data. Second, as technology becomes more advanced, the cost to preparers to provide disclosures may be reduced over time. Therefore, the Board's analysis of cost will change over time.

Potential Adverse Consequences

D28. The assessment of potential adverse consequences of disclosure is separate and distinct from the cost-constraint assessment. Although adverse consequences might have adverse financial effects on an entity, they are not costs as described in paragraphs QC35–QC39 of Chapter 3 of this Concepts Statement, which include the costs to collect, process, verify, and disseminate information to users.

D29. Accounting standards are intended to neutrally reflect economic activity so that users of financial statements can make resource allocation decisions. That being said, accurate financial reporting can have economic consequences, both beneficial and adverse.

D30. Beneficial consequences include fostering economic growth by promoting more efficient capital allocation, greater market liquidity, and a lower cost of capital.

D31. However, certain information might result in adverse economic consequences for some organizations, especially if that reporting sheds light on an area that was not previously transparent. For example, a potential disclosure may require an entity to reveal liabilities that it previously had not been required to provide information about in its financial statements. This new information could result in reduced capital flow or an increased cost of capital for that business. It also could result in some businesses having difficulty attracting and retaining talented employees or, in some extreme cases, in the failure of a business. The Board should not consider this form of potential adverse consequences a reason to not require a disclosure. Those consequences are results of relevant and representationally faithful financial reporting.

D32. The Board should consider the following potential adverse consequences when determining whether to require a particular disclosure:

- a. Legal harm. Some information, if disclosed, may subject the reporting entity to certain legal consequences. For example, disclosing certain information about the reporting entity's contract with a counterparty may cause the reporting entity to breach a confidentiality clause of the contract.
- b. Competitive harm. Various factors could cause competitive harm. For example, requiring an entity to disclose product pricing information may cause competitive harm to the reporting entity.
- c. Reputational harm. Some activities of an entity, if made known, could cause harm to the entity's reputation. For example, information about an entity's waste-disposal practice may cause users to reallocate resources away from the entity and not on the basis of the returns they expect.
- d. Other economic consequences that are not relevant to resource allocation decisions. While general purpose financial reporting is intended for users

to make resource allocation decisions, others may use certain information in notes to financial statements for purposes other than making those decisions. In some cases, the unintended use of that information may negatively affect the entity's ability to operate in its economic, legal, political, and social environments.

Future-Oriented Information

D33. Making decisions about providing resources involves, in part, assessing prospects for the entity's future cash flows. Users 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 numerical goals and objectives, and, in those cases, the incremental direct costs of preparing future-oriented information may not be particularly significant.⁷

D34. However, sometimes there 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.

D35. SEC registrants are required to provide "forward-looking"⁸ information with respect to certain disclosures in portions of certain registrants' regulatory filings that are outside audited financial statements, and they are encouraged to provide forward-looking information where doing so is useful to investors.⁹ Federal

⁷The cost and difficulty of auditing that information might, at least in some cases, change the judgment about whether expected costs are justified by expected benefits.

⁸SEC rules provide a safe harbor for "forward-looking" information, as defined in those rules, which is provided outside audited financial statements. To avoid any confusion over possible differences in definition or scope, the term *forward looking* is not used anywhere else in this chapter.

⁹See, 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.

securities laws and SEC rules provide a “safe harbor” for some forward-looking information.¹⁰ The safe harbor does not extend to audited financial statements, whether or not the reporting entity is an SEC registrant.

D36. 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 users in making their own assessments. Therefore, it is not necessary for the Board to require that entities disclose in notes to financial statements predictions of future outcomes, which could have significant potential for negative consequences to a reporting entity.

D37. However, there are at least two other types of future-oriented information that may be useful disclosures for the Board to consider in some cases and that are not expected to have the same type of adverse consequences as those discussed in paragraph D32.

D38. 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 may 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 and/or discounted at a rate that reflects risk and uncertainty. Furthermore, the results of entity-specific measurement inputs are purported to represent the way an 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 expected credit losses) that are important to faithful representation of the line item. Because that information explains amounts included in financial statement line items, it is 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 is an input to a current measure of an asset or a liability.

