KPMG

Financial statement presentation

Handbook

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Contents

The final mile: Presentation and disclosure

In the financial statement process, considerable time is devoted to determining what items get recorded and how to account for them, but the critical final mile is determining how they need to appear – i.e. how they are presented and disclosed.

Once the debits and credits have been settled, presentation and disclosure is how that information is conveyed to financial statement users in a transparent, understandable and consistent manner. Disclosure goes 'behind the numbers' and is necessary to fully understand the financial statements.

Topics 205 to 280 in the FASB's Accounting Standards Codification® are dedicated to presentation and disclosure and provide the baseline requirements. Other Topics address more detailed requirements, specific to certain transactions or industries. For SEC registrants, there is yet more guidance that contains many additional requirements, which has helped shape practices over the years for all other entities.

In this Handbook, we pull together many of the general requirements and practices to provide you with a fuller picture of how the different financial statements are constructed and how they interact with one another.

We hope you find our analysis and insights useful as you determine the appropriate way to present and disclose information in your organization's financial statements.

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About this publication

The purpose of this Handbook is to assist management in determining the appropriate presentation of financial statement information under the various presentation topics of the Codification (i.e. Topics 205 to 280), other broad topics (e.g. related parties under Topic 850 and subsequent events under Topic 855) and SEC regulations.

Organization of the text

The chapters include excerpts from numerous Topics in the FASB's Accounting Standards Codification (ASC). Practical in-depth explanations and examples are provided to assist with the real-world application of key concepts.

Our commentary is referenced to the Codification and other literature, where applicable. The following are examples.

- 205-10-45-1 is paragraph 45-1 of ASC Subtopic 205-10
- CON 8.PR20 is paragraph PR20 of FASB Concepts Statement No. 8, Conceptual Framework for Financial Reporting, chapter 7, Presentation
- ASU 2014-15.BC26 is paragraph 26 of the basis for conclusions of Accounting Standards Update 2014-15, Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern
- FAS 130.106 is paragraph 106 of FASB Statement No. 130, Reporting Comprehensive Income
- S-X Rule 5-02 is Rule 5-02 of SEC Regulation S-X
- 17 CFR 240.12b-23 is section 23 of SEC Regulation 12B
- SAB Topic 1.M.1 is SEC Staff Accounting Bulletin Topic 1.M.1, Assessing materiality
- FRM 1360.1 is section 1360.1 of the SEC's Financial Reporting Manual
- CFDG 2 is the SEC's Division of Corporation Finance Disclosure Guidance: Topic No. 2, Cybersecurity
- SEC Rel 33-11042 is SEC Release No. 33-11042, The Enhancement and Standardization of Climate-Related Disclosures for Investors
- TQA.1100.03 is section 1100.03 of the AICPA's Technical Questions and Answers
- 2021 AICPA Conf is the 2021 AICPA National Conference on Current SEC and PCAOB Developments
- CAQ 04/2010 is meeting minutes from the April 2010 Center for Audit Quality SEC Regulations Committee
- AS 3320.05 is paragraph 5 of PCAOB Auditing Standard 3320, Association with Financial Statements
- AU-C 700.62 is paragraph 62 of AICPA Statements on Auditing Standards (Clarified) Section 700, Forming an Opinion and Reporting on Financial Statements

Pending content

Some Codification paragraphs reproduced in this Handbook were amended by Accounting Standards Updates 2016-13, Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments and 2018-12, Financial Services – Insurance (Topic 944): Targeted Improvements to the Accounting for Long-Duration Contracts. With one exception, these amendments are presented as current content even though they are not yet effective for all entities. The amendments presented as current content do not affect the analysis in this Handbook differently than the pre-amended Codification paragraphs.

Under the one exception (see Question 9.4.70), an amendment made by ASU 2016-13 does affect the guidance in this Handbook. In this instance, both the pre-amended and amended Codification paragraph are presented and the effect of the amendment is explained.

Scope and terminology

The analysis in this Handbook applies to both SEC registrants and nonpublic entities applying US GAAP.

The following terminology is used in this Handbook.

- **Codification:** The FASB ASC Codification, which excludes SEC regulations
- **Notes:** Notes to financial statements (i.e. disclosures)
- **Registrant(s):** SEC registrant(s)
- **SEC guidance:** All SEC sources, including SEC regulations
- **SEC regulations:** SEC Regulations S-X and S-K
- **US GAAP:** The FASB ASC Codification and SEC regulations

Abbreviations

We use the following abbreviations in this Handbook:

AICPA	American Institute of Certified Public Accountants
AOCI	Accumulated other comprehensive income
DD&A	Depreciation, depletion and amortization
EBIT	Earnings before interest and taxes
EBITDA	Earnings before interest, taxes, depreciation and amortization
EITF	Emerging Issues Task Force
EPS	Earnings per share
IASB	International Accounting Standards Board

IFRS® Accounting Standards	International Financial Reporting Standards
IPO	Initial public offering
IPR&D	In-process research and development
LIBOR	London Interbank Offered Rate
MD&A	Management's Discussion and Analysis
NCI	Noncontrolling interest
NFP	Not-for-profit (entity)
OCI	Other comprehensive income
PP&E	Property, plant and equipment
R&D	Research and development
Reg	Regulation
ROU	Right-of-use (asset)
SG&A	Selling, general and administrative expenses
TCFD	Task Force on Climate-related Financial Disclosures
VIE	Variable interest entity

1. Executive summary

Applicability and scope

This Handbook discusses the presentation and general disclosure requirements relevant for financial statements prepared under US GAAP, focusing on the following FASB ASC Topics and Subtopic:

- Subtopic 205-10 (presentation of financial statements)
- Topic 210 (balance sheet)
- Topic 220 (income statement/comprehensive income)
- Topic 235 (notes to financial statements)
- Topic 275 (risks and uncertainties)
- Topic 850 (related party disclosures)
- Topic 855 (subsequent events).

Besides discussing the requirements in these (Sub)Topics, this Handbook also discusses SEC regulations pertinent to presentation and disclosure of financial statements filed by SEC registrants. Much of the discussion of SEC regulations focuses on Reg S-X Article 5, which relates to commercial and industrial registrants.

This Handbook does not address presentation of financial information outside of the financial statements (e.g. MD&A).

Financial statements: general principles

The objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to investors, lenders and other stakeholders as they make decisions about providing resources to the entity. This generally requires presentation of a full set of financial statements.

Providing financial information for comparative periods enhances the usefulness of the financial statements. Entities generally include at least one comparative period in addition to the current period.

Financial statements are generally prepared on the basis that the entity will continue to operate (i.e. a 'going concern' basis). In our experience, some entities disclose their basis of preparation as 'on a going concern basis' or basis of presentation 'in accordance with US GAAP' either in a basis of presentation or significant accounting policies note.

A full set of financial statements comprises the following statements.

Financial statement	Comments
Statement of financial position	Commonly called the balance sheet.

Financial statement	Comments
Income statement	Presented as a stand-alone statement or as a continuous statement of comprehensive income with other comprehensive income (OCI).
Statement of comprehensive income	Presented when an entity has OCI. Comprises both net income and OCI.
Statement of cash flows	See KPMG Handbook, Statement of cash flows.
Statement of shareholders' equity	Can be included in the notes. See KPMG Handbook, Debt and equity financing.

Financial statements are presented for the reporting period ending on the balance sheet date (reporting date). A reporting period might represent an annual or interim period. Understanding the nature and the length of the reporting period is fundamental to understanding the financial information presented and the applicable requirements.

Financial statements are accompanied by notes and, in some cases, supplemental information.

Presentation and disclosures requirements in US GAAP only apply when the reporting entity has material events or transactions that underlie these requirements.

Role of SEC regulations

Reg S-X and related SEC rules provide more specific requirements than the Codification regarding presentation of financial statements. Most notably, Reg S-X contains a list of minimum captions for the balance sheet and income statement. Reg S-X also requires registrants to provide financial statements from comparative periods in their periodic SEC filings (e.g. Form 10-K) and to file supplemental schedules in certain circumstances.

The SEC requirements technically apply only to SEC registrants. However, they are conceptually consistent with Subtopic 205-10, and therefore may be relevant to nonpublic entities. When they clarify Codification requirements, we believe they should be applied by all entities in the absence of specific Codification guidance. Further, when they go beyond the Codification requirements, they can constitute common or best practice for nonpublic entities.

Read more: Chapter 2

Balance sheet

The balance sheet presents an entity's assets, liabilities and equity as of the reporting date – i.e. the last day of a reporting period.

Reg S-X Rule 5-02 lists the required minimum captions that commercial and industrial registrants are expected to present on the balance sheet. It also requires them to present a classified balance sheet, which distinguishes between current and noncurrent assets and current and noncurrent liabilities. Other entities often present a classified balance sheet but are not required to do so.

Two primary issues in presenting a balance sheet are the classification of assets and liabilities as either current or noncurrent, and offsetting of liabilities against related assets.

Current vs noncurrent classification

Topic 210 provides the general guidance on how to present a classified balance sheet. A classified balance sheet shows separate classifications of current assets and current liabilities, which allows the user of the balance sheet to readily determine working capital.

Current assets	Current liabilities
Assets that are reasonably expected to be realized in cash or sold or consumed during the entity's normal operating cycle	Liabilities incurred in the current operating cycle or expected to be settled within a relatively short period of time (usually 12 months) of the reporting date

Whether assets or liabilities are current depends on the entity's operating cycle. The operating cycle is commonly 12 months but can be longer in certain industries in which the average time between acquiring assets for processing and realizing their value in cash or cash equivalents is longer than 12 months. The time period used as the basis for determining if an asset or liability is classified as current or noncurrent cannot be shorter than 12 months.

Offsetting

Assets and liabilities may be offset against one another on the balance sheet only when all of the following criteria are met.

Mutual liability criterion	Each of the two parties owes the other determinable amounts.
Ability to offset criterion	The reporting party has the right to offset the amount owed with the amount owed by the other party.
Intent to offset criterion	The reporting party intends to offset.
Enforceability criterion	The right of setoff is enforceable by law.

The right of setoff has several nuances and application issues.

In addition, Subtopic 210-20 requires quantitative disclosures for offsetting of derivatives, repurchase agreements and securities lending transactions. Its objective is to allow users of the financial statements to evaluate the effect or potential effect of netting arrangements on an entity's balance sheet, including the effect of rights of setoff.

Read more: Chapter 3

Income statement

The income statement provides a measure of the entity's operational performance, excluding OCI items. While the income statement is often presented as a part of a single continuous statement of comprehensive income along with OCI, it may also be presented as a stand-alone statement.

Reg S-X Rule 5-03 lists the required minimum captions that commercial and industrial registrants are expected to present in the income statement.

A significant issue in presenting an income statement is determining the appropriate classification of items. While the Codification provides guidance on allocating costs to discontinued operations, there is little authoritative guidance on how to allocate items among the captions in income from continuing operations. In general, each income statement caption represents similar classes of items that are relatively consistent across each industry. Further, the right of setoff (used to offset items on the balance sheet) does not apply to the income statement; however, some other Codification Topics permit or require offsetting in specific instances – e.g. recoveries on environmental losses are classified in the same caption as the related loss.

Unusual items

Unusual items require special treatment in income from continuing operations. Items need to fall in at least one of the following categories to be unusual.

Category	Characteristics of the underlying event or transaction
Unusual in nature	• High degree of abnormality; and • Clearly unrelated to, or only incidentally related to, the ordinary activities of the entity.
Infrequent in occurrence	• Not reasonably expected to recur in the foreseeable future.

Read more: Chapter 4

Comprehensive income

Comprehensive income comprises net income and OCI. These elements together represent the change in the entity's equity from all sources except from investments by and distributions to owners.

Comprehensive income

Net income + OCI + Transactions with owners in their capacity as owners = **Change in equity**

OCI is simply any revenues, expenses, gains and losses that affect an entity's equity but are not reported in net income. Only items specifically identified in US GAAP as OCI items can be reported as OCI – e.g. Subtopic 830-30 characterizes foreign currency translation adjustments as OCI. There is no conceptual basis for which items are recorded in OCI (instead of net income) and later reclassified to net income.

An entity presents a statement of comprehensive income only when it has OCI; otherwise, it presents just an income statement. There are two formats for a statement of comprehensive income.

Single-statement	Two-statement
Single continuous statement containing both net income and OCI	Separate but consecutive statements with the income statement first and comprehensive income statement second

Just as with the income statement, Reg S-X Rule 5-03 lists minimum captions that commercial and industrial registrants are required to present in the statement of comprehensive income.

An entity is permitted to present each of the components of OCI either:

- net of the related tax effects; or
- before the related tax effects, with one amount shown for the aggregate income tax expense or benefit related to the total of OCI items.

Regardless of the presentation approach, the tax effect for each component of OCI must be either presented in the statement of comprehensive income or disclosed in the notes.

Accumulated other comprehensive income

The total of OCI for the period is transferred to AOCI (a component of equity) at the reporting date. Amounts transferred to AOCI remain there until an event occurs that requires them to be reclassified to net income. The following diagram depicts how the reporting date AOCI balance and the changes to AOCI during the period are presented in financial statements.

OCI

Beginning AOCI + Reclassifications out of AOCI to net income + Other current-period activity = Ending AOCI

Because OCI items accumulate in AOCI and components of AOCI are reclassified to net income at some point, they affect not only the statement of comprehensive income, but also the balance sheet, statement of changes in equity and notes.

Reclassifications of AOCI amounts to net income are presented in the appropriate captions of the income statement. The effects of significant reclassification adjustments on individual captions are provided either on the face of the income statement or in the notes.

Read more: Chapter 5

Notes to financial statements

The notes to financial statements (notes) supplement, explain or amplify the information presented in the financial statements. Importantly, disclosure is not an acceptable alternative to the proper application of US GAAP.

Each Codification Topic (with a few exceptions) has disclosure requirements relating to its accounting subject. In addition, the notes provide information about:

- financial statement captions;
- the reporting entity; and
- past events and current conditions and circumstances that have not been recognized but could affect the entity's future cash flows.

Other considerations involved in preparing the notes include:

Materiality	Disclosure of immaterial items is not required.
Prior year	Disclosures from the prior year are repeated to the extent they continue to be of significance.

Reg S-X requires additional disclosures from registrants. Further, throughout the Codification, entities meeting the definition of a 'public entity' or 'public business entity' are required to make additional disclosures beyond those required for nonpublic entities.

Topic 235 requires disclosure of all significant accounting policies. An accounting policy is 'significant' if it has a material impact, either quantitatively or qualitatively, on the financial statements presented. Typically, the first note in the financial statements is the accounting policies note. The term 'accounting policy' broadly includes accounting principles, methods and techniques.

Read more: Chapter 6

Risks and uncertainties

Topic 275 requires entities to disclose risks and uncertainties that could significantly affect the amounts reported in the financial statements in the near term or the near-term functioning of the reporting entity. The Topic requires disclosures of such risks and uncertainties in four risk areas, but an entity may disclose risks and uncertainties from other sources.

Risk area	General disclosure requirements
Nature of operations	Describe major products or services and principal markets, including their location.
Estimates in general	Explain that preparation of financial statements in conformity with US GAAP requires use of management's estimates.
Certain significant estimates	When it is reasonably possible that an estimate will change materially in the near term, disclose this fact and indicate the nature of the uncertainty.
Current vulnerabilities due to concentrations	Disclose concentrations in certain areas when: • the concentration makes the entity vulnerable to the risk of near-term severe impact; and • it is at least reasonably possible that events could occur to cause such severe impact.

Topic 275 disclosures may be aggregated in one note or disclosed together with disclosures required by other Topics.

Read more: Chapter 7

Related parties

Transactions between related parties are typically accounted for in accordance with their terms, in the same manner as transactions between unrelated parties. However, related-party transactions can trigger certain qualitative and quantitative disclosure requirements under Topic 850 because they are presumed to not be at arm's length.

The following table includes examples of related entities or individuals.

Principal owners	Affiliates
Management	Trusts for the benefit of employees
Immediate family members of principal owners and management	Investments under significant influence

Required disclosures

Related-party transactions can trigger the Topic 850 disclosure requirements summarized in the table below. However, these requirements are not triggered when a related-party transaction:

- is immaterial;
- occurred in the ordinary course of business; or
- is eliminated in the preparation of the consolidated or combined financial statements.

Qualitative information	Quantitative information
• Nature of the relationship • Description of the transactions • Change in terms from the prior period presented • Terms and manner of settlement	• Dollar amount of the transaction (for each income statement presented) • Amounts due from or to related parties (for each balance sheet presented)

Read more: Chapter 8

Subsequent events

Subsequent events are events or transactions that occur after the reporting date (i.e. balance sheet date) but before the financial statements are issued (SEC filers) or are available to be issued (non-SEC filers).

There are two broad categories of subsequent events.

Recognized events (Type 1)	Nonrecognized events (Type 2)
• Events or transactions that provide additional evidence about conditions that existed at the reporting date • Require adjustment to the financial statements to reflect the impact of events or transactions, and possible specific disclosures	• Events that provide evidence about conditions that did not exist at the reporting date but arose subsequent to that date • May require disclosure in the notes but the financial statements are not adjusted

Recognized subsequent events

Subsequent events are recognized when they provide additional evidence relevant to:

- an accounting judgment, such as confirmation that a liability has been incurred or an asset has been impaired at the reporting date; or
- the measurement of an estimate at the reporting date.

Nonrecognized subsequent events

Generally, a nonrecognized subsequent event is disclosed if the event is expected to have a material effect on the financial statements when recognized, or if not disclosing it would otherwise be misleading.

Quantitative disclosure of the estimated financial effect of a nonrecognized subsequent event is required, if such an estimate can be made. This estimate is based on facts available at the date the financial statements are issued (available to be issued).

Read more: Chapter 9

2. Financial statements: general principles

Detailed contents

New item added in this edition: **
Item significantly updated in this edition: #

2.1 How the standard works

This Handbook explains the individual financial statements that collectively represent a full set of financial statements.

Statement of financial position (balance sheet)	See chapter 3
Income statement (usually part of the statement of comprehensive income)	See chapter 4
Statement of comprehensive income	See chapter 5
Statement of cash flows	See KPMG Handbook, Statement of cash flows
Statement of shareholders' equity	See KPMG Handbook, Debt and equity financing

A full set of financial statements with accompanying notes and required supplemental information are needed to achieve the objective of general purpose financial reporting.

This chapter explains basic principles that apply across financial statements.

2.2 Overview

Excerpt from ASC 205-10

> Entities

15-2 The guidance in the Presentation of Financial Statements Topic applies to business entities and not-for-profit entities (NFPs).

For all entities, Subtopic 205-10 provides a basis for the composition of a full set of financial statements, including the statements to be provided and comparative financial statements and disclosures. [205-10-15-2, 45-3 – 45-4]

Question 2.2.10
How does Subtopic 205-10 interact with SEC regulations and other guidance?

Interpretive response: For registrants, Reg S-X provides detailed requirements in addition to those of Subtopic 205-10. For example, it prescribes specific statements and schedules for certain industries, such as registered investment companies. The SEC supplemental schedule requirements for commercial and industrial registrants are discussed in section 2.7. [S-X Art 3, S-X Rules 5-01 – 5-04]

Reg S-X also clarifies exceptions, such as when statements or items in statements can be omitted. [S-X Art 3, S-X Rules 4-01 – 4-04]

Question 2.2.20
Are the SEC regulations and other guidance relevant to nonpublic entities?

Interpretive response: Yes. The detailed requirements in SEC regulations and other guidance are conceptually consistent with Subtopic 205-10. Therefore, these SEC sources may be relevant to nonpublic entities in two ways.

- They clarify the requirements in the Codification, in the absence of specific guidance in the Codification, in which case we believe they should be applied by all entities.
- They go beyond the requirements in the Codification, in which case they are not required for nonpublic entities but may constitute common or best practice.

2.3 Composition of a full set of financial statements

Excerpt from ASC 205-10

> Comparative Financial Statements

45-1 The presentation of comparative financial statements in annual and other reports enhances the usefulness of such reports and brings out more clearly the nature and trends of current changes affecting the entity. Such presentation emphasizes the fact that statements for a series of periods are far more significant than those for a single period and that the accounts for one period are but an installment of what is essentially a continuous history.

45-1A A full set of financial statements for a period shall show all of the following:

a. Financial position at the end of the period
b. Earnings (net income) for the period, (which may be presented as a separate statement or within a continuous statement of comprehensive income [see paragraph 220-10-45-1A])
c. Comprehensive income (total nonowner changes in equity) for the period in one statement or two separate but consecutive statements (if the reporting entity is required to report comprehensive income, see paragraph 220-10-15-3)
d. Cash flows during the period
e. Investments by and distributions to owners during the period.

45-2 In any one year it is ordinarily desirable that the statement of financial position, the income statement, and the statement of changes in equity be presented for one or more preceding years, as well as for the current year.

45-3 Prior-year figures shown for comparative purposes shall in fact be comparable with those shown for the most recent period. Any exceptions to comparability shall be clearly brought out as described in Topic 250.

45-4 Notes to financial statements, explanations, and accountants' reports containing qualifications that appeared on the statements for the preceding years shall be repeated, or at least referred to, in the comparative statements to the extent that they continue to be of significance. (See paragraph 205-10-50-2.)

> Changes Affecting Comparability

50-1 If, because of reclassifications or for other reasons, changes have occurred in the manner of or basis for presenting corresponding items for two or more periods, information shall be furnished that will explain the change. This procedure is in conformity with the well recognized principle that any change in practice that affects comparability of financial statements shall be disclosed.

50-2 Notes to financial statements, explanations, and accountants' reports containing qualifications that appeared on the statements for the preceding years shall be repeated, or at least referred to, in the comparative statements to the extent that they continue to be of significance. (See paragraph 205-10-45-4.)

Excerpt from Reg S-X Article 3

3-01 Consolidated balance sheets.

(a) There shall be filed, for the registrant and its subsidiaries consolidated, audited balance sheets as of the end of each of the two most recent fiscal years…

3-02 Consolidated statements of comprehensive income and cash flows.

(a) There shall be filed, for the registrant and its subsidiaries consolidated and for its predecessors, audited statements of comprehensive income and cash flows for each of the three fiscal years preceding the date of the most recent audited balance sheet being filed or such shorter period as the registrant (including predecessors) has been in existence…

3-04 Changes in stockholders' equity and noncontrolling interests.

An analysis of the changes in each caption of stockholders' equity and noncontrolling interests presented in the balance sheets shall be given in a note or separate statement…

Excerpt from Reg S-X Article 4

4-01 Form, order, and terminology.

(a) Financial statements should be filed in such form and order, and should use such generally accepted terminology, as will best indicate their significance and character in the light of the provisions applicable thereto. The information required with respect to any statement shall be furnished as a minimum requirement to which shall be added such further material information as is necessary to make the required statements, in the light of the circumstances under which they are made, not misleading.

    (1) Financial statements filed with the Commission which are not prepared in accordance with generally accepted accounting principles will be presumed to be misleading or inaccurate, despite footnote or other disclosures, unless the Commission has otherwise provided. This article and other articles of Regulation S-X provide clarification of certain disclosures which must be included in any event, in financial statements filed with the Commission...

4-03 Inapplicable captions and omission of unrequired or inapplicable financial statements.

(a) No caption should be shown in any financial statement as to which the items and conditions are not present.

(b) Financial statements not required or inapplicable because the required matter is not present need not be filed.
(c) The reasons for the omission of any required financial statements shall be indicated.

US GAAP is a general purpose financial reporting framework. The objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to investors, lenders and other stakeholders as they make decisions about providing resources to the entity. [CON 8.OB2]

This section addresses how the financial statements help achieve the objective of general purpose financial reporting.

Question 2.3.10
What is a full set of financial statements?

Interpretive response: Subtopic 205-10 specifies that a full set of financial statements for a period includes all of the following: [205-10-45-1A, 505-10-50-2]

- statement of financial position at the end of the period (e.g. balance sheet) – see chapter 3;
- earnings for the period (e.g. income statement) – see chapter 4;
- comprehensive income for the period – see chapter 5;
- cash flows for the period – see KPMG Handbook, Statement of cash flows; and
- investments by and distributions to owners for the period (e.g. statement of shareholders' equity), which may be presented as a financial statement or in a note to the financial statements – see section 5.12.30 of KPMG Handbook, Debt and equity financing.