D39. The second is information about management’s existing plans and strategies related to matters under management’s control. This type of future-oriented

¹⁰See, 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*; Securities Act Rule No. 175, *Liability for Certain Statements by Issuers*; and Exchange Act Rule 3b-6, *Liability for Certain Statements by Issuers*.

information may be appropriate if management's existing plans and strategies affect the presentation, recognition, or measurement of line items. However, disclosures of management's existing plans and strategies are rarely required for the following reasons:

- a. Disclosing some types of plans and strategies may render them less effective and, therefore, adversely affect the reporting entity.
- b. Disclosing plans and strategies seldom explains information on the face of the financial statements.

D40. 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

D41. 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.

D42. Those descriptions are very general and might include a wide range of information. However, because of the limitations discussed in paragraphs D22–D40, it is not necessary that notes include all the information that might fit those descriptions.

Additional Information about Line Items

D43. Users can adequately understand some line items with little to no explanation or additional information in notes, for example, a non-interest-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 that users might need more information about. That information is not conveyed by the amount and description of the line item and cannot be gathered by users in a cost-effective manner from other sources.

D44. The volume of information 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 marginally 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 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.

D45. The nature of additional information about line items that is relevant for a user'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.

D46. 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 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.

D47. The following additional types of information would 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 the amounts and timing of uncertain future cash flows (such as probability-weighted estimates, ranges of possibilities, or most positive outcomes or most negative outcomes) that are either one of the following:
 - (i) Contractually required, but whose amounts and timing are not contractually specified

- (ii) 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 accounting methods
- 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

D48. 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 information that should be provided about those particular line items. Appendix A aids that process by expanding on the types of information discussed in paragraphs D46 and D47. Appendix A is organized as a series of questions about the nature of line items being considered that, if answered positively, indicate that 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. Board judgments will be necessary in each circumstance.

D49. Consistent with decisions about other accounting issues (recognition, measurement, and presentation), Board judgments should include a robust consideration of the objective of general purpose financial reporting, qualitative characteristics of useful financial information, differences in activities among entities, and stakeholder feedback (as well as the limitations described in paragraphs D22–D40). Therefore, not all decision questions in Appendix A should be utilized for each Topic of the Codification. Furthermore, additional information that is not derived directly from the decision questions may be necessary for the Board to meet the objective of general purpose financial reporting.

D50. 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.

D51. First, although the Codification addresses most phenomena that an entity needs 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 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.

D52. 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 rather than normal and routine transactions.

Information about the Reporting Entity

D53. There is a variety of general information about an entity that if unknown to users 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

D54. 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 that 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

D55. 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

D56. 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

D57. 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, geographical areas, or other units managed separately.

D58. 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 effect on cash flows to users may not be discernable unless the entity provides additional information in notes about its structure. In some cases, an entity may include a subsidiary or a variable interest entity in consolidated financial statements under conditions of uncertainty. Information about such decisions and the related uncertainties is a candidate for disclosure.

D59. Many business entities provide significantly different products or services, otherwise engage in varied activities such as operating in different geographical areas with different effects on prospects for cash flows to users, or may manage different portions of the consolidated entity separately or differently. Similarly, some not-for-profit entities 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.

D60. Providing these types of information may be accomplished by disaggregating line items. However, the objective of providing such disclosures is for users to understand the nature of the reporting entity, not to identify items of different natures within a line item.

Decision Questions to Be Considered in Establishing Disclosure Requirements

D61. Disclosures of 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 may be in the future, the subjects of separate standards (separate Topics in the 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 updates related requirements or undertakes any such projects.

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

D62. 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 D22–D40 for a discussion of the limitations of disclosures.)

Events

D63. 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.

D64. In most cases, users are likely to want as much information as possible about the potential effects of those events on the entity. Some of the information users may 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 always should be disclosed.

D65. The information about those events that is relevant for resource allocation decisions begins with the fact that an event has occurred, then a description of the event, and possibly which other entities or groups are involved; for example, (a) a lawsuit was filed against the entity by a group of customers to recover \$1 billion in claimed overcharges and punitive damages or (b) the entity signed a contract to provide services to a customer for \$500 million.

D66. Other factors users likely would 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. Users 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.

D67. 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

D68. 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 the 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 the entity's ability to maintain a qualified work force and suitable physical facilities
- e. Other uncertainties specific to the entity (that is, outside of ordinary business risks) that create significant risk that the entity will not be able to continue to operate (that is, that call into question the "going concern" presumption).

D69. The following are the types of information about the conditions and circumstances in paragraph D68 that might be decision useful (not all apply in every case):¹¹

- 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 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

¹¹The considerations of potential disadvantage or loss of advantage to the entity discussed in paragraph D64 as well as the limitations discussed in paragraphs D22–D40 will apply when considering these disclosures.

- 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

D70. Appendix A includes three questions about events and circumstances that will or may affect the amount or timing 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 disclosures of information about those events may be judged to be appropriate. Two examples are potential litigation or suspected violation of laws.

Considerations Specific to Financial Statements for Interim Periods

D71. Interim-period financial statements generally are provided for reasons that are different from those provided for 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.

D72. The interim periods for which financial statements are prepared should be viewed primarily as an integral part of annual periods.¹² In addition, interim-period financial statements generally are not designed to be a full set of financial statements as are annual financial statements primarily because of 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.

D73. Because interim-period financial statements 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.

¹²Paragraph 270-10-45-1 of the Codification states:

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

D74. 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.

D75. Interim-period financial statements generally are aggregated to a greater degree than a full set of 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 Financial Statements and Annual Financial Statements

D76. 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 that 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.

D77. 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 is inconsistent with that design. However, disaggregated information about line items is not inconsistent with that design if the composition changed significantly in ways that users would have no reason to expect.

D78. 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.

D79. 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.

D80. 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 notable example is detailed information about revenues such as disaggregation, contract terms, and related balances.

D81. 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.

D82. Finally, notes to interim-period financial statements 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 Board and stakeholders that use this appendix will be guided and aided by the concepts in this chapter, but judgments based on the particular circumstances of each case will continue to play a major role in improving disclosure. The questions in this appendix are developed as educational guidance for the Board to be used as a tool to identify possible considerations for setting standards for disclosures in Topics in the Codification. Consistent with decisions about recognition, measurement, and presentation, the consideration by the Board should include a robust consideration of the objective of general purpose financial reporting, relevance of the information, cost constraints, and differences in activities among entities. Therefore, not all questions in this appendix will be utilized for each Topic of the Codification. Furthermore, disclosure requirements not derived directly from the decision questions may be considered relevant in advancing the objective of general purpose financial reporting at a standards level.

DQ2. A “yes” answer to a question indicates that the Board should consider requiring that information in notes. However, a “yes” answer does not necessarily mean that the Board should require note disclosure. It also does not indicate the extent of disclosure that would be necessary. Those decisions can be reached only by considering the particular Topic and are subject to all of the constraints listed in paragraphs D22–D40.

DQ3. When the decision questions reference cash flows, and because the decision questions will be used by the Board and staff as a tool 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 relates to information about line items in financial statements that can affect a user’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 assessing 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 assessing 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.
- h. For claims against the entity, information about the priority of those claims.

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 L12) in that it does not relate to uncertainty about measurement, 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 some of those components may affect prospects for cash flows in a different manner. Some examples include the following:

- a. A portfolio of financial instruments of different types
- b. Inventories of different types of products or 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 causes of the changes in an entity's line item of an asset, liability, or equity instrument not readily assessable because there are numerous causes or because the line item is subject to nonroutine changes?

Information to Be Considered for Disclosure

- a. A detailed rollforward, major inflows and outflows, or particular changes in a line item.

It may 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 L6

Could the quality or utility of a nonfinancial asset have changed?

That disclosure is related to measurement but is not strictly a measurement issue. Some productive assets are carried at amounts that are not closely related to their current values, and they do not change in relation to those values. For example, a building with a carrying amount that is being depreciated may actually be appreciating in value, and its cash-flow generating potential may be increasing.

Information to Be Considered for Disclosure

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

Question L7

Does the line item include individual items (or groups) that are measured differently?