In addition to a full set of financial statements, notes (see chapter 6) and required supplemental information (see section 2.7) that provide relevant disclosures are needed to achieve the objective of general purpose financial reporting. [CON 8.PR20]

Question 2.3.20
Can a financial statement be omitted from a full set of financial statements?

Interpretive response: It depends. If a registrant did not enter into transactions related to the required matter, the SEC allows the registrant to omit the related financial statement from a full set of financial statements. The reason for the omission is disclosed. [S-X Rule 4-03(b), (c)]

We believe that similar omission is acceptable for nonpublic entities provided the reason for the omission is disclosed.

Question 2.3.30
How are financial statements labeled?

Interpretive response: Financial statements are labeled using generally accepted terminology that best indicates their character. [S-X Rule 4-01(a)]

Subtopic 205-10 reference	Other commonly used terms
Statement of financial position	• Balance sheet
Earnings (net income)	• Income statement • Statement of net income (loss) • Statement of activities • Statement of operations
Comprehensive income	• Statement of comprehensive income (loss)
Cash flows	• Statement of cash flows
Investments by and distributions to owners	• Statement of changes in equity • Statement of shareholders' equity • Statement of stockholders' equity and noncontrolling interests • Statement of changes in net assets

Question 2.3.40
In what order are financial statements presented?

Interpretive response: Financial statements are presented in the order that best indicates their significance. For example, for an asset-focused business, the balance sheet may be presented first; in contrast, for a service industry business, the income statement may be presented first. [S-X Rule 4-01(a)]

2.4 Form of financial statements

2.4.10 Basis of preparation and presentation

Excerpt from Reg S-X Article 4

4-01 Form, order, and terminology.

(b) All money amounts required to be shown in financial statements may be expressed in whole dollars or multiples thereof, as appropriate: *Provided,* *That*, when stated in other than whole dollars, an indication to that effect is inserted immediately beneath the caption of the statement or schedule, at the top of the money columns, or at an appropriate point in narrative material.

(c) Negative amounts (red figures) shall be shown in a manner which clearly distinguishes the negative attribute. When determining methods of display, consideration should be given to the limitations of reproduction and microfilming processes.

4-02 Items not material.

If the amount which would otherwise be required to be shown with respect to any item is not material, it need not be separately set forth. The combination of insignificant amounts is permitted.

Financial statements are generally prepared on the basis that the entity will continue to operate (i.e. a 'going concern' basis). In our experience, some entities disclose their basis of preparation as 'on a going concern basis' or basis of presentation 'in accordance with US GAAP' either in a basis of presentation or significant accounting policies note.

Question 2.4.10

What are the bases of preparation available in US GAAP?

Interpretive response: Most US GAAP financial statements are prepared on a going concern basis. This basis applies as long as liquidation is not imminent, even if there is substantial doubt about an entity's ability to continue as a going concern or if the entity is entering into or emerging from bankruptcy proceedings. However, in those situations, specific accounting and disclosure requirements apply. See KPMG Handbooks, Going concern and Accounting for bankruptcies. [205-40, 852-10]

When liquidation is imminent, financial statements are prepared under the liquidation basis of accounting. [205-30]

Question 2.4.20

Can non-GAAP financial measures be included in the financial statements?

Background: A non-GAAP financial measure is a numerical measure of an entity's historical or future financial performance, financial position or cash flows that is not determined under US GAAP. Management generally decides which non-GAAP financial measures are used and how they are calculated.

Interpretive response: No. For registrants, SEC regulations expressly prohibit the use of non-GAAP measures in the financial statements. A registrant can only present non-GAAP financial measures outside of the financial statements unless those measures are required or expressly permitted by US GAAP – e.g. a segment measure of profit/loss required or expressly permitted under Topic 280. [S-K Item 10(e)(5)]

In our experience, non-GAAP financial measures are often reported by registrants in conjunction with GAAP measures in MD&A, earnings releases and other communications. Non-GAAP financial measures reported by registrants are subject to certain SEC rules and oversight. The SEC staff frequently comments on the presentation of non-GAAP performance measures that substitute an individually tailored measurement method by adjusting a GAAP-based measure.

For nonpublic entities, the Codification does not address non-GAAP measures. We believe that nonpublic entity financial statements should not include non-GAAP financial measures unless the measures are provided in accordance with an appropriate financial reporting framework (e.g. IFRS Accounting Standards as issued by the IASB) and subject to audit procedures (see Question 4.3.100 and Question 6.4.10).

See KPMG Issues In-Depth, Non-GAAP financial measures.

2.4.20 Presentation of amounts

Monetary amounts must be presented consistently in the financial statements and disclosures.

Question 2.4.25**
In what currency are financial statements presented?

Background: An entity measures its assets, liabilities, equity, income and expenses in its functional currency, which is the currency of the primary economic environment in which it operates. All transactions in currencies other than the functional currency are foreign currency transactions. See KPMG Handbook, Foreign currency, for discussion of functional currency, foreign currency transactions, translation of foreign currency financial statements and changes in reporting currency. [830-10 Glossary, 45-2]

Interpretive response: In our experience, except in situations further described below, an entity generally presents its financial statements in its functional currency – i.e. the reporting currency is generally the functional currency. The currency in which amounts in the financial statements are presented is to be disclosed prominently on the face of the financial statements. [S-X Rule 3-20(b)(1)]

US domestic registrants and foreign issuers who are not FPIs

US domestic registrants and foreign issuers that do not meet the definition of foreign private issuers (FPIs) are required to present their financial statements in US dollars. [S-X Rule 3-20(a)(2)]

In limited instances, the SEC staff has not objected to the use of a different reporting currency. Those instances have been limited to situations where: [SEC FRM 6640]

- the entity had little or no assets or operations in the US;
- substantially all the operations were conducted in a single functional currency other than US dollars; and
- the reporting currency selected was the same as the functional currency.

In these instances, reporting in the currency other than the US dollar would produce little or no foreign currency translation effects under Topic 830 (foreign currency).

Nonpublic entities and FPIs

The Codification does not address the determination of reporting currency. Therefore, we believe a nonpublic entity can make that election. FPIs may also use any reporting currency that management believes is appropriate. [S-X Rule 3-20(a)(1)]

Question 2.4.27**

Does US GAAP permit inflation-adjusted financial statements?

Interpretive response: It depends whether the entity uses the US dollar as its reporting currency.

US dollar is the reporting currency

If the entity uses the US dollar as its reporting currency, it cannot use inflation-adjusted financial statements as primary financial statements. However, disclosing information about the effects of changing prices is encouraged under Topic 255 for business entities. [255-10-15-2 – 15-3]

For the purposes of this disclosure, Topic 255 provides guidance on applying current cost-constant purchasing power accounting, a method of accounting that restates historical cost into current cost in units of constant purchasing power. See KPMG Handbook, Foreign currency, for additional guidance on whether certain assets or liabilities are monetary or nonmonetary items. [255-10 Glossary, 255-10-50-19 – 50-55]

The following table summarizes the optional, supplementary Topic 255 disclosures for changing prices.

Applicability	Optional disclosures
General	Disclose a five-year summary of selected financial data on a current cost basis. The information is stated as either in average-for-the-year or end-of-year units of constant purchasing power or in dollars based on the Consumer Price Index (CPI) for All Urban Consumers. [255-10-50-3 – 50-10] The CPI for All Urban Consumers is published in the Consumer Price Index Detailed Report and available on the Department of Labor, Bureau of Labor Statistics website at http://www.bls.gov/cpi.
Significant differences for income from continuing operations	If income from continuing operations on a current cost-constant purchasing power basis would differ significantly from that in the primary financial statements, disclose certain components of income from continuing operations for the current year on a current cost basis while applying the same constant purchasing power option used for the five-year summary. [255-10-50-11 – 50-15] Disclose certain additional information regarding current cost or lower recoverable amount at the end of the period of inventory and property, plant and equipment. [255-10-5016]
Entities with mineral reserves other than oil and gas	Disclose additional information regarding mineral reserves and mineral products for each of the five most recent fiscal years. [255-10-50-17 – 50-18]

US dollar is not the reporting currency

Price-level adjusted financial statements for certain entities in highly inflationary economies are permitted using historical cost-constant purchasing power accounting. [255-10-45-2 – 45-4]

However, in our experience, price-level adjusted financial statements are presented infrequently in practice.

See paragraph 7.053 of KPMG Handbook, Accounting for income taxes, for additional guidance related to the recognition and measurement of income taxes in general price-level financial statements of non-US entities.

Question 2.4.30
How is the currency convention stated?

Interpretive response: Registrants may show all monetary amounts in whole dollars or multiples thereof – i.e. amounts are rounded to the nearest dollar or multiples thereof. When using multiples, such as ‘000s, the financial statements must state that multiples are being used, either immediately beneath the statement caption, at the top of monetary columns or at a prominent point in the disclosure. [S-X Rule 4-01(b)]

Although not required, these currency conventions are also common practice for nonpublic entities.

Question 2.4.40
How are negative amounts presented?

Interpretive response: Negative amounts must be shown in a way that clearly distinguishes the negative attribute. In our experience, many entities use parentheses to identify negative numbers. [S-X Rule 4-01(c)]

2.4.30 Financial statement captions

Excerpt from ASC 105-10

05-6 The provisions of the Codification need not be applied to immaterial items.

Excerpt from Reg S-X Article 4

4-02 Items not material.

If the amount which would otherwise be required to be shown with respect to any item is not material, it need not be separately set forth. The combination of insignificant amounts is permitted.

The Codification does not specify minimum captions to be presented in the financial statements, but SEC regulations do for registrants; see section 3.2.10 for the balance sheet, and section 4.3.10 for the income statement.

Immaterial items do not require separate presentation or disclosure. Entities may combine insignificant amounts into a single caption. [105-10-05-6, S-X Rule 4-02]

Question 2.4.50
How is materiality assessed in the financial statements?

Interpretive response: The concept of materiality is not discussed in the Codification, but some guidance is included in FASB Concepts Statement No. 8 (CON 8). Although CON 8 is not authoritative for entities in preparing their financial statements, it provides a framework that is consistent with the precedent on 'materiality' established by the Supreme Court, and with the SEC staff's interpretive guidance that is derived from the Supreme Court precedent.

As reported in SAB Topic 1.M.1 (i.e. SAB 99), "The Supreme Court has held that a fact is material if there is 'a substantial likelihood that the...fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available'."

Materiality is entity-specific, and the same concept applies to both recording information in the entity's books and records and disclosing information in the financial statements. Materiality assessments are typically complex and take into account both qualitative and quantitative factors. [SAB Topic 1.M.1, CON 8.QC11-QC11B]

For further discussion of materiality in the financial statements, see section 2.3 of KPMG Handbook, Accounting changes and error corrections.

Question 2.4.60
Are required captions always presented on financial statements?

Interpretive response: No. For registrants, SEC regulations require certain minimum captions to be presented on the financial statements; see section 3.2.10 for the balance sheet, and section 4.3.10 for the income statement. However, a required caption does not need to be presented if it is:

- not applicable because the conditions are not present; or
- immaterial (see Question 2.4.50).

For example, SEC regulations require a separate balance sheet caption for marketable securities. However, if a registrant has no marketable securities for the periods presented, the caption does not need to be presented. [S-X Rule 4-03(a)]

Question 2.4.70
Can captions be aggregated on financial statements?

Interpretive response: It depends. We believe amounts of the same nature or function may be aggregated in a single caption with an appropriately descriptive label, subject to the minimum caption requirements for registrants (see Question 2.4.60).

For example, it may be appropriate to aggregate prepaid insurance and operating supplies (current assets of a prepaid nature). However, it would not be appropriate to aggregate prepaid insurance (a current asset) with cash surrender value of life insurance policies (a noncurrent asset that is not prepaid in nature). [210-10-45-4(d)]

Question 2.4.80
Can captions be disaggregated on financial statements?

Interpretive response: Yes. We believe captions can be disaggregated if the disaggregation is not misleading and does not obscure the financial information.

2.4.40 Unaudited information

Question 2.4.90
Can unaudited information be included in audited financial statements?

Interpretive response: Yes. However, each page or section of unaudited financial statements and/or unaudited supplementary information is captioned, 'Unaudited—see accompanying accountants' report'. [AU-C 700.62, AS 3320.05, AS 2705.11]

2.5 Reporting date and reporting period

Financial statements are presented for the reporting period ending on the balance sheet date (reporting date). [205-10-45-1A]

A reporting period might represent an annual or interim period. Understanding the nature and the length of the reporting period is fundamental to understanding the financial information presented and the applicable requirements. This Handbook discusses annual financial statements.

Question 2.5.10
How long is an annual reporting period?

Interpretive response: While the Codification does not address the length of a reporting period, reporting periods are referred to throughout the Codification as 'periods' or 'fiscal years'. In our experience, an annual reporting period is generally 12 months, and the annual reporting date is the fiscal year-end. In certain industries, such as restaurants and retail, entities often use week-based periods with 52-week annual reporting periods (and 53-week periods every fourth year).

SEC regulations also refer to 'fiscal years', which they define as annual accounting periods (i.e. 12 months) or, if no closing date has been adopted, the calendar year ending on December 31. SEC regulations also provide certain exceptions to accommodate for annual reporting periods shorter than 12 months – e.g. if the registrant has been in existence for less than one fiscal year or had a change in fiscal year. [S-X Rule 1-02(k), S-X Rule 3-06]

SEC guidance further states that audited reporting periods cannot exceed 12 months for domestic issuers. [FRM 1365.3]

Question 2.5.20#
Can an entity change its annual reporting date?

Interpretive response: Yes. We believe an entity can change its reporting date under any circumstances. Nonetheless, in our experience, changes in the reporting date occur infrequently in practice. A change from a fiscal year ending on the last day of the month to a 52-week annual reporting period is not a change in reporting date if the new fiscal year begins at the end of the old fiscal year. [FRM 1365.7]

A registrant may change its fiscal year-end, thereby changing its reporting date. In this case, it files a report covering the transition period. The transition period is the period between the end of the registrant's most recent fiscal year and the opening date of its newly selected fiscal year. [FRM 1360.1]

A nonpublic entity may also change its fiscal year-end. While the Codification does not require specific presentation or disclosure related to the change, disclosure of the change is generally necessary to make the financial statements meaningful to users. [TQA 1800.03]

In our experience, entities changing their reporting date apply either a: [FRM 1360.1, FRM 1365.6]

- stub period approach, where financial statements are prepared for the transition period only (i.e. less than 12 months); or
- recast approach, where financial statements are retrospectively adjusted to reflect the newly selected fiscal year (i.e. 12 months), including the transition period.

For registrants, the timing, audit requirements and form of the reports varies based on the length of the transition period and timing of the election. [FRM 1360.2, 1365.1 – 6]

2.6 Comparative financial information

Providing financial information for comparative periods enhances the usefulness of the financial statements. Entities generally include at least one comparative period in addition to the current period.

Question 2.6.10
Is comparative information for prior periods required?

Interpretive response: It depends.

Registrants are generally required to provide two balance sheets and three years of statements of changes (e.g. income, cash flows and shareholders' equity). However, certain exceptions exist. For example, emerging growth companies may provide only two years of statements of comprehensive income and cash flows in their IPO. [S-X Rule 3-01, S-X Rule 8-02, FRM Topic 10]

For nonpublic entities, providing comparative financial information is desirable because it gives financial statement users important context about the nature and trends of an entity's financial performance. In our experience, nonpublic entities present two balance sheets and two to three years of statements of changes. Single-period financial statements, although not desirable, are still in accordance with US GAAP. [205-10-45-1 – 45-2, 250-10-50-9]

For all entities, disclosures from previous years are repeated to the extent they continue to be of significance. [205-10-50-2]

Question 2.6.20
How is a change affecting comparability presented?

Interpretive response: When provided, comparative information must in fact be comparable. For example, comparative information is for the same length of time immediately preceding the most recent reporting period (e.g. prior 12 months), unless there is a change in reporting date (see Question 2.5.20). [205-10-45-3]

Changes affecting comparability include the following. [205-10-45-3, 205-10-50-1]

- Error corrections and accounting changes (i.e. change in accounting principle, estimate or reporting entity). Topic 250 explains which accounting approach applies – i.e. whether the error or change is recorded retrospectively or prospectively.
- Changes in classification and presentation that do not rise to the level of a change in accounting principle. Topic 250 does not provide specific guidance on these changes. However, consistent with the general requirements of Subtopic 205-10, we believe an entity should nonetheless recast prior-period information to conform to the presentation in the current period.

See KPMG Handbook, Accounting changes and error corrections.

Question 2.6.30#
How is data chronologically ordered?

Interpretive response: Data can be presented current first or oldest first. Although the SEC staff has no preference, it believes financial statements and tabular disclosures should read consistently from left to right in the same chronological order throughout the financial statements (or filing). We believe that financial statements of nonpublic entities should also read consistently to prevent the financial statements from being misleading. [SAB Topic 11.E]

For example, if the comparative balance sheets for December 31, 20X4 presents 20X4 amounts to the left of the comparative 20X3 amounts, then the income statement must do the same. In addition, numerical data in narrative disclosures should be consistently ordered. [SAB Topic 11.E]

2.7 Supplemental schedules for registrants

Excerpt from Reg S-X Article 5

5-04 What schedules are to be filed.

(a) Except as expressly provided otherwise in the applicable form:

(1) The schedules specified below in this Section as Schedules II and III shall be filed as of the date of the most recent audited [balance] sheet for each person or group.
(2) Schedule II of this section shall be filed for each period for which an audited statement of comprehensive income is required to be filed for each person or group.
(3) Schedules I and IV shall be filed as of the date and for periods specified in the schedule.

(b) When information is required in schedules for both the registrant and the registrant and its subsidiaries consolidated it may be presented in the form of a single schedule: Provided, That items pertaining to the registrant are separately shown and that such single schedule affords a properly summarized presentation of the facts. If the information required by any schedule (including the notes thereto) may be shown in the related financial statement or in a note thereto without making such statement unclear or confusing, that procedure may be followed and the schedule omitted.

(c) The schedules shall be examined by the independent accountant if the related financial statements are so examined.

Schedule I—Condensed financial information of registrant. The schedule prescribed by § 210.12–04 shall be filed when the restricted net assets [(§

210.1-02(dd))] of consolidated subsidiaries exceed 25 percent of consolidated net assets as of the end of the most recently completed fiscal year.

Schedule II—Valuation and qualifying accounts. The schedule prescribed by § 210.12–09 shall be filed in support of valuation and qualifying accounts included in each balance sheet but not included in Schedule VI. (See § 210.4–02.)

Schedule III—Real estate and accumulated depreciation. The schedule prescribed by § 210.12–28 shall be filed for real estate (and the related accumulated depreciation) held by persons a substantial portion of whose business is that of acquiring and holding for investment real estate or interests in real estate, or interests in other persons a substantial portion of whose business is that of acquiring and holding real estate or interests in real estate for investment. Real estate used in the business shall be excluded from the schedule.

Schedule IV—Mortgage loans on real estate. The schedule prescribed by § 210.12–29 shall be filed by persons specified under Schedule XI for investments in mortgage loans on real estate.

Schedule V—Supplemental Information Concerning Property-casualty Insurance Operations. The schedule prescribed by § 210.12–18 shall be filed when a registrant, its subsidiaries or 50%-or-less-owned equity basis investees, have liabilities for property-casualty ("P/C") insurance claims. The required information shall be presented as of the same dates and for the same periods for which the information is reflected in the audited consolidated financial statements required by §§ 210.3–01 and 3–02. The schedule may be omitted if reserves for unpaid P/C claims and claims adjustment expenses of the registrant and its consolidated subsidiaries, its unconsolidated subsidiaries and its 50%-or-less-owned equity basis investees did not, in the aggregate, exceed one-half of common stockholders' equity of the registrant and its consolidated subsidiaries as of the beginning of the fiscal year. For purposes of this test only the proportionate share of the registrant and its other subsidiaries in the reserves for unpaid claims and claim adjustment expenses of 50%-or-less-owned equity basis investees taken in the aggregate after intercompany eliminations shall be taken into account.

Registrants are required to file certain supplemental schedules for their particular industry, if applicable. For example, commercial and industrial registrants file the following schedules when the relevant conditions are met: [S-X Rule 5-04]

- Schedule I – Condensed financial information
- Schedule II – Valuation and qualifying accounts
- Schedule III – Real estate and accumulated depreciation
- Schedule IV – Mortgage loans on real estate
- Schedule V – Supplemental information concerning property-casualty insurance operations.

These schedules may be filed outside of the financial statements. Alternatively, they can be omitted if the required information is included in either: [S-X Rule 5-04]

- the notes to financial statements; or
- the related statement itself, as long as that statement doesn't become unclear or confusing.

Question 2.7.10
Must the supplemental schedules be audited?

Interpretive response: Yes. Even if the schedules are presented outside of the financial statements, the required supplemental schedules contain financial information that is considered part of the financial statements. Because these schedules are part of the financial statements, the SEC requires the schedules to be audited. [S-X Rule 1-01(b)]

3. Balance sheet

Detailed contents

3.1 How the standard works

The balance sheet is one of the statements required in a full set of financial statements and presents an entity's assets, liabilities and equity as of the last day of a reporting period. The balance sheet is also referred to as the statement of financial position.

Topic 210 contains the general requirements for balance sheet presentation and disclosures. In particular, it addresses the current versus noncurrent classification of assets and liabilities in a classified balance sheet and explains when assets and liabilities may be offset.

Topic 210 by itself is not prescriptive on other aspects of presentation, such as required captions or disaggregation. It also does not require a classified balance sheet, although this format is widely used in practice in certain industries. However, other Codification Topics, including industry-specific topics as well as Reg S-X for registrants, provide more specific guidance in this area.

This chapter addresses presentation requirements specific to the balance sheet only. Other general presentation requirements applicable to all financial statements (e.g. number of comparative periods, comparability and chronological ordering) are addressed in chapter 2.

3.2 Overview

Excerpt from ASC 210-10

05-1 The Balance Sheet Topic includes the following two Subtopics:

a. Overall
b. Offsetting

05-2 The balance sheet is commonly referred to as statement of financial position. For purposes of the Codification, both titles are interchangeable.

05-3 The Offsetting Subtopic provides guidance about offsetting amounts for certain contracts and repurchase and reverse repurchase agreements.

05-4 The Overall Subtopic provides general guidance on the classification of **current assets** and **current liabilities** and discusses the determination of **working capital**. The balance sheets of most entities show separate classifications of current assets and current liabilities (commonly referred to as classified balance sheets) permitting ready determination of working capital.

Topic 210 provides the general balance sheet presentation requirements. In particular, it addresses:

- current versus noncurrent classification of assets and liabilities in a classified balance sheet, and the determination of working capital (see section 3.3); and
- offsetting of assets and liabilities (see section 3.4).

Topic 210 is silent on other presentation aspects of the balance sheet, such as required captions, disaggregation and ordering. However, guidance may be provided in other general or industry Codification Topics.

For registrants, Reg S-X has specific balance sheet presentation guidance and certain required disclosures by industry. Unless otherwise stated, the SEC requirements discussed in this Handbook address commercial and industrial registrants.

Question 3.2.10
Where is the balance sheet industry guidance located in the Codification?

Interpretive response: The industry guidance in the Codification relevant to balance sheet presentation is summarized in the following table.

Industry	Subtopic reference
Contractors – federal government	912-210
Financial services – brokers and dealers	940-210

Industry	Subtopic reference
Financial services – depository and lending	942-210
Financial services – insurance	944-210
Financial services – investment companies	946-210
Health care entities	954-210
NFP entities	958-210

Question 3.2.20
Where is the balance sheet industry guidance located in SEC guidance?

Interpretive response: Reg S-X Article 5 prescribes the minimum requirements for registrants that are commercial and industrial registrants. The SEC industry guidance relevant to balance sheet presentation for other types of entities is summarized in the following table.

Industry	Reference
Registered investment companies	S-X Article 6
Employee stock purchase, savings, and similar plans	S-X Article 6A
Insurance companies	S-X Article 7
Bank holding companies and banks	S-X Article 9
Brokers and dealers when filing Form X-17A-5	Reg § 240.17a-5

In addition, Reg S-X Article 8 prescribes the form and content of financial statements for smaller reporting companies, as defined by Reg S-K Item 10(f).