Information to Be Considered for Disclosure

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

Question L8

Are there acceptable alternative accounting policies or methods provided under 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 L9

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 L10

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 statements¹³
- c. If readily available, the pro forma effect on current-year financial statements.

Question L11

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 L12

Is the carrying amount of the line item an estimate that requires assumptions, judgments, or other internal inputs that could reasonably have been different?

This question is not limited to fair value or other estimates of current value. At times, accumulations of costs involve uncertainties (about which costs to include, for example), and impairment allowances not based on quoted market prices are nearly always subject to significant uncertainties. Information about how changes between periods for significant estimates, assumptions, judgments, or other internal inputs that have affected a line item also could be 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.

¹³If the data are available without undue effort.

Question L13

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 L14

Does a line item have a direct relationship not otherwise apparent to another line item or items in another statement?

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 relates 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 user'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 (such as the entity's inability to continue as a going concern)?

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 the 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 the 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.

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 Question O1(a) and (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 a liability and a gain or a 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
- c. Potential issuances of an entity's own shares resulting from existing contractual agreements.

This chapter of Concepts Statement 8 was adopted by the affirmative vote of five members of the Financial Accounting Standards Board. Ms. Botosan and Mr. Schroeder dissented.

Ms. Botosan dissents from the issuance of this chapter of Concepts Statement 8 because she believes that excluding one type of entity—an employee benefit plan—from a single chapter of the Conceptual Framework creates inconsistencies within the entire Conceptual Framework. Ms. Botosan believes that choosing to exclude employee benefit plans from this chapter has broader implications for the Conceptual Framework as a whole, which the Board has yet to consider. In Ms. Botosan's view, the applicability of the Conceptual Framework to employee benefit plans should be considered more holistically to ensure that the Conceptual Framework remains "a coherent system of interrelated objectives and fundamental concepts," as described in the introduction of this Concepts Statement.

Chapter 1, *The Objective of General Purpose Financial Reporting*, of this Concepts Statement defines the objective of general purpose financial statements. The existing and future "principles" chapters (including Chapter 3, *Qualitative Characteristics of Useful Financial Information*, of this Concepts Statement and possible forthcoming chapters on element definitions, measurement, and presentation) are intended to offer an internally consistent set of principles that operate as a system to support the achievement of the stated objective. Excluding employee benefit plans from this chapter alone raises a host of questions about the applicability to employee benefit plans of the principles contained in the other chapters of the Conceptual Framework.

Paragraph BC12 of this chapter states that "the Board decided that because users generally *do not use plan financial statements to make resource allocation decisions*, this chapter does not apply to employee benefit plans" (emphasis added). Ms. Botosan believes that this conclusion calls into substantial doubt the applicability of the stated objective of financial reporting to employee benefit plans, which 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 providing resources to the entity” (emphasis added).*¹⁴

Moreover, Ms. Botosan believes that this same justification might imply that employee benefit plans are appropriately excluded from proposed Chapter 7, *Presentation*, or other parts of the Conceptual Framework. Nonetheless, the Board has decided not to address applicability to employee benefit plans in its redeliberations of proposed Chapter 7 (which is silent on the issue) or in its possible forthcoming deliberations of other parts of the Conceptual Framework (for example, measurement principles). In Ms. Botosan’s opinion, failing to more holistically address the applicability of the Conceptual Framework to employee benefit plans impairs the overall coherence of the system and the interrelatedness of the stated objective and the fundamental principles.

Ms. Botosan would have preferred that the Board pursue one of five possible alternative paths to more comprehensively resolve the question of the applicability of the Conceptual Framework to employee benefit plans:

1. Adhere to the conclusion in paragraph BC1.30 of Chapter 1 that the objective of general purpose financial reporting is the same for *all* entities but that cost constraints and differences in activities among entities may lead the Board to permit or require differences in reporting for different types of entities.
2. Clarify in Chapter 1 that employee benefit plan financial statements are not “general purpose” in nature so that the objective of general purpose financial reporting and, consequently, the Conceptual Framework do not apply.
3. Clarify in Chapter 1 that the objective of employee benefit plan financial statements is fundamentally different from the objective of financial reporting specified in Chapter 1.
4. Acknowledge in the basis for conclusions in this chapter that although the question of the applicability of the principles to employee benefit plans first appears in the context of this chapter, through its due process procedures, the Board came to realize that the answer to that question has implications for the Conceptual Framework that extend well beyond this chapter.
5. Include employee benefit plans within the scope of this chapter but clarify that the decision questions, which were drafted with other types of entities in mind, do not apply to employee benefit plans.