3.2.10 Required captions

Question 3.2.30
Are there minimum balance sheet captions required for nonpublic entities?

Interpretive response: Yes. Topic 210 does not include a comprehensive list of captions required to be separately presented on an entity's balance sheet; however, other Codification Topics require certain financial statement captions to be separately presented on the balance sheet. The following are examples.

- Topic 220 (comprehensive income): report AOCI as a separate component of equity. [220-10-45-14]

- Topic 320 (debt and equity securities): report investments in available-for-sale securities and trading securities separately from similar assets that are subsequently measured using another measurement attribute. [320-10-45-1]
- Subtopic 350-20 (goodwill): report goodwill separately from other assets. [350-20-45-1]
- Subtopic 360-10 (property, plant and equipment): report long-lived assets classified as held-for-sale and assets and liabilities of a disposal group classified as held-for-sale separately from other assets and liabilities. [360-10-45-14]

In our experience, the balance sheet of nonpublic entities is generally presented similar to that of registrants. However, there are no quantitative balance sheet disaggregation thresholds in the Codification (see Question 3.2.50).

Question 3.2.40
Are there minimum balance sheet captions required for registrants?

Interpretive response: In addition to the requirements in the Codification (see Question 3.2.30), registrants must provide certain balance sheet captions (known as 'major captions' and 'subcaptions') or disclose certain information, if applicable, on the balance sheet or in the notes.

The following table lists the general requirements and instructions provided in Reg S-X for commercial and industrial registrants. See Appendix for the full excerpt. [S-X Rule 5-02]

See Question 3.2.20 for the location of SEC guidance for other types of entities.

Assets and other debits (current assets when appropriate)

Major caption	Subcaptions	Disclosures related to
Cash and cash items	--	Restricted cash and compensating balances
Marketable securities	--	Current marketable securities other than equity securities
Accounts and notes receivable	Due from: • Customers (trade) • Related parties • Underwriters, promoters and employees (other than related parties) not in the ordinary course of business • Others If the aggregate amount of notes receivable > 10% of	

Major caption	Subcaptions	Disclosures related to
	the aggregate amount of all receivables, provide the above information separately for accounts receivable and notes receivable.[1] Certain amounts due under long-term contracts.[1]	
Allowances for doubtful accounts and notes receivable[1]	--	--
Unearned income	--	--
Inventories	Major classes (e.g. finished goods, work in progress, raw materials, supplies)[1]	• Basis for determining amounts • LIFO inventory method • Long-term contracts or programs
Prepaid expenses	--	--
Other current assets	Any amount > 5% of total current assets[1]	--
Total current assets (subtotal)	--	--
Securities of related parties	--	--
Indebtedness of related parties (noncurrent)	--	--
Other investments	--	Investments other than noncurrent marketable equity securities
Property, plant and equipment	--	• Basis of determining the amounts • Public utility companies
Accumulated depreciation, depletion, and amortization of property, plant and equipment[1]	--	--
Intangible assets	Each class > 5% of total assets	• Basis of determining the amounts • Any significant addition or disposition
Accumulated depreciation and amortization of intangible assets1	--	--
Other assets	Any other item not classified in one of the	• Any significant addition or disposition

Major caption	Subcaptions	Disclosures related to
	preceding asset captions > 5% of total assets[1]	• Policy for deferral and amortization for any significant deferred charge
Total assets (subtotal)	--	--
Note: 1. Can be presented on the balance sheet or in the notes.		

Liabilities and stockholders' equity – Current liabilities (when appropriate)

Major caption	Subcaptions	Disclosures related to
Accounts and notes payable	Amounts payable to: • Banks for borrowings[1] • Factors or other financial institutions for borrowings[1] • Holders of commercial paper[1] • Trade creditors • Related parties • Underwriters, promoters, and employees (other than related parties) • Others	• Lines of credit • Short-term financings
Other current liabilities	Any item > 5% of total current liabilities[1]	--
Total current liabilities (subtotal)	--	--
Note: 1. Can be presented on the balance sheet or in the notes.		

Liabilities and stockholders' equity – Long-term debt

Major caption	Subcaptions	Disclosures related to
Bonds, mortgages and other long-term debt, including capitalized leases	Each issue or type of obligation[1]	General character of each type of debt including interest rate, maturity, priority, unused commitments, etc.
Indebtedness to related parties—noncurrent	--	--
Other liabilities	Any item not classified in one of the preceding liability captions > 5% of total liabilities[1]	--
Commitments and contingent liabilities	--	--

Major caption	Subcaptions	Disclosures related to
Deferred credits	• Deferred income taxes • Deferred tax credits • Material items of deferred income	--
Note: 1. Can be presented on the balance sheet or in the notes.		

Liabilities and stockholders' equity – Preferred stocks

Major caption	Subcaptions	Disclosures related to
Preferred stocks redeemable subject to mandatory redemption requirements or whose redemption is outside the control of the issuer	For each issue: • Title[1] • Carrying amount[1] • Redemption amount[1] • Dollar amount of shares subscribed but unissued • Number of shares authorized, and number of shares issued or outstanding[2]	For each issue: • Description of redemption features • Differences between the carrying value and the redemption amount
Preferred stocks which are not redeemable or are redeemable solely at the option of the issuer	For each issue: • Title[1] • Dollar amount[1] • Dollar amount of shares subscribed but unissued • Number of shares authorized and shares issued or outstanding[2]	• Changes in each class of preferred shares
Notes: 1. Presented on the balance sheet or, if more than one issue, in the notes. 2. Can be presented on the balance sheet or in the notes.		

Liabilities and stockholders' equity – Common stocks

Major caption	Subcaptions	Disclosures related to
Common stocks	For each class: • Number of shares issued or outstanding • Dollar amount thereof • The fact that the shares are convertible (if applicable) • Title[1] • Number of shares authorized[1]	For each class: • Changes in each class of common shares

Major caption	Subcaptions	Disclosures related to
	• Basis for conversion (if applicable)[1] • Dollar amount of shares subscribed but unissued	

Note:
1. Can be presented on the balance sheet or in the notes.

Liabilities and stockholders' equity – Other stockholders' equity

Major caption	Subcaptions	Disclosures related to
Other stockholders' equity	• Additional paid-in capital • Other additional capital • Retained earnings (appropriated vs unappropriated) • Accumulated other comprehensive income	Quasi-reorganizations

Liabilities and stockholders' equity – Noncontrolling interests

Major caption	Subcaptions	Disclosures related to
Noncontrolling interests in consolidated subsidiaries	--	Preferred stock
Total liabilities and equity (subtotal)	--	--

Question 3.2.50
Can balance sheet captions be disaggregated?

Interpretive response: Yes. US GAAP does not preclude disaggregation beyond required captions and subcaptions (see Question 3.2.30). We believe other appropriate captions are permissible beyond those required as long as they are not misleading and do not obscure the financial information (see Question 2.4.80).

In addition, registrants must separately present individual balance sheet amounts that exceed certain quantitative thresholds. The information can be presented on the balance sheet or in the notes, unless otherwise stated. Reg S-X for commercial and industrial registrants includes quantitative thresholds for the following captions (see Question 3.2.40): [S-X Rule 5-02]

- notes receivable;
- other current assets;
- intangible assets;
- other assets;
- other current liabilities; and
- other liabilities.

Question 3.2.60
Are there any specific ordering requirements for the balance sheet?

Interpretive response: No. US GAAP does not prescribe how to order balance sheet captions.

It is common practice for an entity to present assets and liabilities in descending order of liquidity (i.e. order of the amount of time to convert to cash). However, in our experience, assets may also be presented in order of prominence relative to the entity's respective industry.

Question 3.2.70
What are considerations when aggregating individual items in one caption?

Interpretive response: To increase its relevance and usefulness, each caption should only include homogenous classes of items. When determining the individual items to include in each balance sheet caption, consider: [CON 8.PR39, PR40]

- the expected time until realization or settlement of an asset or a liability;
- the expected form (e.g. cash or shares) of realization or settlement of an asset, a liability, or in certain circumstances an equity instrument;
- the types of changes in economic conditions that can affect the cash flows related to similar revenues, expenses, and gains or losses in the future; and
- similarities and differences in measurement methods.

3.3 Classified balance sheet

3.3.10 General requirements

Excerpt from ASC 210-10

05-5 Financial position, as it is reflected by the records and accounts from which the statement is prepared, is revealed in a presentation of the assets and liabilities of the entity. In the statements of manufacturing, trading, and service entities, these assets and liabilities are generally classified and segregated; if they are classified logically, summations or totals of the current or circulating or working assets (referred to as current assets) and of obligations currently payable (designated as current liabilities) will permit the ready determination of working capital.

05-6 The ordinary operations of an entity involve a circulation of capital within the current asset group. Cash is expended for materials, finished parts, operating supplies, labor, and other factory services, and such expenditures are accumulated as inventory cost. Inventory costs, upon sale of the products to which such costs attach, are converted into trade receivables and ultimately into cash again.

> Transactions

15-3 The guidance in this Subtopic that relates to separate classification of current assets and current liabilities (that is, a classified balance sheet) applies only when an entity is preparing a classified balance sheet for financial accounting and reporting purposes.

20 Glossary

Cash Equivalents

Cash equivalents are short-term, highly liquid investments that have both of the following characteristics:

a. Readily convertible to known amounts of cash
b. So near their maturity that they present insignificant risk of changes in value because of changes in interest rates.

Generally, only investments with original maturities of three months or less qualify under that definition. Original maturity means original maturity to the entity holding the investment. For example, both a three-month U.S. Treasury bill and a three-year U.S. Treasury note purchased three months from maturity qualify as cash equivalents. However, a Treasury note purchased three years ago does not become a cash equivalent when its remaining maturity is three months. Examples of items commonly considered to be cash equivalents are Treasury bills, commercial paper, money market funds, and federal funds sold (for an entity with banking operations).

Current Assets

Current assets is used to designate cash and other assets or resources commonly identified as those that are reasonably expected to be realized in cash or sold or consumed during the normal operating cycle of the business. See paragraphs 210-10-45-1 through 45-4.

Current Liabilities

Current liabilities is used principally to designate obligations whose liquidation is reasonably expected to require the use of existing resources properly classifiable as current assets, or the creation of other current liabilities. See paragraphs 210-10-45-5 through 45-12.

Working Capital

Working capital (also called net working capital) is represented by the excess of current assets over current liabilities and identifies the relatively liquid portion of total entity capital that constitutes a margin or buffer for meeting obligations within the ordinary operating cycle of the entity.

A classified balance sheet shows separate classifications of current assets and current liabilities, which allows the user of the balance sheet to readily determine working capital. [210-10-05-4]

Subtopic 210-10 provides general guidance on how to present a classified balance sheet, including the definition of operating cycle, currents assets and current liabilities. This general guidance applies unless other Codification Topics address the current versus noncurrent classification of the specific assets or liabilities – e.g. Topic 470 for debt or Topic 740 for deferred tax assets and liabilities.

Question 3.3.10
When is a classified balance sheet required?

Interpretive response: Subtopic 210-10 does not require a classified balance sheet, even though in our experience it is common for nonpublic entities to present one. Further, the AICPA illustrates a situation when it would be appropriate for a nonpublic entity to present an unclassified balance sheet (see Example 3.3.10). [TQA 1100.03]

However, Reg S-X requires commercial and industrial registrants to present a classified balance sheet. [S-X Rule 5-02]

Example 3.3.10
Unclassified balance sheet for a nonpublic venture with a limited life

This example is based on section 1100.03 of the AICPA's Technical Questions and Answers.

ABC Corp was organized with the sole purpose of constructing a shopping center that will take several years to complete. Upon completion of the construction, ABC will be liquidated. ABC recognizes revenue over time by measuring the progress toward complete satisfaction of its performance obligation (construction of the shopping center) and has only one operating cycle (see Question 3.3.40).

ABC concludes that it is more appropriate to present an unclassified balance sheet than a classified one because a classified balance sheet would not be meaningful under the circumstances. Because the sole purpose of ABC is to construct the shopping center, the time to complete the construction represents the appropriate time frame for reporting purposes, instead of an arbitrary 12-month period.

Question 3.3.20
How is a classified balance sheet presented?

Interpretive response: Subtopic 210-10 requires a current liabilities subtotal to be presented in a classified balance sheet, but does not specifically require a current assets subtotal, although it is often presented. Reg S-X requires commercial and industrial registrants to present both when appropriate. Classified balance sheets are generally presented in descending order of liquidity (see Question 3.2.60). [210-10-45-5, S-X Rule 5-02]

Question 3.3.30
Is a change from a classified to an unclassified balance sheet or vice versa a change in accounting principle?

Interpretive response: Yes. Subtopic 210-10 does not explicitly address how an entity effects a change from a classified to an unclassified balance sheet or vice versa. However, we believe the change in presentation represents a change in accounting principle that would require the entity to assess whether the change is preferable. See Question 3.2.40 in KPMG Handbook, Accounting changes and error corrections, for further discussion.

3.3.20 Operating cycle

Excerpt from ASC 210-10

20 Glossary

Operating Cycle

The average time intervening between the acquisition of materials or services and the final cash realization constitutes an operating cycle.

In a classified balance sheet, an entity classifies each asset and liability as either current or noncurrent. Current assets are those assets that are reasonably expected to be realized in cash or sold or consumed during the entity's normal operating cycle. Current liabilities generally include obligations for items that have entered the operating cycle. Therefore, to classify assets and liabilities, an entity needs to determine its operating cycle. [210-10 Glossary, 210-10-05-4, 45-8]

Question 3.3.40
How is the operating cycle determined?

Interpretive response: To determine its operating cycle, an entity considers the average time between the acquisition of assets for processing and their realization in cash or cash equivalents. It is the ultimate realization in cash that matters for the analysis, not a change in the nature of the item (e.g. a contract asset becoming a trade receivable). [210-10 Glossary]

The time period used as the basis for determining if an asset or liability is classified as current or noncurrent cannot be shorter than 12 months, as follows. [210-10-45-3]

Operating cycle	Time period used for current classification
Undefined	12 months
Shorter than 12 months	12 months
Longer than 12 months (e.g. tobacco, distillery and lumber businesses)	Operating cycle

Example 3.3.20
Operating cycle determination – construction company

Developer enters into a contract with Customer to construct a building for fixed consideration of $100 million. The construction takes 30 months to complete. The milestone payments and actual construction progress are as follows (in millions).

Month	Milestone payments ($)	Actual construction progress	Contract asset/(liability) ($)
0 (at inception)	5	0%	(5)
12	10	30%	15
24	10	80%	55
30	65	100%	10
42	10	100%	-

Of the contract asset of $15 million recognized at the end of the first 12 months, $10 million will be collected within 12 months and the remaining $5 million will be collected after 12 months.

Scenario 1: Identifiable operating cycle

Developer considers the duration of its projects in determining its operating cycle. If all projects are performed within a similar timeframe, this may indicate that Developer's operating cycle is identifiable and approximates the average duration of its projects (e.g. 30 months). In this case, the entire amount of the contract asset of $15 million is presented as a current asset on the classified balance sheet.

Scenario 2: Unidentifiable operating cycle

Modifying the fact pattern, if Developer's contracts in the same business are of different duration, it defaults to the 12-month operating cycle. In this scenario, to classify the contract asset of $15 million, Developer looks at its characteristics and determines that it is similar to a trade receivable (see Question 3.3.60). Therefore, the amount is split into a current ($10 million) and noncurrent ($5 million) portion. The noncurrent portion will subsequently be reclassified into current when it is due within 12 months.

Question 3.3.50
Can an entity with different businesses have multiple operating cycles?

Interpretive response: Yes. We believe that if an entity has different operating cycles for different parts of the business, the classification of an asset or liability as current is based on the operating cycle that is relevant to that particular asset or liability. The entity need not identify a single operating cycle.

For example, if an entity has a construction business with a 30-month operating cycle and a construction equipment retail business with a 12-month operating cycle, the entity would classify the assets and liabilities of the construction and retail businesses as current based on the respective operating cycles of the related businesses.

3.3.30 Classification of assets

Excerpt from ASC 210-10

> Classification of Current Assets

45-1 Current assets generally include all of the following:

a. Cash available for current operations and items that are **cash equivalents**
b. Inventories of merchandise, raw materials, goods in process, finished goods, operating supplies, and ordinary maintenance material and parts
c. Trade accounts, notes, and acceptances receivable
d. Receivables from officers, employees, affiliates, and others, if collectible in the ordinary course of business within a year
e. Installment or deferred accounts and notes receivable if they conform generally to normal trade practices and terms within the business
f. Marketable securities representing the investment of cash available for current operations
g. Prepaid expenses such as the following:
    1. Insurance
    2. Interest
    3. Rents
    4. Taxes
    5. Unused royalties
    6. Current paid advertising service not yet received
    7. Operating supplies

45-2 Prepaid expenses are not current assets in the sense that they will be converted into cash but in the sense that, if not paid in advance, they would require the use of current assets during the **operating cycle**. An asset representing the overfunded status of a single-employer defined benefit pension or postretirement plan shall be classified pursuant to Section 715-20-45.

45-3 A one-year time period shall be used as a basis for the segregation of current assets in cases where there are several operating cycles occurring within a year. However, if the period of the operating cycle is more than 12 months, as in, for instance, the tobacco, distillery, and lumber businesses, the longer period shall be used. If a particular entity has no clearly defined operating cycle, the one-year rule shall govern.

45-4 The concept of the nature of current assets contemplates the exclusion from that classification of such resources as the following:

a. Cash and claims to cash that are restricted as to withdrawal or use for other than current operations, are designated for expenditure in the acquisition or construction of noncurrent assets, or are segregated for the liquidation of long-term debts. Even though not actually set aside in special accounts, funds that are clearly to be used in the near future for the liquidation of long-term debts, payments to sinking funds, or for similar purposes shall also, under this concept, be excluded from current assets. However, if such funds are considered to offset maturing debt that has properly been set up as a current liability, they may be included within the current asset classification.
b. Investments in securities (whether marketable or not) or advances that have been made for the purposes of control, affiliation, or other continuing business advantage.
c. Receivables arising from unusual transactions (such as the sale of capital assets, or loans or advances to affiliates, officers, or employees) that are not expected to be collected within 12 months.
d. Cash surrender value of life insurance policies.
e. Land and other natural resources.
f. Depreciable assets.
g. Long-term prepayments that are fairly chargeable to the operations of several years, or deferred charges such as bonus payments under a long-term lease, costs of rearrangement of factory layout or removal to a new location.

> Current Assets

50-1 It is important that the amounts at which **current assets** are stated be supplemented by information that reveals, for the various classifications of inventory items, the basis upon which their amounts are stated and, where practicable, indication of the method of determining the cost—for example, average cost, first-in first-out (FIFO), last-in first-out (LIFO), and so forth.

Current assets are cash and other assets or resources that are reasonably expected to be realized in cash or sold or consumed during the normal operating cycle of the business. [210-10 Glossary]

Subtopic 210-10 provides a list of assets that are generally classified as current or noncurrent. [210-10-45-1, 45-4]

Current assets	Noncurrent assets
• Unrestricted cash and cash equivalents • Certain operating receivables • Marketable securities available for current operations • Certain prepaid assets	• Restricted cash • Long term investments • Certain non-operating receivables that are not expected to be collected within 12 months • Cash surrender value of life insurance policies • Land and other natural resources • Depreciable assets • Long-term prepayments

Question 3.3.60
How are common types of assets generally classified?

Interpretive response: The following tables identify common assets and their typical classification in an entity's balance sheet as prescribed in Subtopic 210-10 or other Codification Topics.

Cash, cash equivalents and securities

Asset class	Typical classification
Unrestricted cash and cash equivalents	Current. [210-10-45-1(a)] See chapter 6 of KPMG Handbook, Statement of cash flows.
Restricted cash	Noncurrent, unless considered to offset maturing debt that has properly been set up as a current liability. [210-10-45-4(a)] See chapter 6 of KPMG Handbook, Statement of cash flows.
Marketable securities	• Current if available for current operations. [210-10-45-1(f)] • Noncurrent if made for the purposes of control, affiliation or other continuing business advantage. [210-10-45-4(b)]

Trade receivables, customer contract assets and liabilities

Asset class	Typical classification
Trade receivables	Current. [210-10-45-1(c)]
Net customer contract assets	We believe current, noncurrent or bifurcated depending on the characteristics of the net contract asset (or liability), and the contract terms. All relevant facts and circumstances should be considered in this determination. See Question 14.2.50 in KPMG Handbook, Revenue recognition. An entity presents total net contract assets separately from total net contract liabilities, instead of a net position for all contracts with customers. The split of contract assets (or liabilities) between current and noncurrent is determined at the contract level.
Contract cost assets	In general, we believe noncurrent in its entirety unless the original amortization period is less than 12 months. However, there is diversity in practice, and some entities bifurcate the asset between current and noncurrent based on the period of amortization. See Question 14.6.20 in KPMG Handbook, Revenue recognition.

Inventory and prepaid assets

Asset class	Typical classification
Inventory including spare parts	Current, except for the portion of slow-moving inventory that an entity does not reasonably expect to realize in cash during its normal operating cycle. [210-10-45-1(b), TQA 2140.13]

Asset class	Typical classification
	We believe spare parts inventory should be classified as current if it does not exceed the expected consumption over the next 12 months (or expected operating cycle if longer). See Question 5.2.40 in KPMG Handbook, Inventory.
Prepaid assets	Current if the prepayment represents an asset that if not paid in advance would require the use of current assets during the operating cycle. [210-10-45-1(g)] Noncurrent if the long-term prepayment is chargeable to the operations of several years. [210-10-45-4(g)]

Long-lived and ROU assets

Asset class	Typical classification
Long-lived assets	Noncurrent. [210-10-45-4(e) – 45-4(f)]
Lease right-of-use (ROU) assets	Noncurrent, consistent with long-lived assets. [842-20-45-1] See section 6.9.1 of KPMG Handbook, Leases.

Other assets

Asset class	Typical classification
Other receivables	Current if arising in the ordinary course of business and collectible within 12 months. [210-10-45-1(d)] Noncurrent if arising from unusual transactions and not collectible within 12 months – e.g. sale of capital assets, loans to affiliates or employees. [210-10-45-4(c)]
Overfunded single-employer defined benefit pension or postretirement plan assets	Noncurrent. [715-20-45-2] See Question 6.5.10 in KPMG Handbook, Employee benefits.
Deferred tax assets, net of valuation allowance	Noncurrent. [740-10-45-6] See section 9.002 of KPMG Handbook, Accounting for income taxes.
Cash surrender value of life insurance policy, net of policy loans (if appropriate, see Question 3.4.60)	Noncurrent. [210-10-45-4(d)]
Derivative assets	Topic 815 does not provide specific guidance for classifying derivative instruments on a classified balance sheet. See section 14.2.30 of KPMG Handbook, Derivatives and hedging.

Question 3.3.70
How is equipment held for rental classified?

Interpretive response: We believe equipment held for rental should be classified as a noncurrent asset because it is a depreciable asset, which is excluded from the classification of a current asset in Subtopic 210-10. [210-10-45-4(f)]

Question 3.3.80
How are money market funds that have suspended redemptions classified?

Background: We believe money market funds that restrict or suspend redemptions are not cash equivalents because they are no longer highly liquid. See Question 6.3.70 in KPMG Handbook, Statement of cash flows.

Interpretive response: Money market funds that have suspended redemptions are classified as current only if they are available for current operations. We believe investors may need to consider the maturities of the underlying assets held by the fund to make this assessment. [210-10-45-1(f)]

Question 3.3.90
How is classification affected when the asset is pledged?

Interpretive response: Subtopic 210-10 excludes from current assets cash and claims to cash that are restricted as to withdrawal or use for other than current operations. [210-10-45-4(a)]

We believe this guidance applies by analogy to pledged assets other than cash – e.g. receivables, inventories, investments in money market funds or other assets pledged as collateral for a long-term loan. Pledging assets does not affect their classification as current assets if the entity can use these assets in current operations without restriction – as long as no individual accounts or items are specifically designated in the collateral agreement.

Question 3.3.100
How is classification affected when the asset will be used for acquisition or construction of noncurrent assets, or for the liquidation of long-term debts?