Ms. Botosan dissents from the issuance of this chapter because she believes that a piecemeal exclusion of employee benefit plans from this chapter of the Conceptual Framework raises numerous essential questions that have not been answered.

¹⁴Paragraph OB2 of Chapter 1, *The Objective of General Purpose Financial Reporting*, of this Concepts Statement.

Mr. Schroeder dissents from the issuance of this chapter of Concepts Statement 8. In developing this chapter, the Board followed an iterative approach of applying its then-tentative concepts to several existing sets of disclosure requirements. Overall, this approach led to some disclosure improvements by adding new decision-useful information while eliminating disclosures that users found less useful or redundant. However, in Mr. Schroeder's view, this approach also highlighted a substantive weakness in the interplay between (1) the Board's process for assessing information that should be considered for inclusion in notes to financial statements and (2) each entity's process for assessing whether that information is in fact decision useful to its financial statement users and, therefore, must be included in the notes.

Specifically, Mr. Schroeder's concerns with this chapter center on the "limitations on information" articulated in paragraph D22 (particularly item (a)) that hand the Board too blunt an instrument for guiding its decisions. Mr. Schroeder asserts that the results can be, and have been, biased toward only requiring disclosures of information when "relevant to existing and potential users of the financial statements of a *broad range* of entities" (emphasis added). To confirm this bias, he believes that one only need look at the contemporaneous efforts to apply this chapter's guidance to standard-setting projects related to inventory and fair value disclosures. In both projects, the notion of *broad range* led the Board to not require certain disclosures even though stakeholder feedback indicated such information would have been clearly decision useful to users focused on certain entities or on specific industries.

Mr. Schroeder notes that paragraph D23 of this chapter effectively acknowledges that the limitation is too restrictive by suggesting disclosure requirements could be narrowed to a "broad range of entities *within an identified subset* of entities" (emphasis added). However, he agrees with the Board's conclusions in those standard-setting projects that requiring industry-specific disclosures is fraught with complications and generally does not support such an approach. Therefore, Mr. Schroeder believes that the most effective approach to addressing the "limitations on information" articulated in paragraph D22 is twofold.

First, deleting the word *broad* in both paragraphs D22 and D23 would lower the threshold for when the Board should consider requirements to provide information in notes. Second, while outside the scope of this chapter, is the notion of materiality. Mr. Schroeder believes that this chapter will not achieve the broader objective of improving the effectiveness of note disclosures until the notion of materiality becomes more operable in practice.

The notion of materiality is discussed in Chapter 3 of this Concepts Statement, which was amended at the same time this chapter was issued. Specifically, paragraph QC11 of the amended Chapter 3 states:

Relevance and materiality are defined by what influences or makes a difference to an investor or other decision maker; however, the two

concepts can be distinguished from each other. Relevance is a general notion about what type of information is useful to investors. *Materiality is entity specific.* [Emphasis added.]

Furthermore, paragraph 105-10-05-6 of the Codification reinforces this notion by clearly stating that its provisions “need not be applied to immaterial items.” Therefore, in Mr. Schroeder’s view, each entity can most cost effectively communicate with existing and potential investors only by applying the notion of materiality. In doing so, each entity could mitigate disclosure costs, when justified, by concluding which information not to disclose because it is immaterial.

Mr. Schroeder acknowledges that there are real barriers to applying a materiality notion in the current financial reporting ecosystem that includes auditors and regulators. Those barriers make it costlier for an entity to exclude specific immaterial disclosures, even though that information would not prove decision useful. Mr. Schroeder also accepts that certain of those barriers are outside the Board’s authority to unilaterally address. However, he believes that using the *broad range* limitation in paragraph D22 of this chapter is not the best long-term path for achieving the Board’s mission of improving financial reporting. He believes that the financial reporting ecosystem will be more effective and efficient only when entities are able to use greater discretion in providing disclosures that best fit the needs of each entity’s existing and potential investors. Therefore, in Mr. Schroeder’s view, the Board should make every effort to work with others within the ecosystem to remove both real barriers and perceived barriers.

Mr. Schroeder notes that without contemplating each entity’s ability to apply a reasonable and rational assessment of materiality, the generic-questions approach used in this chapter too often can result in financial statement users being provided with collectively less information. More important, because most analysis is performed by industry specialists, user needs are not being met. This is particularly true for investors focused on specific industries or on conglomerates operating in a diverse set of industries (often including both financial activities and nonfinancial activities). Therefore, Mr. Schroeder has more broad concerns about the way future Boards may evaluate those generic questions in making cost-benefit assessments at a standard-setting level.

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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 issued for public comment an Invitation to Comment, *Disclosure Framework*, and received 84 comment letters on that document. In March 2014, the Board issued the proposed Concepts Statement of this chapter for public comment and received 54 comment letters on it. Additional outreach included public roundtables, individual stakeholder meetings, forums with individuals from all parts of the financial reporting system, and meetings with the FASB's various advisory groups.

BC3. After issuing the 2014 proposed Concepts Statement, the Board tested the concepts and decision questions in this chapter by applying them in standard-setting projects on the following Codification Subtopic and Topics:

- a. Topic 820, Fair Value Measurement
- b. Subtopic 715-20, Compensation—Retirement Benefits—Defined Benefit Plans—General
- c. Topic 740, Income Taxes
- d. Topic 330, Inventory.

The purpose of the Topic-level testing was to assess the effectiveness of the proposed disclosure concepts in aiding the Board to develop decision-useful disclosures. Stakeholder feedback from that Topic-level testing was used to fine-tune and improve the disclosure concepts as proposed.

BC4. This chapter sets out the FASB's views after considering all the above outreach efforts and Topic-level testing.

Notes to Financial Statements

Purpose and Boundary of the Notes

BC5. 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 are not adequate to describe the purpose or create a boundary for notes to financial statements. Therefore, paragraphs D4–D13 have been 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

BC6. 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.

BC7. 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 Quality¹⁵ 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 eliminate duplication or overlap.

BC8. 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.

Not-for-Profit Entities

BC9. Initially, the decision questions in the 2012 Invitation to Comment and the 2014 proposed Concepts Statement 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 are useful in identifying relevant disclosures in not-for-profit financial statements.

BC10. The 2012 Invitation to Comment and the 2014 proposed Concepts Statement asked whether the decision questions and the indicated disclosures could be used to identify disclosures relevant to contributors to not-for-profit entities even though contributors do not expect cash flows to themselves. Respondents said that the questions could be used as long as the Board considers the contributor'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.

¹⁵The Center for Audit Quality is affiliated with the American Institute of Certified Public Accountants (AICPA).

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 are not addressed by the decision questions in that document. 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 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 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. Respondents to the 2014 proposed Concepts Statement were asked whether employee benefit plans should be included within the scope of this chapter. The Board decided that because users generally do not use plan financial statements to make resource allocation decisions, this chapter does not apply to employee benefit plans.

Private Company Considerations

BC13. This chapter applies to all business as well as not-for-profit 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 *Private Company Decision-Making Framework: A Guide for Evaluating Financial Accounting and Reporting for Private Companies*. Procedurally, the Private Company Decision-Making Framework is applied after the Board has established general applicability of disclosure requirements to all entities.

Future-Oriented Information

BC14. Some respondents to the 2012 Invitation to Comment and the 2014 proposed Concepts Statement 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), but that information is based on existing circumstances and conditions. That information relates to the entity's current financial position and is not highly subjective.

BC16. The Board concluded that although some information may be subjective and oriented toward the future, that information is appropriate if it affects the presentation, recognition, or measurement of an item.