Interpretive response: Subtopic 210-10 excludes from current assets cash and claims to cash that are designated for expenditure in the acquisition or construction of noncurrent assets, are segregated for the liquidation of long-term debts, or are clearly to be used in the near future for similar purposes. For example, proceeds from a bond issuance restricted to finance the construction of a manufacturing facility are classified as noncurrent. [210-10-45-4(a)]

We believe this guidance may be applied in limited circumstances by analogy to classify the assets and liabilities of a discontinued operation when the proceeds from their sale will clearly be used in the near future as described in this guidance. See Question 6.2.40 in KPMG Handbook, Discontinued operations and held-for-sale disposal groups.

3.3.40 Classification of liabilities

Excerpt from ASC 210-10

> Classification of Current Liabilities

45-5 A total of **current liabilities** shall be presented in classified balance sheets.

45-6 The concept of current liabilities includes estimated or accrued amounts that are expected to be required to cover expenditures within the year for known obligations the amount of which can be determined only approximately (as in the case of provisions for accruing bonus payments) or where the specific person or persons to whom payment will be made cannot as yet be designated (as in the case of estimated costs to be incurred in connection with guaranteed servicing or repair of products already sold).

45-7 Section 470-10-45 includes guidance on various debt transactions that may result in current liability classification. These transactions are the following:

a. Due on demand loan agreements
b. Callable debt agreements
c. **Short-term obligations** expected to be refinanced.

• > Obligations in the Operating Cycle

45-8 As a balance sheet category, the classification of current liabilities generally includes obligations for items that have entered into the operating cycle, such as the following:

a. Payables incurred in the acquisition of materials and supplies to be used in the production of goods or in providing services to be offered for sale.
b. Collections received in advance of the delivery of goods or performance of services. Examples of such current liabilities are obligations resulting from advance collections on ticket sales, which will normally be liquidated in the ordinary course of business by the delivery of services. On the contrary, obligations representing long-term deferments of the delivery of goods or services would not be shown as current liabilities. Examples of the latter are the issuance of a long-term warranty or the advance receipt by a lessor of rental for the final period of a 10 year lease as a condition to execution of the lease agreement.
c. Debts that arise from operations directly related to the operating cycle, such as accruals for wages, salaries, commissions, rentals, royalties, and income and other taxes.

• > Other Liabilities

45-9 Other liabilities whose regular and ordinary liquidation is expected to occur within a relatively short period of time, usually 12 months, are also generally included, such as the following:

a. Short-term debts arising from the acquisition of capital assets
b. Serial maturities of long-term obligations
c. Amounts required to be expended within one year under sinking fund provisions
d. Agency obligations arising from the collection or acceptance of cash or other assets for the account of third persons. Loans accompanied by pledge of life insurance policies would be classified as current liabilities if, by their terms or by intent, they are to be repaid within 12 months. The pledging of life insurance policies does not affect the classification of the asset any more than does the pledging of receivables, inventories, real estate, or other assets as collateral for a short-term loan. However, when a loan on a life insurance policy is obtained from the insurance entity with the intent that it will not be paid but will be liquidated by deduction from the proceeds of the policy upon maturity or cancellation, the obligation shall be excluded from current liabilities.

45-10 A liability representing the underfunded status of a single-employer defined benefit pension or postretirement plan shall be classified pursuant to Section 715-20-45.

45-11 If the amounts of the periodic payments of an obligation are, by contract, measured by current transactions, as for example by rents or revenues received in the case of equipment trust certificates or by the depletion of natural resources in the case of property obligations, the portion of the total obligation to be included as a current liability shall be that representing the amount accrued at the balance sheet date.

45-12 The current liability classification is not intended to include debts to be liquidated by funds that have been accumulated in accounts of a type not properly classified as current assets, or long-term obligations incurred to provide increased amounts of **working capital** for long periods.

Subtopic 210-10 requires an entity to present a total of current liabilities on its classified balance sheet. It identifies and illustrates two categories into which a current liability may fall. [210-10-45-5]

Current liability category	Examples
Incurred in the operating cycle	• Trade payables • Collections received in advance of the delivery of goods or performance of services • Debts that arise from operations directly related to the operating cycle [210-10-45-8]
Expected to be settled within a relatively short period, usually 12 months, after the reporting date	• Short-term debts arising from the acquisition of capital assets • Serial maturities of long-term obligations • Amounts required to be expended within 12 months under sinking fund provisions • Agency obligations arising from the collection or acceptance of cash or other assets for the account of third persons [210-10-45-9]

Question 3.3.110
How are common types of liabilities generally classified?

Interpretive response: The following table identifies common liabilities and their typical classification on an entity's balance sheet as prescribed in Subtopic 210-10 or other Codification Topics.

Trade payables and net customer contract liabilities

Liability class	Typical classification
Trade accounts payable	Current. [210-10-45-8(a)]
Net customer contract liabilities	See Question 3.3.60.

Debt and lease liabilities

Liability class	Typical classification
Debt	Current if due on demand, callable or for its short-term portion – i.e. portion due within 12 months (or an operating cycle, if longer). This assessment is complex and factors in the likelihood at the reporting date of whether the creditor will accelerate repayment of the debt (e.g. in the case of subjective acceleration clauses). [210-10-45-7, 45-9, 470-10-45] Noncurrent otherwise. See section 3.6.10 of KPMG Handbook, Debt and equity financing

Liability class	Typical classification
Lease liabilities	Current for the short-term portion. We believe either of the following approaches may be acceptable under Subtopic 210-10 to determine the short-term portion of a lease liability. • Approach 1. The current portion of the lease liability is the amount by which the total lease liability will be reduced over the next 12 months (or operating cycle, if longer). This equals the payment(s) the lessee will make, less interest/accretion of the lease liability. • Approach 2. The current portion of the lease liability is equal to the present value of the lease payment(s) scheduled to be made over the next 12 months (or operating cycle, if longer). Under both approaches, the noncurrent portion of the lease liability is the difference between the carrying amount of the total lease liability and the current portion. See section 6.9.1 of KPMG Handbook, Leases.

Other liabilities

Liability class	Typical classification
Estimated and accrued amounts (e.g. accruals and loss contingencies)	Current, if: • directly related to the operating cycle (e.g. accruals for wages, salaries, commissions, rentals, royalties, and income and other taxes); or [210-10-45-8(c)] • expected to cover expenditures within 12 months. [210-10-45-6] Noncurrent otherwise. Estimated and accrued amounts cover known obligations: [210-10-45-6] • for which amounts can only be estimated (e.g. accruals for bonuses payable); or • where the specific person(s) to whom payment will be made cannot be identified (e.g. estimated costs incurred in connection with guaranteed servicing or repair of products sold).
Underfunded single-employer defined benefit pension or postretirement plan obligation	Current for the amount by which the net benefit obligation payable in the next 12 months (or an operating cycle if longer) exceeds the fair value of plan assets. Noncurrent otherwise. This generally results in employers with funded plans classifying the obligation as noncurrent. However, for unfunded plans or significantly underfunded plans, the liability may be partially current and noncurrent. [715-20-45-2]
Deferred tax liabilities	Noncurrent. [740-10-45-6] See paragraph 9.002 of KPMG Handbook, Accounting for income taxes.

Liability class	Typical classification
Derivative liabilities	Topic 815 does not provide specific guidance for classifying derivative instruments on a classified balance sheet. See section 14.2.30 of KPMG Handbook, Derivatives and hedging.

Question 3.3.120

Is a long-term obligation classified as current if it funds short-term needs?

Interpretive response: No. Long-term obligations are not classified as current because they fund short-term needs – e.g. provide increased amounts of working capital for long periods. [210-10-45-12]

Question 3.3.130

Are short-term obligations always classified as current liabilities?

Interpretive response: No. Short-term obligations incurred in the normal course of business with customary terms are generally classified as current liabilities (see Question 3.3.110) but there are exceptions. [210-10-45-8 – 45-9]

We believe certain short-term obligations may be excluded from current liabilities if the entity has the intent and ability to refinance the obligations on a long-term basis. Examples include:

- short-term obligations incurred from the purchase or construction of noncurrent assets, if they are refinanced on a long-term basis;
- short-term obligations not directly related to the operating cycle (such as a note given to a supplier that replaces an account payable) if the note is refinanced on a long-term basis.

A short-term obligation can be excluded from current liabilities only if the entity intends to refinance it on a long-term basis and that intent is supported by an ability to consummate the refinancing. See section 3.6.20 of KPMG Handbook, Debt and equity financing, for further discussion related to an entity's intent and ability to refinance. [470-10-45-14]

3.3.50 Valuation allowances

Excerpt from ASC 210-10

> Valuation Allowances

45-13 Asset valuation allowances for losses such as those on receivables and investments shall be deducted from the assets or groups of assets to which the allowances relate.

Valuation allowances for losses on receivables, loans and investments are deducted from the related assets – e.g. not presented separately. See chapter 24 of KPMG Handbook, Credit impairment, regarding the required disclosures for valuation allowances. [210-10-45-13]

3.4 Offsetting

3.4.10 Right of setoff

Excerpt from ASC 210-20

20 Glossary

Right of Setoff

A right of setoff is a debtor's legal right, by contract or otherwise, to discharge all or a portion of the debt owed to another party by applying against the debt an amount that the other party owes to the debtor.

05-1 This Subtopic provides criteria for offsetting amounts related to certain contracts and provides guidance on presentation. It is a general principle of accounting that the offsetting of assets and liabilities in the balance sheet is improper except if a **right of setoff** exists.

05-2 The general principle that the offsetting of assets and liabilities is improper except where a right of setoff exists is usually thought of in the context of unconditional receivables from and payables to another party. That general principle also applies to conditional amounts recognized for contracts under which the amounts to be received or paid or items to be exchanged in the future depend on future interest rates, future exchange rates, future commodity prices, or other factors.

> Entities

15-1 The guidance in this Subtopic applies to all entities.

> Transactions

15-2 The guidance in this Subtopic does not apply to the following types of transactions and contract arrangements:

a. The derecognition or nonrecognition of assets and liabilities. Derecognition by sale of an asset or extinguishment of a liability results in removal of a recognized asset or liability and generally results in the recognition of gain or loss. Although conceptually different, offsetting that results in a net amount of zero and derecognition with no gain or loss are indistinguishable in their effects on the statement of financial position. Likewise, not recognizing assets and liabilities of the same amount in financial statements achieves similar reported results.

> Other Considerations

15-3 The general principle of a **right of setoff** involves only two parties, and exceptions to that general principle shall be limited to practices specifically permitted by the Subtopics listed in this paragraph. Various accounting Subtopics specify accounting treatments in circumstances that result in offsetting or in a presentation in a statement of financial position that is similar to the effect of offsetting. The guidance in this Subtopic does not modify the accounting treatment in the particular circumstances prescribed by any of the following Subtopics:

a. Subtopic 842-50 (**leveraged leases**)
b. Subtopic 715-30 (accounting for pension plan assets and liabilities)
c. Subtopic 715-60 (accounting for plan assets and liabilities)
d. Subtopic 740-10 (net tax asset or liability amounts reported)
dd. Paragraphs 815-10-45-1 through 45-7 (derivative instruments with the right to reclaim cash collateral or the obligation to return cash collateral)
e. Subtopics 940-320 (trade date accounting for trading portfolio positions) and 910-405 (advances received on construction contracts)
f. Paragraph 942-210-45-3A (reciprocal balances with other banks).

> Right of Setoff Conditions

45-1 A **right of setoff** exists when all of the following conditions are met:

a. Each of two parties owes the other determinable amounts.
b. The reporting party has the right to set off the amount owed with the amount owed by the other party.
c. The reporting party intends to set off.
d. The right of setoff is enforceable at law.

45-2 A debtor having a valid right of setoff may offset the related asset and liability and report the net amount.

45-3 If the parties meet the criteria specified in paragraph 210-20-45-1, specifying currency or interest rate requirements is unnecessary. However, if maturities differ, only the party with the nearer maturity could offset because the party with the longer term maturity must settle in the manner that the other party selects at the earlier maturity date.

45-4 If a party does not intend to set off even though the ability to set off exists, an offsetting presentation in the statement of financial position is not representationally faithful.

45-5 Acknowledgment of the intent to set off by the reporting party and, if applicable, demonstration of the execution of the setoff in similar situations meet the criterion of intent.

> Offsetting Securities Against Taxes Payable

45-6 The offset of cash or other assets against the tax liability or other amounts owing to governmental bodies shall not be acceptable except in the circumstances described in the following paragraph.

45-7 Most securities issued by governments are not by their terms designed specifically for the payment of taxes and, accordingly, shall not be deducted from taxes payable on the balance sheet. The only exception to this general principle occurs when it is clear that a purchase of securities (acceptable for the payment of taxes) is in substance an advance payment of taxes that will be payable in the relatively near future, so that in the special circumstances the purchase is tantamount to the prepayment of taxes. This occurs at times, for example, as an accommodation to a local government and in some instances when governments issue securities that are specifically designated as being acceptable for the payment of taxes of those governments.

> Assurance that Right of Setoff Is Enforceable in a Bankruptcy

45-8 State laws about the right of setoff may provide results different from those normally provided by contract or as a matter of common law. Similarly, the U.S. Bankruptcy Code imposes restrictions on or prohibitions against the **right of setoff** in bankruptcy under certain circumstances. Legal constraints should be considered to determine whether the right of setoff is enforceable.

45-9 The phrase *enforceable at law* encompasses the idea that the right of setoff should be upheld in bankruptcy. The nature of support required for an assertion in financial statements that a right of setoff is enforceable at law is subject to a cost-benefit constraint and depends on facts and circumstances. All of the information that is available, either supporting or questioning enforceability, should be considered. Offsetting is appropriate only if the available evidence, both positive and negative, indicates that there is reasonable assurance that the right of setoff would be upheld in bankruptcy.

> Implementation Guidance

• > Other Considerations

55-18A Cash on deposit at a financial institution shall be considered by the depositor as cash rather than as an amount owed to the depositor.

Subtopic 210-20 provides the general guidance on when assets and liabilities may be presented net on the balance sheet.

Certain considerations related to whether specific assets and liabilities may be offset are addressed in other KPMG Handbooks as follows.

Type of asset/liability	Reference to relevant KPMG Handbook
Derivative instruments	Section 14.2.20, Derivatives and hedging.
Income taxes payable or receivable	Paragraph 9.013, Accounting for income taxes.
Tax credits	Section 2.2.40, Tax credits.
Assets and liabilities in deferred compensation arrangements	Question 3.6.20, Employee benefits.
Repurchase and reverse repurchase agreements	Section 8.3.20, Transfers and servicing of financial assets.

Question 3.4.10
What are the right of setoff criteria?

Interpretive response: A debtor may offset assets and liabilities if a right of setoff exists – i.e. when all the following criteria are met. [210-20-05-1, 45-1 – 45-2]

Mutual liability criterion	Each of the two parties owes the other determinable amounts.
Ability to offset criterion	The reporting party has the right to offset the amount owed with the amount owed by the other party.
Intent to offset criterion	The reporting party intends to offset.
Enforceability criterion	The right to setoff is enforceable at law.

Subtopic 210-20 also covers offsetting requirements specific to repurchase and reverse repurchase agreements, which are addressed in chapter 8 of KPMG Handbook, Transfers and servicing of financial assets.

Specific offsetting requirements may also be found in other Codification Topics – e.g. Topic 606 for customer contract assets and liabilities or Topic 740 for deferred tax.

Question 3.4.20
Can a right of setoff exist with more than two parties?

Interpretive response: No. A right of setoff can exist only with two parties involved. [210-20-45-1(a)]

Example 3.4.10
Right of setoff not permitted in three-party arrangements

Relo Corp is a provider of relocation services. ABC Corp engages Relo to provide services to its employees that involve funding their relocation expenses. Relo draws on a line of credit from Bank to advance cash to ABC's relocating employees. ABC is obligated to reimburse Relo for the advance, but if ABC is unable to do so, Relo is still obligated to pay Bank.

Because there are three parties to the transaction, Relo cannot offset the receivable from ABC with the borrowing from Bank.

Question 3.4.30
Can a right of setoff exist between assets and liabilities of different currency, interest or maturity?

Interpretive response: It depends. Assuming a right of setoff exists, Subtopic 210-20 does not preclude offsetting between assets and liabilities of differing currency or interest rates. However, if assets and liabilities have different maturities, only the party with the nearer liability maturity can offset because the other party must settle in the manner that the party with the nearer liability maturity selects at that earlier maturity date – i.e. only the party with the nearer liability maturity meets the ability to offset criterion. [210-20-45-3]

Example 3.4.20
Right of setoff when assets and liabilities have different maturities

ABC Corp and XYZ Corp are commercial partners. ABC owes XYZ $100 in three months. XYZ owes ABC $100 in six months. The parties have a legal right of setoff.

ABC has the nearer liability maturity and can offset its payable to XYZ against its receivable from XYZ if it has the intent to do so in three months when its payable becomes due.

Conversely, XYZ cannot offset its six-month payable to ABC against its three-month receivable from XYZ. This is because it must ultimately settle its payable in the manner ABC will select in three months when ABC's payable to XYZ becomes due.

Question 3.4.40
Can a right of setoff exist without both intent and ability to offset?

Interpretive response: No. Ability to offset is not sufficient if parties lack intent. A debtor meets the intent to offset criterion if it acknowledges its intent to do so and, if applicable, demonstrates the execution of setoff in similar situations. In addition, intent to offset is not sufficient without an enforceable right to do so. [210-20-45-4 – 45-5]

For example, nonrecourse debt is debt secured by a pledge of collateral, typically real property, but for which the borrower is not personally liable. If the borrower defaults, the lender can seize and sell the collateral. We believe the parties to nonrecourse debt would not ordinarily have the ability to offset the debt and the pledged asset, regardless of their intent to do so. Therefore, it would be uncommon for those assets and liabilities to meet the right of setoff criteria to be presented on a net basis.

Question 3.4.50
When is a right of setoff enforceable at law?

Interpretive response: Enforceability at law includes situations in which an entity can enforce the right of setoff through regulatory procedures or as part of normal business practice even if a setoff is not specifically included in a contract. Enforceability at law also encompasses the idea that the right of setoff should be upheld.

The US Bankruptcy Code includes certain restrictions on or prohibitions against the right of setoff in bankruptcy. There is no separate requirement in Subtopic 210-20 for bankruptcy protection. An entity should consider all of the available information that either supports or questions enforceability, including legal constraints imposed by the Bankruptcy Code. Offsetting is appropriate only if the available evidence, both positive and negative, indicates that there is reasonable assurance that the right of setoff would be upheld in bankruptcy. [210-20-45-8 – 45-9]

See KPMG Handbook, Accounting for bankruptcies, for additional financial statement presentation requirements for entities in Chapter 11 bankruptcy.

3.4.20 Application issues

Question 3.4.60
Can the cash surrender value of a life insurance policy be presented net of policy loans?

Interpretive response: Generally, yes. Certain life insurance policies allow the insured entity to take a loan out against the cash surrender value built up in the underlying policy. Typically, the policy owner has the right to offset the loans against the proceeds on the policy's maturity or cancellation. In this case, the entity can appropriately apply the amount of the loans to reduce the cash surrender value and disclose the amount offset. [TQA 2240.01]

Question 3.4.70
Can deferred compensation or other benefit arrangement liabilities be presented net of an investment in life insurance?

Interpretive response: Generally, no. We believe an investment in life insurance and any associated deferred compensation or other benefit arrangement should be accounted for separately because there is generally no right of setoff. See Question 3.6.40 in KPMG Handbook, Employee benefits.

Question 3.4.80
Can a liability be presented net of a related insurance recovery?

Interpretive response: Generally, no. The SEC staff has stated that the right of setoff for an insurance recovery and related liability is usually rare. An entity reports the gross liability for the loss and a separate asset for the estimate of the probable amount recoverable from the insurance company. When a third-party actuary develops an estimate of a liability, it often reports the liability net of estimated insurance recoveries. Therefore, an entity should request that the actuary report the gross and net estimates to record the gross amounts for the asset and liability. [2002 AICPA Conf]

We believe that if the insurance company rather than the entity is the primary obligor in the claim, the entity should not recognize a liability for the loss recoverable under the insurance policy.

Example 3.4.30
Insurance recovery – general liability

ABC Corp (a building owner) purchases general liability insurance to manage risk of loss related to injury and property damage claims arising from the property's use by others (e.g. insurance coverage for slips and falls at a retail property). Under the terms of the policy, the insurer undertakes the defense of all claims and, in the event of loss, the insurer pays or reimburses damages subject to the deductible and other limits of the insurance policy.

Following a winter storm, an ABC employee slips on ice located on the property, breaks their leg, and files a personal injury claim against ABC for their losses.

ABC recognizes a liability for the full amount of the probable payment to the employee for the claim (the probable loss). Any insurance recovery is evaluated and recognized separately. The insurance recovery receivable is not netted against the liability because a right of setoff does not exist and ABC has not been legally released by the injured party from being the primary obligor, even though the insurer has undertaken the defense of the claim.

Example 3.4.40
Insurance recovery – medical expenses

ABC Corp pays for the medical expenses of active employees and purchases an insurance policy that covers medical expenses exceeding $15,000 of lifetime benefits per employee.

ABC recognizes a liability for its obligation to cover all of the medical expenses of its employees as of the reporting date. It does not consider the insurance coverage in its measurement of the liability. Any insurance recovery is evaluated and recognized separately. The insurance recovery receivable is not netted against the liability recorded for the medical expenses because a right of setoff does not exist and ABC has not been legally released from being the primary obligor for the health benefits.

Question 3.4.90
Can bank overdrafts be presented net of cash balances?

Interpretive response: No. Cash on deposit at a financial institution is considered cash by the depositor, not as an amount owed by the bank (i.e. it is not a receivable). Conversely, amounts in an overdraft position with the bank (bank overdrafts) are considered owed to the bank (a liability). Therefore, bank overdrafts cannot be offset by cash balances with the bank because those cash balances are not an amount owed to the depositor by the bank. [210-20-55-18A]

Sections 6.2.20 and 6.2.30 of KPMG Handbook, Statement of cash flows, discuss bank and book overdrafts, and centralized cash management arrangements.

Question 3.4.100

Can tax liabilities be presented net of securities issued by governments?

Interpretive response: Generally, no. Offsetting of tax liabilities with securities issued by governments is not permitted except when the securities represent a prepayment of taxes. This is because most government securities are not by their terms designed specifically for the payment of taxes.

To represent a prepayment of taxes, the government securities must be acceptable for the payment of taxes, and it must be clear that the purchase is in substance an advance payment of taxes due in the relatively near future. [210-20-45-6 – 45-7]

3.4.30 Right of setoff disclosures

Excerpt from ASC 210-20

> Offsetting of Derivatives, Repurchase Agreements, and Securities Lending Transactions

50-1 The disclosure requirements in paragraphs 210-20-50-2 through 50-5 apply to both of the following: …

c. Recognized **derivative instruments** accounted for in accordance with Topic 815, including bifurcated embedded derivatives, **repurchase agreements accounted for as collateralized borrowings** and reverse repurchase agreements, and securities borrowing and securities lending transactions that are offset in accordance with either Section 210-20-45 or Section 815-10-45

d. Recognized derivative instruments accounted for in accordance with Topic 815, including bifurcated embedded derivatives, repurchase agreements and reverse repurchase agreements, and securities borrowing and securities lending transactions that are subject to an enforceable master netting arrangement or similar agreement, irrespective of whether they are offset in accordance with either Section 210-20-45 or Section 815-10-45.

50-2 An entity shall disclose information to enable users of its financial statements to evaluate the effect or potential effect of netting arrangements on its financial position for recognized assets and liabilities within the scope of the preceding paragraph. This includes the effect or potential effect of **rights of**

setoff associated with an entity's recognized assets and recognized liabilities that are in the scope of the preceding paragraph.

50-3 To meet the objective in the preceding paragraph, an entity shall disclose at the end of the reporting period the following quantitative information separately for assets and liabilities that are within the scope of paragraph 210-20-50-1:

a. The gross amounts of those recognized assets and those recognized liabilities
b. The amounts offset in accordance with the guidance in Sections 210-20-45 and 815-10-45 to determine the net amounts presented in the statement of financial position
c. The net amounts presented in the statement of financial position
d. The amounts subject to an enforceable master netting arrangement or similar agreement not otherwise included in (b):
    1. The amounts related to recognized financial instruments and other derivative instruments that either:
        i. Management makes an accounting policy election not to offset.
        ii. Do not meet some or all of the guidance in either Section 210-20-45 or Section 815-10-45.
    2. The amounts related to financial collateral (including cash collateral).
e. The net amount after deducting the amounts in (d) from the amounts in (c).