Decision Questions

BC17. The decision questions in Appendix A exclude some of those included in the 2012 Invitation to Comment and the 2014 proposed Concepts Statement because of stakeholder feedback, experience in performing the Topic-level reviews, and additional consideration by the Board. The Board also evaluated certain feedback specific to particular decision questions and elected to retain those questions as proposed or with some modification.

Changes in Line Items

BC18. Many stakeholders noted that Decision Question L5 could lead the Board to require disclosure of changes in opening and closing balances for every line item. Through the Topic-level review of Topic 330, Inventory, the Board noted that an appropriate level of useful information could be provided to users by requiring particular changes within the inventory balance (instead of a comprehensive analysis of all of the changes in the balance). Furthermore, the Board concluded that disclosures about changes in line items are most relevant when the causes of the changes are difficult to understand because the causes of the changes are numerous or because the line item is subject to nonroutine changes. The Board modified the decision question to emphasize that view.

Information about General Economic, Market, or Entity-Specific Factors That May Affect a Line Item

BC19. The Board concluded that information about how particular line items are sensitive to potential changes in the future because of general economic, market, or entity-specific factors is more appropriate for inclusion by public companies in management's discussion and analysis. The Board is not likely to require these types of disclosures for private companies because users of private company financial statements have greater access to management (according to the Private Company Decision-Making Framework). Therefore, the Board decided to remove those concepts and the related decision questions.¹⁶ This means that the Board will not systematically consider these types of disclosures when evaluating what sort of information is relevant to certain line items.

Alternative Measures

BC20. The 2012 Invitation to Comment and 2014 proposed Concepts Statement 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.

¹⁶Designated as Decision Questions L5 and L6 in the 2014 proposed Concepts Statement.

BC21. The Board decided that alternative measures are useful and appropriate for the notes in certain circumstances. 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).

BC22. As stated in the 2014 proposed Concepts Statement, alternative measures should be considered for disclosure only if they are clearly useful in assessing the prospects for cash flows.¹⁷ Topic-level testing indicated that the notion of “clearly useful” may not be necessary because, as with all potential disclosures, expected costs and expected benefits must be assessed for this type of disclosure. However, there could be many alternative measures of a particular item for the Board to consider. To be more efficient, the “clearly useful” notion helps the Board to focus on alternative measures that are most important to users of financial statements.

Potential Adverse Consequences

BC23. In Topic-level testing (particularly in the area of income tax disclosures), some stakeholders noted that certain information, if disclosed, could adversely affect the reporting entity. While the 2014 proposed Concepts Statement did not discuss potential adverse consequences of disclosures in detail, the Board already had considered some of those consequences as possible reasons not to require a disclosure. However, the Board decided to include a discussion about potential adverse consequences of disclosures in this chapter to help the Board be more consistent in its consideration of those consequences.

Evaluating Costs

BC24. Some stakeholders noted that additional decision questions or concepts should be added to this chapter to explain how costs should be evaluated when the Board is considering disclosures. The Board indicated that other aspects of the Conceptual Framework already describe (a) the types of costs that should be considered when setting standards, including disclosures (for example, the cost to collect, process, verify, and disseminate information), and (b) that cost and benefit assessments are subjective (paragraph QC39 of Chapter 3 of this Concepts Statement). Therefore, the Board decided not to provide any additional detail on the application of the cost constraints in this chapter.

Notes to Financial Statements at Interim Periods

BC25. A number of respondents suggested that the Board should not have a role in setting disclosure requirements for interim reporting but, rather, should include

¹⁷Designated as Decision Question L4 in the 2014 proposed Concepts Statement.

within 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.”

BC26. However, users expressed concern about allowing decisions about what to disclose at interim periods to rest solely with the reporting entity. The Board concluded that it is appropriate for the Board to require at least some level of disclosure for interim financial reporting.

BC27. 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 achieve a fair measure of the results of the annual period or the financial position at the end of the annual period for which they are a part.

BC28. 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 will assist the Board in evaluating whether an annual disclosure is both useful and appropriate for disclosure at interim periods.

BC29. 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.

BC30. It also is possible that the Codification could incorporate something similar to (or exactly like) the guidance in SEC Regulation S-X, Rule 10-01 (see paragraph BC25). 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.

BC31. 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, such as size.