50-4 The information required by the preceding paragraph shall be presented in a tabular format, separately for assets and liabilities, unless another format is more appropriate. The total amount disclosed in accordance with paragraph 210-20-50-3(d) for an instrument shall not exceed the amount disclosed in accordance with paragraph 210-20-50-3(c) for that instrument.

50-5 An entity shall provide a description of the rights of setoff associated with an entity's recognized assets and recognized liabilities subject to an enforceable master netting arrangement or similar agreement disclosed in accordance with paragraph 210-20-50-3(d), including the nature of those rights.

50-6 If the information required by paragraphs 210-20-50-1 through 50-5 is disclosed in more than a single note to the financial statements, an entity shall cross-reference between those notes.

• > Disclosure of Quantitative Information for Recognized Assets and Liabilities within the Scope of Paragraph 210-20-50-1

55-6 Instruments disclosed in accordance with paragraph 210-20-50-3 may be subject to different measurement attributes (for example, a payable related to a repurchase agreement may be measured at amortized cost, while a derivative will be measured at fair value). An entity should include instruments at their recognized amounts and describe any resulting measurement differences in the related disclosures.

• > Disclosure of the Gross Amounts of Recognized Assets and Liabilities

55-7 The disclosures required by paragraph 210-20-50-3(a) relate solely to recognized assets and liabilities within the scope of paragraph 210-20-50-1.

• > Disclosure of the Amounts Offset in Accordance with Sections 210-20-45 and 815-10-45

55-8 Paragraph 210-20-50-3(b) requires that entities disclose the amounts offset in accordance with Sections 210-20-45 and 815-10-45 to determine the net amounts presented in the statement of financial position. The amounts of both the recognized assets and the recognized liabilities subject to setoff under the same arrangement will be disclosed in the respective tables; however, the amounts included in the tables are limited to the amount that is subject to setoff. For example, an entity may have a recognized derivative asset and recognized derivative liability that meet the offsetting guidance in Section 815-10-45. If the gross amount of the derivative asset is larger than the gross amount of the derivative liability, the asset disclosure table will include the entire amount of the derivative asset and the entire amount of the derivative liability. The liability disclosures table, however, will include the entire amount of the derivative liability, but it will only include the amount of the derivative asset equal to the amount of the derivative liability.

• > Disclosure of the Net Amounts Presented in the Statement of Financial Position

55-9 If an entity has instruments that meet the scope of the disclosures but that do not meet the offsetting guidance in either Section 210-20-45 or Section 815-10-45 or that management does not elect to offset, the amounts required to be disclosed by paragraph 210-20-50-3(c) would equal the amounts required to be disclosed by paragraph 210-20-50-3(a).

55-10 The amounts required by paragraph 210-20-50-3(c) must be reconciled to the individual line item amount(s) presented in the statement of financial position. For example, if an entity determines that the aggregation or disaggregation of individual financial statement line items provides more relevant information, it must reconcile the aggregated or disaggregated amounts disclosed in accordance with paragraph 210-20-50-3(c) to the statement of financial position.

55-10A An entity also may elect to include all recognized derivatives accounted for in accordance with Topic 815, including bifurcated embedded derivatives, repurchase agreements and reverse repurchase agreements, and securities borrowing and securities lending transactions in the scope of paragraph 210-20-50-1 to reconcile to the individual line-item amount(s) presented in the statement of financial position. For instruments not subject to an enforceable master netting arrangement or similar agreement, the amounts disclosed in accordance with paragraph 210-20-50-3(a) would equal the amounts disclosed for those instruments in accordance with both paragraph 210-20-50-3(c) and paragraph 210-20-50-3(e).

• > Disclosure of Amounts Subject to an Enforceable Master Netting Arrangement or Similar Agreement Not Otherwise Included in Paragraph 210-20-50-3(b)

55-11 Paragraph 210-20-50-3(d) requires that entities disclose other amounts for instruments that are within the scope of paragraph 210-20-50-1 but are not included in paragraph 210-20-50-3(b). These amounts include those that meet the guidance in either Section 210-20-45 or Section 815-10-45 to qualify for offsetting but management elects not to offset.

55-12 An entity should also disclose the fair value amounts related to cash or financial instrument collateral received or pledged (see paragraph 210-20-50-3(d)(2)).

• > Limits on the Amounts Disclosed in Paragraph 210-20-50-3(d)

55-13 When disclosing amounts in accordance with paragraph 210-20-50-3(d), an entity must take into account the effect of overcollateralization by instrument. To do so, an entity must first deduct the amounts disclosed in accordance with paragraph 210-20-50-3(d)(1) from the amount disclosed in accordance with paragraph 210-20-50-3(c). An entity should then limit the amounts disclosed in accordance with paragraph 210-20-50-3(d)(2) to the remaining amount for the related instrument. However, if rights to collateral can be enforced across financial instruments, such rights may be included in the disclosure provided in accordance with 210-20-50-3(d).

• > Description of the Rights of Setoff Subject to Enforceable Master Netting Arrangements and Similar Agreements

55-14 An entity should describe the types of rights of setoff and similar agreements disclosed in accordance with paragraph 210-20-50-3(d), including the nature of those rights. For example, for a conditional right of setoff, an entity should describe the related condition(s). For any financial collateral received or pledged, an entity should describe the terms of the collateral agreement (for example, when the collateral is restricted).

• > Disclosure by Type of Financial Instrument or by Counterparty

55-15 The disclosures required by paragraph 210-20-50-3(a) through (e) may be grouped by type of instrument or transaction (for example, derivatives, repurchase and reverse agreements, and securities borrowing and lending agreements).

55-16 Alternatively, an entity may group the information required by paragraph 210-20-50-3(a) through (c) by type of instrument and paragraph 210-20-50-3(c) through (e) by counterparty. If an entity provides the required information by counterparty, the entity is not required to identify the counterparties by name. However, designation of the counterparties (Counterparty A, Counterparty B, Counterparty C, and so forth) should remain consistent from year to year to maintain comparability, and qualitative disclosures should be considered to give further information about the types of counterparties. When disclosure of the amounts in paragraph 210-20-50-3(c) through (e) is provided by counterparty, the amounts related to individually significant counterparties with respect to total counterparty amounts should be separately disclosed, and the remaining individually insignificant counterparties should be aggregated into one line item.

• > Other Considerations

55-17 The disclosures required by paragraphs 210-20-50-3 through 50-5 are minimum requirements, and to meet the objective in paragraph 210-20-50-2 an entity may need to supplement the disclosures with additional (qualitative) disclosures depending on the terms of the enforceable master netting arrangements and related agreements, including the nature of the rights of setoff and their effect or potential effect on the entity's financial position.

55-18 An entity should present the disclosures in a manner that clearly explains to users of its financial statements the nature of rights of setoff and related arrangements and their effect on the entity's assets and liabilities in the scope of paragraph 210-20-50-1 and its financial position. An entity should determine how much detail it must provide to satisfy the disclosure requirements. The entity must strike a balance between obscuring important information because of excessive aggregation and obscuring important information because of excessive detail that may not help users of financial statements to understand the entity's financial position. For example, an entity should not disclose information that is so aggregated that it obscures important differences between the different types of rights of setoff or related arrangements.

Subtopic 210-20 requires quantitative disclosures for offsetting of derivatives, repurchase agreements and securities lending transactions. Its objective is to allow users of the financial statements to evaluate the effect or potential effect of netting arrangements on an entity's balance sheet, including the effect of rights of setoff as discussed in section 3.4.10. See section 11.4.20 of KPMG Handbook, Transfers and servicing of financial assets, for additional disclosure considerations related to offsetting of repurchase and reverse repurchase agreements. [210-20-50-1 – 50-2]

The following table summarizes the required disclosures and related implementation guidance. [210-20-50-3]

Disclosures for offsetting of derivatives, repurchase agreements, and securities lending transactions	Implementation guidance
Gross amounts of recognized assets and recognized liabilities	210-20-55-6 – 55-7
Amounts offset to determine the net amounts presented on the balance sheet	210-20-55-8
Net amounts presented on the balance sheet	210-20-55-9 – 55-10-A
Amounts subject to an enforceable master netting arrangement or similar agreement	210-20-55-11 – 55-14
The net amount after deducting the amounts subject to an enforceable master netting or similar arrangement from the net amounts presented on the balance sheet	n/a

The required disclosures are presented in a tabular format unless another format is more appropriate. If the information is presented across notes, it is cross-referenced between notes. [210-20-40-5 – 50-6]

Subtopic 210-20 also includes illustrative disclosure examples, which are reproduced below.

Excerpt from ASC 210-20

> Illustrations

55-19 The following Examples illustrate ways to meet the quantitative disclosure requirements in paragraphs 210-20-50-1 through 50-5 by type of financial instrument or other derivative instrument.

• > Example 1: Disclosure by Type of Financial Instrument

55-20 In this Example, the reporting entity has entered into transactions subject to an enforceable master netting arrangement or other similar agreement with the following counterparties. The reporting entity has the following recognized financial assets and financial liabilities resulting from those transactions that meet the scope of the disclosure requirements in paragraph 210-20-50-1. This Example has the following assumptions.

a. Counterparty A:

   1. The reporting entity has a derivative asset (fair value of $100 million) and a derivative liability (fair value of $80 million) with Counterparty A. Assume that the entity qualifies for and makes an accounting policy election to offset in accordance with Section 815-10-45. Cash collateral also has been received from Counterparty A for a portion of the net derivative asset ($10 million). The derivative liability and the cash collateral received are set off against the derivative asset in the statement of financial position, resulting in the presentation of a net derivative asset of $10 million.

b. Counterparty B:

   1. The reporting entity had entered into a sale and repurchase agreement with Counterparty B that is accounted for as a collateralized borrowing. The carrying value of the financial asset (bonds) used as collateral and held by the reporting entity for the transaction is $79 million, and their fair value is $85 million. The carrying value of the collateralized borrowing (repo payable) is $80 million.
   2. The reporting entity also has entered into a reverse sale and repurchase agreement with Counterparty B that is accounted for as a collateralized lending. The fair value of the asset (bonds) received as collateral (and not recognized in the statement of financial position) is $105 million. The carrying value of the secured lending (reverse repo receivable) is $90 million.
   3. Assume that the transactions are not offset.

Application of Paragraph 210-20-50-3(a)-(e)

Offsetting of Financial Assets and Derivative Assets

$ million As of December 31, 20XX	(i)	(ii)	(iii)=(i)-(ii)	(iv)		(v)=(iii)-(iv)
				Gross Amounts Not Offset in the Statement of Financial Position		
	Gross Amounts of Recognized Assets	Gross Amounts Offset in the Statement of Financial Position	Net Amounts of Assets Presented in the Statement of Financial Position	Financial Instruments	Cash Collateral Received	Net Amount
Description						
Derivatives	$100	$(90)	$ 10	-	$ -	$10
Reverse repurchase, securities borrowing, and similar arrangements	90	-	90	(90)	-	-
Total	$190	$(90)	$100	$(90)	$ -	$10

Offsetting of Financial Liabilities and Derivative Liabilities

$ million As of December 31, 20XX	(i)	(ii)	(iii)=(i)-(ii)	(iv)		(v)=(iii)-(iv)
				Gross Amounts Not Offset in the Statement of Financial Position		
	Gross Amounts of Recognized Liabilities	Gross Amounts Offset in the Statement of Financial Position	Net Amounts of Liabilities Presented in the Statement of Financial Position	Financial Instruments	Cash Collateral Pledged	Net Amount
Description						
Derivatives	$ 80	$(80)	$ -	$ -	$ -	$ -
Repurchase, securities lending, and similar arrangements	80	-	80	(80)	-	-
Total	$160	$(80)	$80	$(80)	$ -	$ -

• > Example 2: Disclosure by Type of Financial Instrument and Type of Counterparty

55-21 The following table illustrates how an entity might provide the quantitative disclosure requirements in paragraph 210-20-50-3(a) through (c) by type of instrument and the information required in paragraph 210-20-50-3(c) through (e) by counterparty.

Application of Paragraph 210-20-50-3(a)-(c) by Instrument and Paragraph 210-20-50-3(c)-(e) by Counterparty

Offsetting of Financial Assets and Derivative Assets

$ million

As of December 31, 20XX	(i) Gross Amounts of Recognized Assets	(ii) Gross Amounts Offset in the Statement of Financial Position	(iii)=(i)-(ii) Net Amounts of Assets Presented in the Statement of Financial Position
Description			
Derivatives	$100	$(90)	$ 10
Reverse repurchase, securities borrowing, and similar arrangements	90	-	90
Total	$190	$(90)	$100

Financial Assets, Derivative Assets, and Collateral Held by Counterparty

$ million

As of December 31, 20XX	(iii)	(iv) Gross Amounts Not Offset in the Statement of Financial Position		(v)=(iii)-(iv)
	Net Amount of Assets in the Statement of Financial Position	Financial Instruments	Cash Collateral Received	Net Amount
Counterparty A	$ 10	$ -	$ -	$10
Counterparty B	90	(90)	-	-
Other				
Total	$100	$(90)	$ -	$10

Application of Paragraph 210-20-50-3(a)-(c) by Instrument and Paragraph 210-20-50-3(c)-(e) by Counterparty

Offsetting of Financial Liabilities and Derivative Liabilities

$ million

As of December 31, 20XX	(i) Gross Amounts of Recognized Liabilities	(ii) Gross Amounts Offset in the Statement of Financial Position	(iii)=(i)-(ii) Net Amounts of Liabilities Presented in the Statement of Financial Position
Description			
Derivatives	$ 80	$(80)	$ -
Repurchase, securities lending, and similar arrangements	80	-	80
Total	$160	$(80)	$80

Financial Liabilities, Derivative Liabilities, and Collateral Pledged by Counterparty

$ million

As of December 31, 20XX	(iii)	(iv)		(v)=(iii)-(iv)
		Gross Amounts Not Offset in the Statement of Financial Position		
	Net Amounts of Liabilities Presented in the Statement of Financial Position	Financial Instruments	Cash Collateral Pledged	Net Amount
Counterparty A	$ -	$ -	$ -	$ -
Counterparty B	80	(80)	-	-
Other				
Total	$80	$(80)	$ -	$ -

• > Example 3: Sophisticated Entity Disclosure by Type of Financial Instrument and Type of Counterparty

55-22 The following table illustrates how a sophisticated entity that engages in significant derivative activity might provide the quantitative disclosure requirements in paragraph 210-20-50-3(a) through (c) by type of instrument and paragraph 210-20-50-3(c) through (e) by type of counterparty. In this Example, the entity further disaggregates the derivative line item by type of contract as discussed in paragraph 815-10-50-4D, with further disaggregation based on how the derivative is transacted.

Application of Paragraph 210-20-50-3(a)-(c) by Instrument and Paragraph 210-20-50-3(c)-(e) by Counterparty

Offsetting of Financial Assets and Derivative Assets

$ million

As of December 31, 20XX	(i) Gross Amounts of Recognized Assets	(ii) Gross Amounts Offset in the Statement of Financial Position	(iii)=(i)-(ii) Net Amounts of Assets Presented in the Statement of Financial Position
Description			
Derivatives			
Interest rate contracts			
Over the counter	$XX,XXX	$XX,XXX	$XX,XXX
Exchange traded	XX,XXX	XX,XXX	XX,XXX
Exchange cleared	XX,XXX	XX,XXX	XX,XXX
Foreign exchange contracts			
Over the counter	XX,XXX	XX,XXX	XX,XXX
Exchange traded	XX,XXX	XX,XXX	XX,XXX
Exchange cleared	XX,XXX	XX,XXX	XX,XXX
Equity contracts			
Over the counter	XX,XXX	XX,XXX	XX,XXX
Exchange traded	XX,XXX	XX,XXX	XX,XXX
Exchange cleared	XX,XXX	XX,XXX	XX,XXX
Commodity contracts			
Over the counter	XX,XXX	XX,XXX	XX,XXX

Exchange traded	XX,XXX	XX,XXX	XX,XXX
Exchange cleared	XX,XXX	XX,XXX	XX,XXX
Credit contracts			
Over the counter	XX,XXX	XX,XXX	XX,XXX
Exchange traded	XX,XXX	XX,XXX	XX,XXX
Exchange cleared	XX,XXX	XX,XXX	XX,XXX
Other contracts			
Over the counter	XX,XXX	XX,XXX	XX,XXX
Exchange traded	XX,XXX	XX,XXX	XX,XXX
Exchange cleared	XX,XXX	XX,XXX	XX,XXX
Total derivatives, subject to a master netting arrangement or similar arrangement	XX,XXX	XX,XXX	XX,XXX
Total derivatives, not subject to a master netting arrangement or similar arrangement	XX,XXX	XX,XXX	XX,XXX
Total derivatives	XX,XXX	XX,XXX	XX,XXX
Reverse repurchase, securities borrowing, and similar arrangements	XX,XXX	XX,XXX	XX,XXX
Total	$XX,XXX	$XX,XXX	$XX,XXX

Financial Assets, Derivative Assets, and Collateral Held by Counterparty

$ million

As of December 31, 20XX	(iii)	(iv)		(v)=(iii)-(iv)
		Gross Amounts Offset in the Statement of Financial Position		
	Net Amount of Assets in the Statement of Financial Position	Financial Instruments	Cash Collateral Received	Net Amount
Counterparty A	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX
Counterparty B	XX,XXX	XX,XXX	XX,XXX	XX,XXX
Other	XX,XXX	XX,XXX	XX,XXX	XX,XXX
Total	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX

Application of Paragraph 210-20-50-3(a)-(c) by Instrument and Paragraph 210-20-50-3(c)-(e) by Counterparty

Offsetting of Financial Liabilities and Derivative Liabilities

$ million

As of December 31, 20XX	(i)	(ii)	(iii)=(i)-(ii)
Description	Gross Amounts of Recognized Liabilities	Gross Amounts Offset in the Statement of Financial Position	Net Amounts of Liabilities Presented in the Statement of Financial Position
Derivatives			
Interest rate contracts			
Over the counter	$XX,XXX	$XX,XXX	$XX,XXX
Exchange traded	XX,XXX	XX,XXX	XX,XXX
Exchange cleared	XX,XXX	XX,XXX	XX,XXX
Foreign exchange contracts			

Over the counter	XX,XXX	XX,XXX	XX,XXX
Exchange traded	XX,XXX	XX,XXX	XX,XXX
Exchange cleared	XX,XXX	XX,XXX	XX,XXX
Equity contracts			
Over the counter	XX,XXX	XX,XXX	XX,XXX
Exchange traded	XX,XXX	XX,XXX	XX,XXX
Exchange cleared	XX,XXX	XX,XXX	XX,XXX
Commodity contracts			
Over the counter	XX,XXX	XX,XXX	XX,XXX
Exchange traded	XX,XXX	XX,XXX	XX,XXX
Exchange cleared	XX,XXX	XX,XXX	XX,XXX
Credit contracts			
Over the counter	XX,XXX	XX,XXX	XX,XXX
Exchange traded	XX,XXX	XX,XXX	XX,XXX
Exchange cleared	XX,XXX	XX,XXX	XX,XXX
Other contracts			
Over the counter	XX,XXX	XX,XXX	XX,XXX
Exchange traded	XX,XXX	XX,XXX	XX,XXX
Exchange cleared	XX,XXX	XX,XXX	XX,XXX
Total derivatives, subject to a master netting arrangement or similar arrangement	XX,XXX	XX,XXX	XX,XXX
Total derivatives, not subject to a master netting arrangement or similar arrangement	XX,XXX	XX,XXX	XX,XXX
Total derivatives	XX,XXX	XX,XXX	XX,XXX
Reverse repurchase, securities borrowing, and similar arrangement	XX,XXX	XX,XXX	XX,XXX
Total	$XX,XXX	$XX,XXX	$XX,XXX

Financial Liabilities, Derivative Liabilities, and Collateral Held by Counterparty

$ million

As of December 31, 20XX	(iii)	(iv)		(v)=(iii)-(iv)
		Gross Amounts Not Offset in the Statement of Financial Position		
	Net Amount of Liabilities in the Statement of Financial Position	Financial Instruments	Cash Collateral Pledged	Net Amount
Counterparty A	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX
Counterparty B	XX,XXX	XX,XXX	XX,XXX	XX,XXX
Other	XX,XXX	XX,XXX	XX,XXX	XX,XXX
Total	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX

4. Income statement

Detailed contents

Item significantly updated in this edition: #

4.6.60 How are exit or disposal costs presented in the income statement?

4.6.70 Can litigation expenses arising from cases with shareholders be reported outside of operating expenses?

Example

4.6.10 Depreciation and depletion as a separate caption

4.7 Other classification issues

Questions

4.7.10 How are gains and losses from involuntary conversions presented in the income statement?

4.7.20 How are gains and losses on the sale of a business that is not a discontinued operation presented in the income statement?

4.1 How the standard works

The income statement, also referred to as the statement of activities or operations, is one of the statements required in a full set of financial statements. It provides a measure of the performance of the entity's operations, excluding items of OCI (see chapter 5). While the income statement is often presented as a part of a single continuous statement of comprehensive income along with OCI, it may also be presented in a stand-alone statement.

Subtopic 220-10 contains the general presentation and disclosure requirements for the statement of comprehensive income but is not prescriptive on the format of the income statement itself. Other Codification Topics, including industry specific topics and Reg S-X for registrants, provide more specific guidance in this area.

This chapter addresses the presentation requirements specific to the income statement only – either as a stand-alone statement or as part of a statement of comprehensive income. Chapter 5 addresses the formatting requirements for the statement of comprehensive income and the components of OCI. Other general presentation requirements applicable to all financial statements (e.g. number of comparative periods, comparability, chronological ordering) are addressed in chapter 2.

4.2 Overview

Excerpt from ASC 220-10

20 Glossary

Net Income

A measure of financial performance resulting from the aggregation of revenues, expenses, gains, and losses that are not items of **other comprehensive income**. A variety of other terms such as net earnings or earnings may be used to describe net income.

• > Components within Net Income

45-7 Items included in net income are presented in various components. Those components can include items of income from continuing operations and discontinued operations. This Subtopic does not change those components or other requirements for reporting the results of operations included in net income.

45-7A Net income shall reflect all items of profit and loss recognized during the period with the sole exception of error corrections as addressed in Topic 250. However, the requirement that net income be presented as one amount does not apply to the following entities that have developed income statements with formats different from those of the typical commercial entity:

a. Investment companies
b. Insurance entities
c. Certain not-for-profit entities (NFPs).

Net income is the measure of financial performance that reflects all items of profit and loss recognized during the period – i.e. revenues, expenses, gains and losses that are not items of OCI – except for error corrections in the scope of Topic 250. [220-10 Glossary]

The income statement presents net income and its various components. However, it is acceptable for the following types of entities to not present a net income amount because their income statement is formatted differently from that of typical commercial entities: investment companies, insurance entities and certain NFPs (see Question 4.2.10). [220-10-45-7A]

Subtopic 220-10 requires separate subtotals for continuing operations and discontinued operations but is otherwise silent about other formatting aspects of the income statement, such as required captions, disaggregation, ordering and subtotals. However, additional guidance is provided in other general or industry Codification Topics. [220-10-45-7]

For registrants, Reg S-X has certain additional requirements. Unless otherwise stated, the SEC requirements discussed in this Handbook address commercial and industrial registrants.

Section 5.3.40 includes an example income statement.

Question 4.2.10
Where is the income statement industry guidance located in the Codification?

Interpretive response: The industry guidance in the Codification relevant to income statement presentation is summarized in the following table.

Industry	Subtopic reference
Contractors – federal government	912-220
Extractive activities – oil and gas	932-220
Financial services – depository and lending	942-220
Financial services – insurance	944-220
Financial services – investment companies	946-220
Health care entities	954-220
NFP entities	958-220

Question 4.2.20
Where is the income statement industry guidance located in SEC guidance?

Interpretive response: Reg S-X Article 5 prescribes the minimum requirements for commercial and industrial registrants. The SEC industry guidance relevant to income statement (statement of comprehensive income) presentation for other types of entities is summarized in the following table.

Industry	Reference
Registered investment companies	S-X Article 6
Employee stock purchase, savings, and similar plans	S-X Article 6A
Insurance companies	S-X Article 7
Bank holding companies and banks	S-X Article 9
Brokers and dealers when filing Form X-17A-5	Reg § 240.17a-5

In addition, Reg S-X Article 8 prescribes the form and content of financial statements for 'smaller reporting companies' (as defined by Reg S-X).

4.3 Format of the income statement

4.3.10 Required captions

Question 4.3.10
Are specific income statement captions required for nonpublic entities?

Interpretive response: Yes. Subtopic 220-10 requires that the components of net income be shown but does not list which components. However, other Codification Topics require certain financial statement captions to be separately presented in the income statement if applicable – for example:

- goodwill impairment loss. See section 10.2 of KPMG Handbook, Impairment of nonfinancial assets; [350-20-45-2 – 45-3]
- an investor's share of profit or loss from equity-method investees; [323-10-35-4, 35-18]
- discontinued operations. See section 6.3 of KPMG Handbook, Discontinued operations and held-for-sale disposal groups; [205-20-45-3 – 45-3B]
- net income attributable to NCI. [810-10-50-1A(a)]

In addition, some other Codification Topics provide an option for certain captions to be either separately presented in the income statement or disclosed – for example:

- revenue from contract with customers; [606-10-50-4]
- income arising from leases. [842-30-45-3]

In our experience, the income statement of nonpublic entities is generally presented similar to that of registrants (see Question 4.3.20).

Question 4.3.20#
What captions are presented separately in a registrant's income statement?

Interpretive response: In addition to the requirements in the Codification (see Question 4.3.10), Reg S-X contains a list of captions (known as 'major captions' and 'subcaptions') required in an income statement for commercial and industrial registrants. [S-X Rule 5-03]

The following table lists these requirements for commercial and industrial registrants; see Appendix for a full excerpt. Question 4.2.20 discusses the location of SEC guidance for other types of entities.

Major caption	Subcaptions	Disclosures related to
Net sales and gross revenues	Related-party transactions and any of the following revenue categories that exceed 10% of total revenues: • Net sales of tangible products (gross sales less discounts, returns and allowances) • Revenues from services • Income from rentals • Operating revenues of public utilities • Other revenues	Excise taxes
Costs and expenses applicable to sales and revenues	Costs and expenses related to each subcaption of revenues presented	--
Other operating costs and expenses	Any material amounts not included under the above 'costs and expenses applicable to sales and revenues' caption	--
Selling, general and administrative expenses (SG&A)	--	--
Provision for doubtful accounts and notes	--	--
Other general expenses	--	--
Nonoperating income	Amounts earned from:[1] • Dividends • Interest on securities • Profits on securities (net of losses) • Miscellaneous other income	Transactions in securities of related parties and material miscellaneous other income
Interest and amortization of debt discount and expense	--	--
Nonoperating expenses	Amounts of:[1] • Losses on securities (net of profits) • Miscellaneous expenses	Material miscellaneous expenses
Income or loss before income tax expense and appropriate items below (subtotal)	--	--
Income tax expense	--	--

Major caption	Subcaptions	Disclosures related to
Equity in earnings of unconsolidated subsidiaries and 50% or less owned entities	Amount of dividends received from such entities (parenthetically)[1]	--
Income or loss from continuing operations (subtotal)	--	--
Discontinued operations	--	--
Net income or loss (subtotal)	--	--
Net income attributable to the noncontrolling interest	--	--
Net income attributable to the controlling interest (subtotal)	--	--
Earnings per share[2]		

Notes:

1. Can be presented in the income statement or in the notes.
2. Rule 5-03 contains a few additional captions between net income attributable to the controlling interest and earnings per share data. These additional captions (omitted in this table) pertain to presentation of comprehensive income and OCI, which are explained in chapter 5. An entity presenting just an income statement (i.e. no OCI) would omit these additional captions.

Question 4.3.30
Can income statement captions be disaggregated?

Interpretive response: Yes. US GAAP does not preclude disaggregation beyond required captions and subcaptions (see Questions 4.3.10 and 4.3.20). We believe other appropriate captions are permissible if they are not misleading and do not obscure the financial information (see Question 2.4.80).

For example, the SEC staff has indicated that when disaggregating elements of cost of sales or SG&A, such as technology costs, registrants must make clear which required caption the disaggregated amount relates to (e.g. a particular cost of sales subcaption or SG&A) such that investors can interpret relevant measures like gross margin. [2021 AICPA Conf]

Question 4.3.40
How are the income statement captions ordered?

Interpretive response: Reg S-X Rule 5-03 includes a list of required captions and a general order of the captions. Subtopic 220-10 includes example income statements (see section 5.3.40). While there is some flexibility in the order in which captions are presented, the presentation cannot be misleading.

For example, in our experience, many commercial and industrial registrants present revenues and cost of sales together with a subtotal for gross margin. Other entities may present revenue and other income followed by operating expenses and other expenses or losses.

See Question 4.3.50 for ordering considerations relating to the earnings of an equity method investee.

Question 4.3.50#
How does an investor present equity in earnings of equity method investees?

Interpretive response: For commercial and industrial registrants, Reg S-X requires equity in earnings of equity method investees to be presented as a separate caption after the income tax expense caption, but before discontinued operations. To understand exceptions to this rule and implication on the presentation of related income tax, see Question 7.2.50 in KPMG Handbook, Equity method of accounting. [S-X Rule 5-03(b)]

In our experience, nonpublic entities' income statement presentation typically is similar to that of registrants; however, other presentations may be acceptable.

Question 4.3.60
Is income or loss attributable to common stock reported in the income statement?

Excerpt from SAB Topic 6.B

Accounting Series Release 280—General Revision Of Regulation S-X: Income Or Loss Applicable To Common Stock

Facts: A registrant has various classes of preferred stock. Dividends on those preferred stocks and accretions of their carrying amounts cause income applicable to common stock to be less than reported net income.

Question: In ASR 280, the Commission stated that although it had determined not to mandate presentation of income or loss applicable to common stock in all cases, it believes that disclosure of that amount is of value in certain situations. In what situations should the amount be reported, where should it be reported, and how should it be computed?

Interpretive Response: Income or loss applicable to common stock should be reported on the face of the income statement[1] when it is materially different in quantitative terms from reported net income or loss[2] or when it is indicative of significant trends or other qualitative considerations. The amount to be reported should be computed for each period as net income or loss less: (a) dividends on preferred stock, including undeclared or unpaid dividends if cumulative; and (b) periodic increases in the carrying amounts of instruments reported as redeemable preferred stock (as discussed in Topic 3.C) or increasing rate preferred stock (as discussed in Topic 5.Q).

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[1] When a registrant reports net income and total comprehensive income in one continuous financial statement, the registrant must continue to follow the guidance set forth in the SAB Topic. One approach may be to provide a separate reconciliation of net income to income available to common stock below comprehensive income reported on a statement of income and comprehensive income.

[2] The assessment of materiality is the responsibility of each registrant. However, absent concerns about trends or other qualitative considerations, the staff generally will not insist on the reporting of income or loss applicable to common stock if the amount differs from net income or loss by less than ten percent.

Interpretive response: It depends. Income or loss attributable to common stock is reported in the income statement when it is materially different in quantitative terms from reported net income or loss or when it is indicative of significant trends or other qualitative considerations. [SAB Topic 6.B]

4.3.20 General classification principles

In general, each income statement caption represents a similar class of items. Captions are relatively consistent across each industry. This enables financial statement users to compare similar transactions across similar entities. [CON 8.PR39]

Question 4.3.70
What are considerations when aggregating individual items in one caption?

Interpretive response: To increase its relevance and usefulness, each caption should include only a homogenous class of items. When determining the individual items to include in each income statement caption, consider: [CON 8.PR40]

- the event that caused an item to be recognized – e.g. whether the event was caused by a transaction, a change in circumstances or conditions, an accounting adjustment like systematic allocation, or an accounting change;
- the activity with which an item is associated;
- similarities and differences in the frequency with which similar items are expected to result in similar amounts to be recognized in the future;
- the types of changes in economic conditions that can affect the cash flows related to similar revenues, expenses, and gains or losses in the future; and
- similarities and differences in measurement methods.

Question 4.3.80#
What is the meaning of operating?

Interpretive response: Neither SEC guidance nor the Codification define operating, although the concept is used in both. For example, Reg S-X explicitly refers to other operating costs and expenses and the Codification refers to income from operations (i.e. operating income) as a possible subtotal. [360-10-45-5, 410-30-45-4, 420-10-45-3]

Separating operating from nonoperating items helps financial statement users understand the performance of an entity's ongoing operations. The determination of whether an item is operating or nonoperating is entity-specific and requires judgment based on the circumstances of the entity and the event or transaction.

In our experience, operating activities are often viewed as those activities that are part of the entity's ongoing operations. This view is from superseded FASB Concepts Statement No. 6. Operating items generally include those that are expected to recur. Conversely, nonoperating items are generally expected to not recur frequently. In addition, Reg S-X provides specific examples of nonoperating income and nonoperating expenses for commercial and industrial registrants. [S-X Rule 5-03, CON 8.E87]

Common classification practices and requirements are summarized below:

Operating items	Nonoperating items
• revenue • cost of sales • R&D costs • SG&A • impairments of goodwill, intangible assets and other long-lived assets (see Question 4.6.50) [360-10-45-4] • gain or loss on the sale of long-lived assets [360-10-45-5] • environmental remediation-related expenses and corresponding recoveries [410-30-45-4] • exit or disposal activities [420-10-45-3] • asset retirement obligation accretion expense [410-10 Glossary]	• dividends [S-X Rule 5-03] • interest on securities [S-X Rule 5-03] • net profits or losses on securities [S-X Rule 5-03]

4.3.30 Offsetting

Question 4.3.90
Can items of income and expense be offset?

Interpretive response: It depends. While there is explicit general offsetting guidance for balance sheet items (see section 3.4), the Codification is silent about offsetting income statement items. In our experience, items of income and expense are generally not offset unless:

- offsetting is required or permitted by another Codification Topic. For example:
  - derivatives executed with the same counterparty under a master netting arrangement may be offset; [815-10-45]
  - recoveries on environmental losses must be classified in the same caption as the related loss; [410-30-45-4]
- the amounts relate to similar transactions or events that are not significant;
- the entity is being reimbursed for costs incurred outside a contract with a customer, such as certain R&D expenses or transition services (see Question 3.4.80 in KPMG Handbook, Research and development). When determining if the entity is being reimbursed for costs incurred, we believe all relevant facts and circumstances should be considered. We believe Subtopic 410-30 (environmental obligations) may be applied by analogy to perform this assessment; or
- the entity is acting as an agent in the transaction. When determining if the entity is acting as an agent or a principal in the transaction, all relevant facts

and circumstances should be considered. We believe Topic 606 (revenue from customers) may be applied by analogy to perform this assessment.

Because transactions are generally presumed to be presented gross, we believe entities should have a clear rationale for offsetting them and should clearly disclose the facts surrounding the transactions. See Question 4.5.30 for discussion about government grants and Question 4.5.40 for discussion about business interruption insurance.

4.3.40 Subtotals

Question 4.3.100
Can subtotals be presented in the income statement?

Interpretive response: Yes, provided they are not non-GAAP measures and that the terminology used to describe them is not misleading. Reg S-X requires the use of certain subtotals, such as 'Income or loss before income tax' (see Question 4.3.20). In our experience, both registrants and nonpublic entities often use additional subtotals, such as gross margin, operating income, and income from operations (see Question 4.3.80).

Subtotals that represent non-GAAP financial measures (e.g. EBIT or EBITDA) may not be presented in the financial statements. A non-GAAP financial measure is a numerical measure of an entity's historical or future financial performance, financial position or cash flows that is not determined under US GAAP. See Question 2.4.20 and KPMG Issues in-depth, Non-GAAP financial measures.

For a discussion of EBITDA, see Question 4.3.110. For a discussion of operating income before restructuring charges or exit costs, see Question 4.6.60.

Question 4.3.110
Can income before depreciation, depletion and amortization (DD&A) be presented?

Excerpt from SAB Topic 7.D

Income Before Depreciation

Facts: Occasionally an income statement format will contain a subtitle or caption titled "Income before depreciation and depletion."

Question: Is this caption appropriate?

Interpretive Response: The staff objects to this presentation because in the staff's view the presentation may suggest to the reader that the amount so captioned represents cash flow for the period, which is rarely the case (see ASR 142).

Interpretive response: No. For registrants, SEC guidance states that DD&A may not be positioned in the income statement in a manner that presents income before DD&A (e.g. EBITDA). [SAB Topic 7.D]

In our experience, nonpublic entities generally also do not present income before DD&A.

4.4 Unusual or infrequently occurring items

Excerpt from ASC 220-20

20 Glossary

Infrequency of Occurrence

The underlying event or transaction should be of a type that would not reasonably be expected to recur in the foreseeable future, taking into account the environment in which the entity operates (see paragraph 220-20-60-1).

Unusual Nature

The underlying event or transaction should possess a high degree of abnormality and be of a type clearly unrelated to, or only incidentally related to, the ordinary and typical activities of the entity, taking into account the environment in which the entity operates (see paragraph 220-20-60-1).

> Presentation of Unusual or Infrequently Occurring Items

45-1 A material event or transaction that an entity considers to be of an **unusual nature** or of a type that indicates **infrequency of occurrence** or both shall be reported as a separate component of income from continuing operations. The nature and financial effects of each event or transaction shall be presented as a separate component of income from continuing operations or, alternatively, disclosed in notes to financial statements (see paragraph 220-20-50-1). Gains or losses of a similar nature that are not individually material shall be aggregated. Such items shall not be reported on the face of the income statement net of income taxes. Similarly, the EPS effects of those items shall not be presented on the face of the income statement.

> Unusual or Infrequently Occurring Items

50-1 The nature and financial effects of each event or transaction that is unusual in nature or occurs infrequently or both shall be presented as a separate component of income from continuing operations or, alternatively, disclosed in notes to the financial statements.

> Implementation Guidance

• > Unusual Nature

55-1 The specific characteristics of the entity, such as type and scope of operations, lines of business, and operating policies should be considered in determining ordinary and typical activities of an entity. The environment in which an entity operates is a primary consideration in determining whether an underlying event or transaction is abnormal and significantly different from the ordinary and typical activities of the entity. The environment of an entity includes such factors as the characteristics of the industry or industries in which it operates, the geographical location of its operations, and the nature and extent of governmental regulation. Thus, an event or transaction may be unusual in nature for one entity but not for another because of differences in their respective environments. **Unusual nature** is not established by the fact that an event or transaction is beyond the control of management.

• > Infrequency of Occurrence

55-2 For purposes of this Subtopic, an event or transaction of a type not reasonably expected to recur in the foreseeable future is considered to occur infrequently. Determining the probability of recurrence of a particular event or transaction in the foreseeable future should take into account the environment in which an entity operates. Accordingly, a specific transaction of one entity might meet that criterion and a similar transaction of another entity might not because of different probabilities of recurrence. The past occurrence of an event or transaction for a particular entity provides evidence to assess the probability of recurrence of that type of event or transaction in the foreseeable future.

• > Events or Transactions That Are Unusual In Nature or Occur Infrequently

55-3 The following are illustrative of events or transactions that are unusual in nature or occur infrequently:

a. A large portion of a tobacco manufacturer's crops are destroyed by a hail storm. Severe damage from hail storms in the locality where the manufacturer grows tobacco is rare.
b. A steel fabricating entity sells the only land it owns. The land was acquired 10 years ago for future expansion, but shortly thereafter the entity abandoned all plans for expansion and held the land for appreciation.
c. An earthquake destroys one of the oil refineries owned by a large multinational oil entity.

Material events or transactions that are unusual or infrequently occurring (referred to as unusual items throughout this chapter) are presented as a separate component of income from continuing operations, in a way that communicates their nature and financial effects. [220-20-45-1, 50-1]

4.4.10 Unusual items defined

Question 4.4.10
What are unusual items?

Interpretive response: An item is unusual when it results from a material transaction or event that is either unusual in nature or infrequent in occurrence. [220-20-45-1]

Category	Characteristics of the underlying event or transaction
Unusual in nature	• high degree of abnormality • clearly unrelated to, or only incidentally related to, the ordinary activities of the entity
Infrequent in occurrence	• not reasonably expected to recur in the foreseeable future

This determination is entity-specific, and therefore an event or transaction might be unusual or infrequently occurring for one entity and not for another. It requires judgment by considering: [220-20-50-1 – 55-2]

- the ordinary activities of the entity – e.g. type and scope of operations, lines of business and operating policies; and
- the environment in which the entity operates – e.g. industry, location and regulatory environment.

Question 4.4.20
Is a natural disaster considered an unusual item?

Interpretive response: It depends on the environment in which the entity operates. Natural disasters (e.g. floods, fires, earthquakes) may be unusual or infrequent in certain geographies, resulting in separate presentation in income from continuing operations. However, in other geographies natural disasters may be more common or less severe and would not warrant separate presentation.

Subtopic 220-20 provides examples of events and transactions that are considered unusual or infrequently occurring. [220-20-55-1 – 55-3]

Question 4.4.30
Is COVID-19 considered an unusual item?

Interpretive response: Although this determination is entity-specific, we believe many entities may have considered COVID-19 an unusual item during much of 2020.

However, we believe that as the conditions created by COVID-19 persist, entities may need to consider which aspects of COVID-19 are unusual and not expected to recur. For example, a retailer may determine that a government lockdown order is an unusual item, but operating stores under stricter cleaning and social distancing protocols is not. This is because these new protocols have become part of the new operating model for the foreseeable future and are likely to recur.

4.4.20 Financial effects of unusual items

Subtopic 220-20 is silent on how to determine the financial effects of unusual items for separate presentation or disclosure (see section 4.4.30). Judgment is required in this area.

Question 4.4.40
How are the financial effects of a natural disaster determined?

Interpretive response: We believe the financial effects of a natural disaster should generally be limited to the losses and costs that are incremental and directly attributable to the natural disaster. Assessing which losses and costs are incremental and directly attributable to a natural disaster versus other events, and should be reported separately, may require judgment.

Incremental and directly attributable losses and costs may include:

- physical destruction of property;
- losses on right-of-use assets for unusable leased facilities or equipment (unusable refers to facilities or equipment that cannot be used due to physical damage or constraints imposed by government or other authoritative bodies);
- losses on advances, guarantees, receivables and loans to entities that are a direct result of the natural disaster;
- losses on debt securities due to default or bankruptcy by entities that are a direct result of the natural disaster;
- recreation of lost data;
- clean-up of facilities;
- relocation of operations.

We believe the financial effects of a natural disaster should not include:

- lost revenues,
- interest expense or
- increases in valuation allowances on deferred tax assets.

We believe that the financial effects of COVID-19 may be assessed similar to the effects of a natural disaster.

4.4.30 Presentation and disclosures

Question 4.4.60
How are unusual items presented?

Interpretive response: Unusual items are presented as a separate caption in income from continuing operations. Gains or losses of a similar nature are aggregated if they are not individually material. [220-20-45-1]

The nature and financial effects of each unusual item can be described either as a separate caption in income from continuing operations or, alternatively, in the notes. [220-20-50-1]

Unusual or infrequently occurring items cannot be presented in the income statement net of income taxes. Similarly, the EPS effects of those items cannot be presented in the income statement. [220-20-45-1]

Registrants also consider the requirements in Reg S-X for commercial and industrial registrants. The regulation allows registrants to disaggregate material amounts as a separate caption(s) in the income statement subject to clear disclosure of the nature of those costs (see Question 4.3.30). However, certain costs are expected to be part of cost of sales or SG&A, when they relate to activities historically included in those captions (see Question 4.3.20). For example, we believe inventory markdowns are expected to be part of cost of sales and should be included in gross margin and operating income if those subtotals are presented, whereas inventory destroyed in a natural disaster may qualify as an unusual item (see Question 4.6.50). [S-X Rule 5-03]

Question 4.4.70
How are unusual items described?

Interpretive response: While specific terminology is not required to describe an unusual transaction, it cannot be described as extraordinary or exceptional. US GAAP previously included a caption for extraordinary events to describe events that were both unusual in nature and infrequent in occurrence. However, that caption was eliminated and cannot be used any longer. [ASU 2015-01]

Question 4.4.80
What other disclosures may be relevant for unusual or infrequently occurring items?

Interpretive response: An entity may need to provide disclosures in addition to those in Subtopic 220-20 to enable financial statement users to evaluate the financial effects resulting from the occurrence of unusual items. Additional disclosures may include:

- the amounts of any related insurance recoveries;
- a description of contingencies from the event that have not yet been recognized in the financial statements but for which there is a reasonable possibility of financial statement impact; [450-20-50-3, 450-30-50-1]
- the amount of exposure to credit losses and how that risk was evaluated; [326-20-50-4]
- the potential loss of customer base and the related revenue recognition; [275-10-50-18(a)]
- major disruptions in supply chain that affect inventory; [275-10-50-18(c)]
- additional information regarding significant estimates and uncertainties related to the event that may impact the financial statements (see Question 7.7.50). [275-10-50-6]

Question 4.4.90
Can a registrant adjust unusual items in non-GAAP financial measures?

Interpretive response: It depends. A registrant may not present in an SEC filing a non-GAAP performance measure that eliminates or smooths items identified as nonrecurring, infrequent or unusual: [S-K Item 10(e)(ii)(B)]

- when the nature of the charge or gain makes it reasonably likely to recur within two years; or
- there was a similar charge or gain within the prior two years (i.e. the item is considered recurring).

For further discussion, see section 3.8.20 of KPMG Issues In-Depth, Non-GAAP financial measures.

4.5 Revenue and other income classification issues

Question 4.5.10
What is the difference between revenue and other income?

Excerpt from ASC 606-10

20 Glossary

Revenue

Inflows or other enhancements of assets of an entity or settlements of its liabilities (or a combination of both) from delivering or producing goods, rendering services, or other activities that constitute the entity's ongoing major or central operations.

Excerpt from FASB Concepts Statement No. 8

E80. Revenues are inflows or other enhancements of assets of an entity or settlements of its liabilities (or a combination of both) from delivering or producing goods, rendering services, or carrying out other activities.

E82. Gains are increases in equity (net assets) from transactions and other events and circumstances affecting an entity except those that result from revenues or investments by owners.

E84. Revenues and expenses result from delivering or producing goods, rendering services, or carrying out other activities. Other activities, as referenced in the definitions of revenues and expenses in this chapter, are those activities that permit others to use the entity's resources, which, for example, result in interest, rent, royalties, and fees. Other activities also include charitable contributions received and made.

E85. Gains and losses typically result from one of the following three circumstances:

a. Nonreciprocal transactions or events such as natural catastrophes
b. Exchange transactions
c. Holding gains and losses.

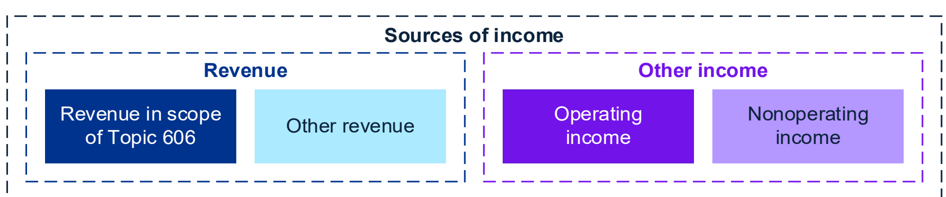
Additionally, current updates or adjustments of estimates of prior periods are often referred to in practice as gains and losses. These are not gains and losses; they are adjustments to previously recognized revenues, expenses, gains, or losses that should be reported as initially recognized.

E86. Nonreciprocal transactions or events are generally distinguishable from revenues and expenses. Holding gains and losses can be a result of a contractual change in value of an asset or a liability from a passage of time, as is the case of interest, or a change in the value of the asset or liability. Those value changes would be distinguished between those that are classified as revenues and expenses or those that are classified as gains and losses. Distinctions between revenues and gains and expenses and losses from exchange transactions of an entity depend to a significant extent on the nature of the entity and the activity with which an item is associated. An identical item can be used by entities differently. As a result, the proceeds from the sale of an asset may be revenue for one entity and may be a factor in determining gain or loss for another. For example, the proceeds from the sale of a machine displayed as inventory would be considered revenue, and the cost of that machine would be considered an expense. However, the proceeds from the sale of a machine used by an entity in a productive capacity would not be considered revenue, and the entity would report a gain or a loss upon disposition of that machine to be consistent with the representations in the statement of financial position.

E87. The difference between items recognized as a result of transactions, especially routine transactions that result in recognizing revenues or expenses, and those recognized from other events and circumstances is fundamental in meeting the objective of providing information to help resource providers assess the amount, timing, and uncertainty of potential future cash flows. Gains and losses also can provide useful information about a particular activity even though gains and losses in similar amounts would not be expected to reoccur frequently or at all.

FASB Concepts Statement No. 8 (CON 8) distinguishes revenues from gains. The term gains is used to describe all other positive changes in net assets flowing through comprehensive income that are not revenues. [606-10 Glossary, CON 8.E82]

In this chapter, we refer to revenues and gains collectively as sources of income. In our experience, the term other income rather than gains is generally used to describe sources of income other than revenues, as depicted in the below diagram. [610-10-05-1]



CON 8 provides a broad framework to distinguish revenue from other income and the Codification defines 'revenue' as outputs from the entity's ongoing major or central operations. In our experience, the determination of revenue versus other income depends on the entity's business model and the frequency with which the transactions recur. [606-10 Glossary, CON 8.E80, E84 – E87]

Revenue

Revenue transactions in the scope of Topic 606 are those in which the entity contracts with a customer to provide goods or services that are outputs of its ordinary activities in exchange for consideration. [606-10-15-2 – 15-3]

Sources of income outside the scope of Topic 606 are presented as other revenue in the income statement if they otherwise meet the definition of revenue. [606-10-15-2]

The different sources of revenue (i.e. those in the scope of Topic 606 versus those that are not) are presented separately in the income statement or disclosed in the notes. See Question 4.3.20 for additional requirements applicable to registrants. [606-10-50-4]

For detailed guidance about the scope of Topic 606 and presentation of revenue, see sections 2.2 and 14.7 of KPMG Handbook, Revenue recognition.

Other income

Sources of income that are not revenue are presented as other income, unless it is appropriate in the circumstances to offset them against related expenses (see Question 4.3.90). Other income typically results from nonreciprocal transactions, exchange transactions or holding gains – e.g. gain from the sale of a long-lived asset, gain on the involuntary conversion of a nonmonetary asset to monetary assets resulting from destruction in a natural disaster. [CON 8.E85, 610-20-15-2, 610-30-15-2]

Other income can be either operating income or nonoperating income, if such a distinction is provided in the income statement. As discussed in Question 4.3.80, operating is not defined in US GAAP. However: [CON 8.E82, E84 – E87, S-X Rule 5-03(b)(7)]

- operating items generally include those items that are expected to recur as part of the entity's ongoing operations, such as gains on the disposal of long-lived assets (e.g. property, plant and equipment).
- nonoperating items are generally expected to not recur frequently. For commercial and industrial registrants, nonoperating income also includes dividends received, interest earned on securities, net profits on securities and miscellaneous other income (see Question 4.3.20).

4.5.10 Lease income

Question 4.5.20
How is lease income presented in the income statement?

Interpretive response: Presentation of lease income depends on the nature of the lease and the lessor's business model. Additionally, registrants present lease income separately in the income statement when it exceeds 10% of total revenue (see Question 4.3.20). [S-X Rule 5-03]

Sales-type and direct financing leases

Lessors present selling profit or loss recognized at lease commencement on sales-type and direct financing leases in a manner that best reflects the lessor's business model – i.e. on a gross (revenue and cost of goods sold) or net (in a single line-item) basis. [842-30-45-4]

Interest income earned on those leases (see section 7.3.2 of KPMG Handbook, Leases) is presented in the same manner as any other interest income.

Lease income is presented separately in the income statement or in the notes. If only disclosed separately in the notes, the disclosure includes reference to the caption in which lease income is included. [842-30-45-3]

Operating leases

Topic 842 does not provide any income statement presentation guidance for operating lease income. We believe operating lease income should be presented as revenue if leasing constitutes the entity's ongoing major or central operations.

Section 7.7 of KPMG Handbook, Leases, addresses lessor financial statement presentation more broadly.

4.5.20 Government grants and subsidies

Question 4.5.30
How are government grants presented in the income statement of a business entity?

Background: There is currently limited explicit US GAAP guidance about how a business entity should account for government grants. Unless specific guidance applies, business entities should consider the most appropriate guidance to apply by analogy given the facts and circumstances – e.g. by analogizing to IFRS Accounting Standards (IAS 20), to Subtopic 958-605 (NFPs), or to Subtopic 450-30 (gain contingencies). If the transaction is in the scope of Topic 606 because the government is a customer in the transaction, the transaction is not a government grant. [606-10-15-3]

Interpretive response: We do not believe government grants should be presented as revenue from contracts with customers. In our experience, business entities typically present government grants as other income or a reduction of the related expense, which are policy choices allowed under IAS 20. [IAS 20.29 – 31]

Regardless of the presentation used, Topic 832 (government assistance) requires disclosures for certain government assistance, including the income statement captions affected and the amounts of assistance. [832-10-50-3]

4.5.30 Gain contingencies and insurance recoveries

Question 4.5.40
How are gain contingencies and insurance recoveries presented in the income statement?

Interpretive response: The presentation of gain contingencies in the income statement requires judgment and depends on the nature of the contingencies. All relevant facts and circumstances should be considered.

Subtopic 410-30 (environmental obligations) requires environmental claims recoveries to be presented in the same captions as the related costs. This guidance is often used by analogy to support a presentation of other types of loss recoveries, such as insurance recoveries, as a reduction of the corresponding costs. [410-30-45-4]

For business interruption insurance, see Question 4.5.50. For insurance proceeds received for involuntary conversions of nonmonetary assets, see Question 4.7.10.

Question 4.5.50
How are the proceeds from business interruption insurance presented in the income statement?

Excerpt from Subtopic 220-30

20 Glossary

Business Interruption Insurance

Insurance that provides coverage if business operations are suspended due to the loss of use of property and equipment resulting from a covered cause of loss. Business interruption insurance coverage generally provides for reimbursement of certain costs and losses incurred during the reasonable period required to rebuild, repair, or replace the damaged property.

45-1 An entity may choose how to classify **business interruption insurance** recoveries in the statement of operations, as long as that classification is not contrary to existing generally accepted accounting principles (GAAP).

50-1 The following information shall be disclosed in the notes to financial statements in the period(s) in which **business interruption insurance** recoveries are recognized:

a. The nature of the event resulting in business interruption losses
b. The aggregate amount of business interruption insurance recoveries recognized during the period and the line item(s) in the statement of operations in which those recoveries are classified.

Interpretive response: Subtopic 220-30 provides flexibility around the income statement classification of business interruption insurance, as long as the presentation does not contradict existing US GAAP. [220-30-45-1]

We do not believe proceeds from business interruption insurance should be presented as revenue. However, in our experience entities frequently include these proceeds in operating income, if such a subtotal is presented. Examples of income statement display include presenting:

- proceeds representing recoveries of costs and losses incurred as a separate caption, reducing total operating expenses, or netted from the corresponding expense lines. In the latter case, we believe the amounts received should be disclosed (see Question 4.3.90);
- proceeds in excess of costs and losses incurred as a separate caption from operating expenses; or
- the total amount of proceeds as a separate caption from operating expenses.

Judgment may be needed to select the most appropriate presentation in the circumstances. The presentation approach should be disclosed and applied consistently.

4.6 Expense classification issues

The following table identifies common expense captions and the types of transactions included in an entity's income statement.

Caption	Typical transactions
Cost of sales	Cost of sales includes costs related to the revenue caption: • direct costs – e.g. materials and labor for product manufacturing; • indirect costs – e.g. depreciation of manufacturing facilities; lease expense, managerial salaries and overhead for such facilities; and amortization of revenue-related intangible assets.

Caption	Typical transactions
SG&A	SG&A includes: • direct and indirect selling expenses – e.g. advertising and selling costs paid to third parties and compensation costs for sales employees; • general and administrative expenses – e.g. direct costs of administering the business and other indirect costs excluding those included in cost of sales.
Other operating expenses	Other operating expenses are expected to recur as part of the entity's ongoing operations but are not otherwise included in other captions.
Nonoperating expenses	Nonoperating expenses are those that are expected to not recur frequently.

Question 4.6.10#
Are expenses presented by nature or function?

Excerpt from ASC Master Glossary

Functional Expense Classification

A method of grouping expenses according to the purpose for which costs are incurred. The primary functional classifications of a not-for-profit entity are program services and supporting activities.

Natural Expense Classification

A method of grouping expenses according to the kinds of economic benefits received in incurring those expenses. Examples of natural expense classifications include salaries and wages, employee benefits, professional services, supplies, interest expense, rent, utilities, and depreciation.

Interpretive response: Reg S-X specifies expense classification for registrants. As described in Question 4.3.20, for commercial and industrial registrants, Reg S-X indicates classification of certain operating expenses by function (e.g. cost of sales, SG&A). However, we observe that some industries classify expenses by nature (e.g. employee compensation, lease expense).

The Codification does not require business entities to classify expenses by either nature of expense or by function. In our experience, nonpublic entities' income statement presentation typically is similar to that of registrants; however, other presentations may be acceptable. See Question 4.3.70 for considerations on determining financial statement captions.

The Codification requires NFPs to report information about all expenses in one location on the face of the statement of activities, as a schedule in the notes to financial statements or in a separate financial statement. NFPs may present expenses in the statement of activities by either natural classification or functional classification or both. NFPs are also required to present the relationship between functional classification and natural classification for all expenses in an analysis that disaggregates functional expense classifications by their natural expense classifications. [958-205-45-6, 958-720-45-15]

Question 4.6.20

How is the cost of sales caption presented if it excludes DD&A?

Excerpt from SAB Topic 11.B

Depreciation And Depletion Excluded From Cost Of Sales

Facts: Company B excludes depreciation and depletion from cost of sales in its income statement.

Question: How should this exclusion be disclosed?

Interpretive Response: If cost of sales or operating expenses exclude charges for depreciation, depletion and amortization of property, plant and equipment, the description of the line item should read somewhat as follows: "Cost of goods sold (exclusive of items shown separately below)" or "Cost of goods sold (exclusive of depreciation shown separately below)." To avoid placing undue emphasis on "cash flow," depreciation, depletion and amortization should not be positioned in the income statement in a manner which results in reporting a figure for income before depreciation.

Interpretive response: For registrants, the SEC staff expects that the cost of sales caption include applicable DD&A, unless the description of the caption is modified to clearly indicate that DD&A is excluded. For example, the caption might be titled: [SAB Topic 11.B]

- ‘cost of goods sold (exclusive of items shown separately below)’; or
- ‘cost of goods sold (exclusive of depreciation shown separately below)’.

If DD&A is excluded from cost of sales, a separate caption for appropriate DD&A must be included before any subtotals, such as gross margin or operating income. If the registrant presents both product and service revenues (and therefore both cost of product and cost of service captions), the SEC staff expects disclosure of DD&A related to each cost of revenue category. See Question 4.3.30 about disaggregation and Question 4.3.110 about income before DD&A. [2021 AICPA Conf]

In our experience, nonpublic entities generally follow the same guidance.

Example 4.6.10
Depreciation and depletion as a separate caption

Example income statement
Total revenues
Costs and expenses
Cost of materials
Operating expenses (exclusive of depreciation and amortization reflected below)
Depreciation and amortization
Total cost of goods sold
General and administrative (G&A) (exclusive of depreciation and amortization reflected below)
Depreciation and amortization
Total costs and expenses

Question 4.6.30
Which caption includes stock-based compensation expense?

Excerpt from SAB Topic 14.F

Classification of Compensation Expense Associated with Share-Based Payment Arrangements

Facts: Company G utilizes both cash and share-based payment arrangements to compensate its employees and nonemployee service providers. Company G would like to emphasize in its income statement the amount of its compensation that did not involve a cash outlay.

Question: How should Company G present in its income statement the non-cash nature of its expense related to share-based payment arrangements?

Interpretive Response: The staff believes Company G should present the expense related to share-based payment arrangements in the same line or lines as cash compensation paid to the same employees.[84] The staff believes a company could consider disclosing the amount of expense related to share-based payment arrangements included in specific line items in the financial statements. Disclosure of this information might be appropriate in a parenthetical note to the appropriate income statement line items, on the cash flow statement, in the footnotes to the financial statements, or within MD&A.

[84] FASB ASC Topic 718 does not identify a specific line item in the income statement for presentation of the expense related to share-based payment arrangements, with the exception of the guidance in ASC 718-10-15-5A on share-based payment awards granted to a customer.

Interpretive response: For registrants, the SEC staff expects share-based payment expense to be presented in the same caption(s) as the cash compensation to the same employee. Registrants may disclose the amount of share-based payment expense included in each income statement caption. Such disclosure can be parenthetical in the income statement, statement of cash flows, notes or MD&A. [SAB Topic 14.F]

In our experience, nonpublic entities typically follow the same guidance.

Question 4.6.40

How is bad debt expense presented in the income statement?

Interpretive response: Reg S-X requires commercial and industrial registrants to present 'Provision for doubtful accounts and notes' (credit loss expense) as a separate caption in the income statement (see Question 4.3.20). [S-X Rule 5-03]

Question 4.6.50

How are impairment losses of nonfinancial assets presented in the income statement?

Interpretive response: It depends on the nature of the nonfinancial asset being impaired and its use to the entity. Impairment losses associated with discontinued operations are included (net of tax) in the results of discontinued operations. The following table summarizes presentation requirements when the impairment loss is associated with continuing operations. [350-20-45-3]

Asset	Income statement presentation
Goodwill	Presented as a separate income statement caption. [350-20-45-2] We believe the impairment loss should be included in operating income (see Question 4.3.80), if such a subtotal is presented.
Other intangible assets	May be presented: [350-30-45-2 – 45-3, 35-11, 50-3] • as a separate income statement caption; or • together with amortization in the relevant income statement caption based on the use of the asset – e.g. cost of sales if the asset is a patent used in production (see Question 4.6.20). The amount of the impairment loss and the caption that includes the loss are disclosed. We believe the impairment loss should be included in operating income (see Question 4.3.80), if such a subtotal is presented.

Asset	Income statement presentation
Long-lived assets to be held and used	May be presented: [360-10-50-2(b)] • as a separate income statement caption; or • together with depreciation, in the relevant income statement caption based on the use of the asset – e.g. cost of sales if manufacturing equipment. The impairment loss and the caption that includes the loss are disclosed. The impairment loss is included in operating income, if such a subtotal is presented (see Question 4.3.80). [360-10-45-4]
Inventory	We believe that subsequent measurement adjustments of inventory (lower of cost and net realizable value, or market adjustment) are generally expected to be part of cost of sales. [330-10-50-2, 420-10-S99-3] In our experience, entities rarely present subsequent measurement adjustments of inventory separate from cost of sales, except in circumstances such as when inventory is destroyed as a result of an unusual item (e.g. fire, flood, other natural disaster). See section 4.4 and Question 4.7.10.

Question 4.6.60
How are exit or disposal costs presented in the income statement?

Excerpt from SAB Topic 5.P.3

Income statement presentation of restructuring charges

Facts: Restructuring charges often do not relate to a separate component of the entity, and, as such, they would not qualify for presentation as losses on the disposal of a discontinued operation. …

Question 1: May such restructuring charges be presented in the income statement as a separate caption after income from continuing operations before income taxes (i.e., preceding income taxes and/or discontinued operations)?

Interpretive Response: No. … the staff believes that restructuring charges should be presented as a component of income from continuing operations, separately disclosed if material. Furthermore, the staff believes that a separately presented restructuring charge should not be preceded by a sub-total representing “income from continuing operations before restructuring charge” (whether or not it is so captioned). Such a presentation would be inconsistent with the intent of FASB ASC Subtopic [220-20].

Question 2: Some registrants utilize a classified or “two-step” income statement format (i.e., one which presents operating revenues, expenses and income followed by other income and expense items). May a charge which relates to assets or activities for which the associated revenues and expenses have historically been included in operating income be presented as an item of "other expense" in such an income statement?

Interpretive Response: No. The staff believes that the proper classification of a restructuring charge depends on the nature of the charge and the assets and operations to which it relates. Therefore, charges which relate to activities for which the revenues and expenses have historically been included in operating income should generally be classified as an operating expense, separately disclosed if material. Furthermore, when a restructuring charge is classified as an operating expense, the staff believes that it is generally inappropriate to present a preceding subtotal captioned or representing operating income before restructuring charges. Such an amount does not represent a measurement of operating results under GAAP.

Conversely, charges relating to activities previously included under "other income and expenses" should be similarly classified, also separately disclosed if material.

Excerpt from ASC 420-10

• > Comments Made by SEC Observer at Emerging Issues Task Force (EITF) Meetings

• • > SEC Observer Comment: Classification of Inventory Markdowns and Other Costs Associated with Restructuring

S99-3 The following is the text of SEC Observer Comment: Classification of Inventory Markdowns and Other Costs Associated with Restructuring.

Subtopic 420-10 states that costs associated with exit or disposal activities that do not involve a discontinued operation should be included in income from continuing operations before taxes. If a subtotal such as "income from operations" is presented, that Subtopic indicates that subtotal should include the amounts of exit or disposal costs. However, the guidance does not address where within income from continuing operations or income from operations inventory markdowns associated with an exit or restructuring activity. The SEC staff recognizes that there may be circumstances in which it can be asserted that inventory markdowns are costs directly attributable to a decision to exit or restructure an activity. However, the staff believes that it is difficult to distinguish inventory markdowns attributable to a decision to exit or restructure an activity from inventory markdowns attributable to external market factors that are independent of a decision to exit or restructure an activity. Further, the staff believes that decisions about the timing, method, and pricing of dispositions of inventory generally are considered to be normal, recurring activities integral to the management of the ongoing business. Accordingly, the SEC staff believes that inventory markdowns should be classified in the income statement as a component of cost of goods sold.

Interpretive response: Exit or disposal costs involving a discontinued operation are included (net of tax) in the results of discontinued operations.

Other exit or disposal activities (e.g. restructuring) are presented in income from continuing operations before taxes, and in operating income if such a subtotal is presented (see Question 4.3.80). They may be presented in a separate caption, as long as the separate caption is not preceded by a subtotal representing income from continuing operations before restructuring charge. In addition, the terminology used to describe the caption should not be misleading. For example, using the term 'nonrecurring' may be misleading if it is reasonably likely to recur within two years (see Question 4.4.90). In our experience, some entities use the term 'restructuring and other charges' when exit or disposal costs are combined with related costs, such as postemployment benefits under Topic 712. [420-10-45-2 – 45-3, SAB Topic 5.P.3]

If a previously accrued liability for exit or disposal costs is reversed, the reversal is presented in the same income statement caption where it was initially recognized. [420-10-40-1]

Examples of costs that may be classified as an exit or disposal activity include:

- one-time employee termination benefits; [420-10-25-4 – 25-10]
- contract termination costs, excluding leases in the scope of Topic 842; [420-10-25-11 – 25-13]
- other associated costs including (1) relocation costs for existing employees and (2) costs to consolidate or close facilities; [420-10-25-14]
- accretion expense associated with exit or disposal activities. Topic 420 specifies that accretion expense cannot be classified as interest cost. However, it does not specify whether the accretion expense should be included in the same caption as the original exit or disposal costs, or in another caption in operating activities. We believe an entity should select an accounting policy for the classification of accretion expense and apply that policy consistently. [420-10-35-4]

It is not appropriate to classify inventory writedowns as an exit or disposal activity, even when the markdowns are costs directly attributable to a decision to exit or restructure an activity. The SEC staff believes that such writedowns should be classified as a component of cost of sales. [420-10-S99-3]

See section 4.8.10 of KPMG Handbook, Employee benefits, for additional discussion.

Question 4.6.70

Can litigation expenses arising from cases with shareholders be reported outside of operating expenses?

Interpretive response: Yes. Shareholder lawsuits arise when the value of shareholders' general interests in the entity have been harmed, and therefore related expenses may be more appropriately reported outside of operating expenses. This view was supported by the SEC staff in a 2007 SEC Correspondence Letter with a registrant.

In contrast, expenses related to lawsuits with vendors, customers or other third parties arising in the normal course of operations are costs of revenue or operating expenses.

4.7 Other classification issues

Question 4.7.10
How are gains and losses from involuntary conversions presented in the income statement?

Background: Monetary assets are money (or a claim to receive a sum of money) where the amount is fixed or determinable without reference to future prices of specific goods or services. For involuntary conversions, monetary assets are generally insurance proceeds. [845-10 Glossary, 610-30-05-1]

Nonmonetary assets are assets other than monetary assets – e.g. inventories or property, plant, and equipment. [845-10 Glossary]

Example involuntary conversions include total or partial destruction, theft, seizure or the condemnation of property. [610-30-15-2]

Interpretive response: Recoveries and losses from involuntary conversions of nonmonetary assets to monetary assets are presented net as a gain or loss (e.g. the loss from writing off the carrying amount of property destroyed in a natural disaster is presented net of the related insurance proceeds recognized in the period of the loss). The guidance in Question 4.5.40 applies to related insurance recoveries. If the involuntary conversion qualifies as an unusual item, the guidance in section 4.4 also applies. [610-30-45-1]

Question 4.7.20
How are gains and losses on the sale of a business that is not a discontinued operation presented in the income statement?

Interpretive response: US GAAP does not specify the income statement presentation for the sale of a business that is not a discontinued operation. In our experience, some entities present the gain or loss in operating income and others present it in nonoperating income.

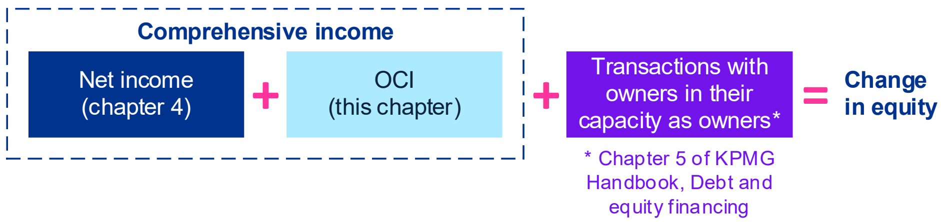
5. Comprehensive income

Detailed contents

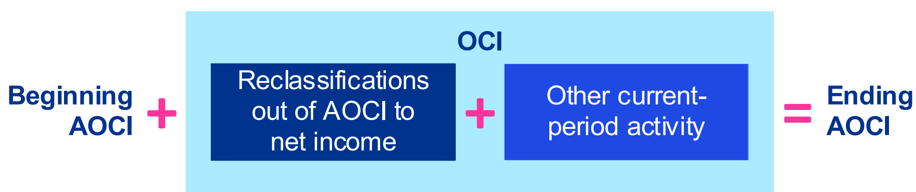
5.1 How the standard works

The statement of comprehensive income is one of the statements required in a full set of financial statements. If an entity has OCI in any period presented, it presents a statement of comprehensive income.

Comprehensive income comprises net income and OCI (e.g. foreign currency translation adjustments). These elements together represent the change in an entity's equity from all sources except from transactions with owners in their capacity as owners (i.e. investments by owners and distributions to owners).



At the reporting date, the total of OCI for the period is transferred to AOCI, a component of equity. Those amounts remain in AOCI until an event occurs that requires them to be reclassified to net income. These reclassification adjustments flow through OCI to avoid double counting in comprehensive income items that are included in net income for a period that had also been included in OCI in that period or earlier periods.



Subtopic 220-10 contains the general presentation and disclosure requirements for the statement of comprehensive income and changes in the components of AOCI.

This chapter addresses:

- the format of the statement of comprehensive income;
- the requirements for reporting OCI and its components; and
- the requirements for reporting the balance of and changes in the components of AOCI.

Chapter 4 addresses the presentation requirements specific to the income statement – either as a stand-alone statement or as part of a statement of comprehensive income. Other general presentation requirements applicable to all financial statements (e.g. number of comparative periods, comparability, chronological ordering) are addressed in chapter 2.

5.2 Overview

5.2.10 Scope of Subtopic 220-10

Excerpt from ASC 220-10

10-1 The purpose of reporting **comprehensive income** is to report a measure of all changes in equity of an entity that result from recognized transactions and other economic events of the period other than transactions with owners in their capacity as owners.

10-2 If used with related disclosures and other information in the financial statements, the information provided by reporting comprehensive income should assist investors, creditors, and others in assessing an entity's activities and an entity's future cash flows.

10-3 Although total comprehensive income is a useful measure, information about the components that make up comprehensive income also is needed. A single focus on total comprehensive income is likely to result in a limited understanding of an entity's activities. Information about the components of comprehensive income often may be more important than the total amount of comprehensive income.

> Entities

15-2 Except as noted in the following paragraph, the guidance in the Income Statement—Reporting Comprehensive Income Topic applies to all entities, including:

a. Entities that provide a full set of financial statements that report financial position, results of operations, and cash flows
b. Investment companies, defined benefit pension plans, and other employee benefit plans that are exempt from the requirement to provide a statement of cash flows by paragraph 230-10-15-4.

15-3 The guidance in this Topic does not apply to the following entities:

a. An entity that has no items of **other comprehensive income** in any period presented. In such cases, the entity is not required to report other comprehensive income or **comprehensive income**. See paragraph 220-10-45-10A for items that are required to be reported as other comprehensive income.
b. A not-for-profit entity (NFP) that is required to follow the provisions of Subtopic 958-205.

15-5 The guidance in the Income Statement—Reporting Comprehensive Income Topic applies to general-purpose statements that purport to present results of operations in conformity with generally accepted accounting principles (GAAP).

20 Glossary

Comprehensive Income

The change in equity (net assets) of a business entity during a period from transactions and other events and circumstances from nonowner sources. It includes all changes in equity during a period except those resulting from investments by owners and distributions to owners. Comprehensive income comprises both of the following:

a. All components of **net income**
b. All components of **other comprehensive income**.

Other Comprehensive Income

Revenues, expenses, gains, and losses that under generally accepted accounting principles (GAAP) are included in **comprehensive income** but excluded from **net income**.

25-1 This Subtopic does not specify when to recognize the items that make up **comprehensive income**.

30-1 This Subtopic does not specify how to measure the items that make up **comprehensive income**.

Comprehensive income has two components: net income and OCI. These elements together represent the change in the entity's equity from all sources except from investments by and distributions to owners. [220-10 Glossary]

Comprehensive income

Net income (chapter 4) + OCI (this chapter)

All entities present comprehensive income under Subtopic 220-10 except: [220-10-15-2 – 15-3]

- those that do not have OCI in any period presented; they present only an income statement (see chapter 4);
- NFPs required to apply Subtopic 958-205 – i.e. those in the scope of Subtopic 958-10.

Question 5.2.10

Do NFP, business-oriented healthcare entities in the scope of Topic 954 have to apply Subtopic 220-10?

Interpretive response: No. NFP, business-oriented healthcare entities are in the scope of Topic 954 (healthcare entities) and Topic 958 (NFP entities) and therefore are not required to apply Subtopic 220-10. [220-10-15-3, 954-10-05-3, 958-10-15-2, 15-3(g)]

Subtopic 954-220 provides a list of specific items that an NFP, business-oriented healthcare entity reports separately from its performance indicator (a performance indicator is analogous to income from continuing operations of a for-profit entity). This list includes items typically considered OCI by other entities – e.g. certain pension items and foreign currency translation adjustments. However, an NFP, business-oriented healthcare entity would classify these specific items as 'other changes in net assets', not as OCI. [954-220-45-5, 45-8]

Subtopic 954-220 also requires an NFP, business-oriented healthcare entity to include its performance indicator in a statement that also presents the total changes in net assets without donor restrictions. Other changes in net assets may be presented separately or in the same statement, which is similar to the requirements in Subtopic 220-10 to report comprehensive income in either a single continuous financial statement or in two separate but consecutive financial statements. [954-220-45-5, 220-10-45-1]

Although not required, we would not object to an NFP, business-oriented healthcare entity providing disclosures consistent with the provisions of Subtopic 220-10.

Question 5.2.20
Does Subtopic 220-10 address the recognition and measurement of items of OCI?

Interpretive response: No. Subtopic 220-10 does not specify when to recognize or how to measure items of OCI. Instead, recognition and measurement of these items is based on the relevant underlying accounting literature. [220-10-25-1, 30-1]

5.2.20 OCI defined

The second component of a statement of comprehensive income (after net income) is OCI. OCI is simply any revenues, expenses, gains and losses that affect an entity's equity but are not reported in net income. [220-10 Glossary]

Question 5.2.30
Which items are considered OCI?

Excerpt from ASC 220-10

> Items within Other Comprehensive Income

45-10A Items of other comprehensive income include the following:

a. Foreign currency translation adjustments (see paragraph 830-30-45-12)
b. Gains and losses on foreign currency transactions that are designated as, and are effective as, economic hedges of a net investment in a foreign entity, commencing as of the designation date (see paragraph 830-20-35-3(a))
c. Gains and losses on intra-entity foreign currency transactions that are of a long-term-investment nature (that is, settlement is not planned or anticipated in the foreseeable future), when the entities to the transaction are consolidated, combined, or accounted for by the equity method in the reporting entity's financial statements (see paragraph 830-20-35-3(b))
d. Gains and losses on derivative instruments that are designated as, and qualify as, cash flow hedges (see paragraph 815-20-35-1(c))
dd. For derivatives that are designated in qualifying hedging relationships, the difference between changes in fair value of the excluded components and the initial value of the excluded components recognized in earnings under a systematic and rational method in accordance with paragraphs 815-20-25-83A and 815-35-35-5A
e. Unrealized **holding gains and losses** on available-for-sale debt securities (see paragraph 326-30-35-2)
f. Unrealized holding gains and losses that result from a debt security being transferred into the available-for-sale category from the held-to-maturity category (see paragraph 320-10-35-10(c))

…

i. Gains or losses associated with pension or other postretirement benefits (that are not recognized immediately as a component of net periodic benefit cost) (see paragraph 715-20-50-1(j))
j. Prior service costs or credits associated with pension or other postretirement benefits (see paragraph 715-20-50-1(j)
k. Transition assets or obligations associated with pension or other postretirement benefits (that are not recognized immediately as a component of net periodic benefit cost) (see paragraph 715-20-50-1(j)).
l. Changes in fair value attributable to instrument-specific credit risk of liabilities for which the fair value option is elected (see paragraph 825-10-45-5).
m. The effect of changes in the discount rates used to measure traditional and limited-payment long-duration insurance contracts (see paragraph 944-40-35-6A(b)(1)).

n. The effect of changes in the fair value of a **market risk benefit** attributable to a change in the instrument-specific credit risk (see paragraph 944-40-35-8A).

Additional classifications or additional items within current classifications may result from future accounting standards.

45-10B None of the following items qualify as an item of comprehensive income:

a. Changes in equity during a period resulting from investments by owners and distributions to owners
b. Items required to be reported as direct adjustments to paid-in capital, retained earnings, or other nonincome equity accounts such as the following types of transactions:
    1. A reduction of shareholders' equity related to employee stock ownership plans (see paragraph 718-740-25-5)
    2. Recognition of tax benefits related to deductible temporary differences and carryforwards arising from a quasi-reorganization as defined in Subtopic 852-20 (see paragraph 852-740-45-3)
    3. Net cash settlement resulting from a change in value of a contract that gives the entity a choice of net cash settlement or settlement in its own shares (see paragraph 815-40-25-4(b)(2)).

Interpretive response: Only those items that are specifically identified in US GAAP as OCI items can be reported outside of net income – e.g. Subtopic 830-30 identifies foreign currency translation adjustments as OCI items. There is no conceptual basis for which items are recorded in OCI (instead of net income) and later reclassified to net income (see section 5.4). [CON 8. PR32]

Paragraph 220-10-45-10A contains a list of OCI items. This table summarizes the broad categories.

OCI item category	Addressed in
Unrealized gains or losses on available-for-sale debt securities	Topics 320 and 326 See KPMG Handbook, Investments
Certain gains or losses related to defined benefit plans	Topic 715 See KPMG Handbook, Employee benefits
Certain gains or losses resulting from hedging activities	Topic 815 See KPMG Handbook, Derivatives and hedging
Cumulative translation adjustments – i.e. adjustments to translate an entity's financial statements from a functional currency that is a foreign currency to the reporting currency	Topic 830 See KPMG Handbook, Foreign currency

OCI item category	Addressed in
Changes in the fair value of financial liabilities attributable to instrument-specific credit risk when those liabilities are measured using the 'fair value option'	Topic 825 See KPMG Handbook, Investments

5.3 Reporting comprehensive income

5.3.10 Format of the statement of comprehensive income

Excerpt from ASC 220-10

20 Glossary

Noncontrolling Interest

The portion of equity (net assets) in a subsidiary not attributable, directly or indirectly, to a parent. A noncontrolling interest is sometimes called a minority interest.

Parent

An entity that has a controlling financial interest in one or more subsidiaries. (Also, an entity that is the primary beneficiary of a variable interest entity.)

Subsidiary

An entity, including an unincorporated entity such as a partnership or trust, in which another entity, known as its parent, holds a controlling financial interest. (Also, a variable interest entity that is consolidated by a primary beneficiary.)

> Reporting Comprehensive Income

45-1 This Subtopic requires an entity to report **comprehensive income** either in a single continuous financial statement or in two separate but consecutive financial statements.

45-1A An entity reporting **comprehensive income** in a single continuous financial statement shall present its components in two sections, **net income** and **other comprehensive income**. If applicable, an entity shall present the following in that financial statement:

a. A total amount for net income together with the components that make up net income.
b. A total amount for other comprehensive income together with the components that make up other comprehensive income. As indicated in paragraph 220-10-15-3, an entity that has no items of other comprehensive

income in any period presented is not required to report comprehensive income.

c. Total comprehensive income.

45-1B An entity reporting comprehensive income in two separate but consecutive statements shall present the following:

a. Components of and the total for net income in the statement of net income
b. Components of and the total for other comprehensive income as well as a total for comprehensive income in the statement of comprehensive income, which shall be presented immediately after the statement of net income. A reporting entity shall begin the second statement with net income.

45-1C An entity shall present, either in a single continuous statement of comprehensive income or in a statement of net income and statement of other comprehensive income, all items that meet the definition of comprehensive income for the period in which those items are recognized. Components included in other comprehensive income shall be classified based on their nature. For related guidance, see paragraphs 220-10-45-10A through 45-10B.

45-4 This Subtopic does not require that an entity use the terms *comprehensive income or other comprehensive income* in its financial statements, even though those terms are used throughout this Subtopic.

There are two possible formats for a statement of comprehensive income (illustrated in section 5.3.40): [220-10-45-1 – 45-1C; FRM 1110.1]

- a single continuous statement (single-statement format); and
- separate but consecutive statements (two-statement format).

The single-statement format contains components of both net income and OCI in one statement. The two-statement format presents a separate income statement followed immediately by the statement of comprehensive income. When the two-statement format is used, the statement of comprehensive income starts with net income. [220-10-45-1A, 45-1B]

An entity is not required to use the labels 'comprehensive income' or 'other comprehensive income'. [220-10-45-4]

Question 5.3.10
If two statements are presented, can they be on separate pages?

Interpretive response: Yes, but the statement of comprehensive income must immediately follow the income statement. [220-10-45-1B]

Question 5.3.20

Does a change in format (from a single statement to two statements or vice versa) represent a change in accounting principle?

Interpretive response: No. We believe that such a change in format does not represent a change in accounting principle because it is a change in presentation only, which does not significantly alter the financial statement information provided. Therefore, the requirements in Topic 250 for changes in accounting principle do not apply. See Question 3.2.40 in KPMG Handbook, Accounting changes and error corrections.

Question 5.3.30

What captions representing comprehensive income are presented in the statement of comprehensive income?

Interpretive response: Subtopic 220-10 requires that the components of comprehensive income be shown – either net of or before related tax effects (see section 5.3.20). Each component of comprehensive income may comprise the items listed in Subtopic 220-10, classified based on their nature. [220-10-45-1A – 45-1C]

Similarly, Reg S-X Rule 5-03 contains a list of required captions (known as 'major captions' and 'subcaptions') to be presented in the statement of comprehensive income for commercial and industrial registrants, if applicable; see Question 4.2.20 for other types of entities. These captions are presented after 'net income attributable to the controlling interest' (see Question 4.3.20). [S-X Rule 5-03]

Major caption	Subcaptions
Other comprehensive income	• Components of OCI, either (1) net of related tax effects or (2) before related tax effects with one amount shown for the aggregate income tax expense or benefit • Amount of income tax expense or benefit allocated to each component, including reclassification adjustments[1] • OCI total
Comprehensive income (subtotal)	
Comprehensive income attributable to the noncontrolling interest	
Comprehensive income attributable to the controlling interest	
Note: 1. Can be presented in the statement of comprehensive income or in the notes.	

Question 5.3.40
How is EPS reported in the statement of comprehensive income?

Background: Entities with common stock (or potential common stock) that is traded in a public market are required to present EPS under Topic 260. Other entities that voluntarily present EPS also follow Topic 260. [260-10-15-2 – 15-3]

Interpretive response: An entity that reports comprehensive income in a single continuous financial statement presents EPS after presenting net income and before presenting other comprehensive income information. See Question 9.2.45 in KPMG Handbook, Earnings per share. [220-10-55-7]

Entities may not display per-share amounts for comprehensive income or the components of OCI in the statement of comprehensive income. However, disclosure of such per-share amounts is permitted in the notes to financial statements. See Question 9.2.115 in KPMG Handbook, Earnings per share.

5.3.20 Income tax effects of OCI

Excerpt from ASC 220-10

> Presentation of Income Tax Effects

45-11 An entity shall present components of other comprehensive income in the statement in which other comprehensive income is reported either net of related tax effects or before related tax effects with one amount shown for the aggregate income tax expense or benefit related to the total of other comprehensive income items.

45-12 An entity shall present the amount of income tax expense or benefit allocated to each component of other comprehensive income, including **reclassification adjustments**, in the statement in which those components are presented or disclose it in the notes to financial statements. Example 1 (see paragraphs 220-10-55-7 through 55-8B) illustrates the alternative formats for disclosing the tax effects related to the components of other comprehensive income. (See paragraph 220-10-50-4.)

> Disclosing Changes and Certain Income Tax Effects within Accumulated Other Comprehensive Income

50-4 An entity shall present the amount of income tax expense or benefit allocated to each component of other comprehensive income, including **reclassification adjustments**, in the statement in which those components are presented or disclose it in the notes to financial statements. Example 1 (see paragraphs 220-10-55-7 through 55-8B) illustrates the alternative formats for disclosing the tax effects related to the components of other comprehensive income. (See paragraph 220-10-45-12.)

Question 5.3.50
How are the tax effects for components of OCI presented?

Interpretive response: An entity is permitted to present each of the components of OCI either: [220-10-45-11]

- net of the related tax effects; or
- before the related tax effects, with one amount shown for the aggregate income tax expense or benefit related to the total of OCI items.

Regardless of the presentation approach, the tax effect for each component of OCI must be either presented in the statement of comprehensive income or disclosed in the notes. [220-10-45-12, 50-4]

Section 5.3.40 illustrates these two presentation approaches and related disclosures.

5.3.30 Special situations

Question 5.3.60
How is comprehensive income attributable to NCI presented?

Excerpt from ASC 220-10

> Reporting Comprehensive Income

45-5 Paragraph 810-10-50-1A(a) states that, if an entity has an outstanding **noncontrolling interest**, amounts for both net income and comprehensive income attributable to the **parent** and net income and comprehensive income attributable to the noncontrolling interest in a less-than-wholly-owned **subsidiary** shall be reported in the financial statement(s) in which net income and comprehensive income are presented in addition to presenting consolidated net income and comprehensive income. For more guidance, see paragraph 810-10-50-1A(c).

Interpretive response: The statement of comprehensive income presents both net income and comprehensive income attributable to NCI separately from amounts attributable to owners of the entity. [220-10-45-5]

An entity also provides a reconciliation at the beginning and the end of the period of the carrying amount of total equity (net assets), equity (net assets) attributable to its owners, and equity (net assets) attributable to NCI. That reconciliation separately discloses each component of comprehensive income and may be presented in either the statement of changes in equity or the notes. [810-10-50-1A(c)]

However, Subtopic 220-10 requires the components of OCI to be listed in the statement of comprehensive income (see section 5.3.10). Instead of presenting these components twice – once in the statement of comprehensive income and again in the statement of changes in equity – in our experience, many entities with NCI provide this reconciliation in the notes. See section 8.3.50 of KPMG Handbook, Consolidation, for example presentation and disclosure of NCI.

Question 5.3.70
How does an equity method investor present its share of an investee's equity adjustments for OCI items?

Interpretive response: An investor recognizes in its OCI its share of the investee's OCI with a corresponding increase or decrease to the carrying amount of its equity method investment. [323-10-35-18]

The investee's presentation format of OCI does not affect how an investor presents its share of those amounts. Regardless of how an investee chooses to present OCI, an investor may combine its share of those amounts with its own OCI items and present the aggregate of those amounts. The investor may also report what portion comprises its share of the investee's AOCI. See sections 4.5 and 7.2 of KPMG Handbook, Equity method of accounting. [323-10-45-3]

Question 5.3.80
How are prior-period adjustments affecting OCI presented?

Interpretive response: If a prior-period adjustment (e.g. a change in accounting principle or error correction) involves an OCI item, OCI is appropriately adjusted in the retroactive restatement of the financial statements. In single-period financial statements, prior-period adjustments that involve an OCI item are reported as an adjustment of the opening balance of AOCI and NCI, if applicable. See Question 3.3.190 and section 4.4 of KPMG Handbook, Accounting changes and error corrections. [FAS 130.106]

5.3.40 FASB examples

Subtopic 220-10 contains a series of examples to illustrate the single continuous statement versus the two-statement approach to presenting comprehensive income and demonstrate some of the reporting requirements for the statement comprehensive income, OCI and AOCI.

These examples are reproduced below as follows:

- Example 5.3.10: Single-statement format – OCI components shown net of tax effects
- Example 5.3.20: Single-statement format – OCI components shown before tax
- Example 5.3.30: Two-statement format – OCI components shown net of tax effects
- Example 5.3.40: Disclosure of related tax effects allocated to each component of OCI

For comparability purposes, these FASB examples are built on a single fact pattern (fact pattern A), with the following key amounts.

Caption	Amount
Net income	$63,600
OCI, before tax	$22,666
OCI, net of tax	$17,000
Comprehensive income attributable to NCI	$16,120
AOCI at December 31, 201X	$32,000

The FASB examples use the following conventions.

Excerpt from ASC 220-10

> Illustrations

55-5 Brackets are used to highlight certain basic totals that must be presented in financial statements to comply with the provisions of this Subtopic. This Subtopic requires not only presenting those certain basic totals but also reporting components of those aggregates. For example, among other items, it requires reporting information about unrealized gains and losses on available-for-sale debt securities, foreign currency items, gains or losses associated with pension or other postretirement benefits, prior service costs or credits associated with pension or other postretirement benefits, and transition assets or obligations associated with pension or other postretirement benefits.

55-6 The tables use the term *comprehensive income* to label the total of all parts of comprehensive income, including **net income**. The tables use the term **other comprehensive income** to label revenues, expenses, gains, and losses that are included in comprehensive income but excluded from net income. This Subtopic does not require that an entity use those terms in its financial statements. Other equivalent terms, such as *total nonowner changes in equity*, can be used as labels for what this Subtopic refers to as comprehensive income.

Example 5.3.10

FASB example: Single-statement format – OCI components shown net of tax effects

Excerpt from ASC 220-10

• • > Single Continuous Statement

55-7 The following illustrates the statement of comprehensive income for the year ended December 31, 201X, with other comprehensive income components shown net of tax effects.

Entity XYZ
Consolidated Statement of Comprehensive Income
Year Ended December 31, 201X

Revenues			$ 140,000	
Expenses			(65,700)	
Other gains and losses			8,000	
Gain on sale of securities			2,500	
Income from operations before tax			84,800	
Income tax expense			(21,200)	
[Net income			63,600	]
Less: net income attributable to the noncontrolling interest		$(12,720)		
Net income attributable to Entity XYZ shareholders		50,880		
Earnings per share				
Basic and diluted	0.46			
Other comprehensive income, net of tax: [KPMG Note 1]				
Foreign currency translation adjustments[(a)]			8,000	
Unrealized gains on debt securities[(b)]				
Unrealized holding gains arising during period		13,000		
Less: reclassification adjustment for gains included in net income		(1,500)	11,500	
Defined benefit pension plans:[(c)]				
Prior service cost arising during period		(1,600)		
Net loss arising during period [KPMG Note 2]		(1,000)		
Less: amortization of prior service cost included in net periodic pension cost		100	(2,500)	
[Other comprehensive income			17,000	]
[Comprehensive income			80,600	]
Less: comprehensive income attributable to the noncontrolling interest			(16,120)	
Comprehensive income attributable to Entity XYZ shareholders			$64,480	

(a) It is assumed that there was no sale or liquidation of an investment in a foreign entity. Therefore, there is no reclassification adjustment for this period.

(b) This illustrates the gross display of amounts reclassified out of accumulated other comprehensive income. Alternatively, a net display can be used, with disclosure of the gross amounts (current-period gain and reclassification adjustment) in the notes to the financial statements.

(c) This illustrates the gross display of amounts reclassified out of accumulated other comprehensive income. Alternatively, a net display can be used, with disclosure of the gross amounts (prior service cost and net loss for the defined benefit pension plans less amortization of prior service cost) in the notes to the financial statements

Notes:

1. This line indicates 'before tax' in paragraph 220-10-55-7; however, this example illustrates a 'net of tax' presentation. Therefore, we have edited the example to indicate that the amount on this line is net of tax.
2. The amount in this line is $1,600 in paragraph 220-10-55-7; however, that was a typographical error. Therefore, we have edited the example to indicate the correct amount.

Example 5.3.20

FASB example: Single-statement format – OCI components shown before tax

Excerpt from ASC 220-10

• • > Single Continuous Statement

55-8 Alternatively, components of other comprehensive income could be presented before tax with one amount shown for the aggregate income tax expense or benefit, as shown in the following single continuous statement of comprehensive income.

Entity XYZ
Consolidated Statement of Comprehensive Income
Year Ended December 31, 201X

Revenues			$140,000	
Expenses			(65,700)	
Other gains and losses			8,000	
Gain on sale of securities			2,500	
Income from operations before tax			84,800	
Income tax expense			(21,200)	
[Net income			63,600	]
Less: net income attributable to the noncontrolling interest		$(12,720)		
Net income attributable to Entity XYZ shareholders		50,880		
Earnings per share				
Basic and diluted	0.46			
Other comprehensive income, before tax:				
Foreign currency translation adjustments[(a)]			10,666	
Unrealized gains on debt securities[(b)]				
Unrealized holding gains arising during period		17,333		
Less: reclassification adjustment for gains included in net income		(2,000)	15,333	
Defined benefit pension plans:[(c)]				
Prior service cost arising during period		(2,133)		
Net loss arising during period		(1,333)		
Less: amortization of prior service cost included in net periodic pension cost		133	(3,333)	
Other comprehensive income, before tax			22,666	
[Income tax expense related to items of other comprehensive income			(5,666)	]
[Other comprehensive income, net of tax			17,000	]
[Comprehensive income			80,600	]

Less: comprehensive income attributable to the noncontrolling interest	(16,120)
Comprehensive income attributable to Entity XYZ shareholders	$64,480

(a) It is assumed that there was no sale or liquidation of an investment in a foreign entity. Therefore, there is no reclassification adjustment for this period.

(b) This illustrates the gross display of amounts reclassified out of accumulated other comprehensive income. Alternatively, a net display can be used, with disclosure of the gross amounts (current-period gain and reclassification adjustment) in the notes to the financial statements.

(c) This illustrates the gross display of amounts reclassified out of accumulated other comprehensive income. Alternatively, a net display can be used, with disclosure of the gross amounts (prior service cost and net loss for the defined benefit pension plans less amortization of prior service cost) in the notes to the financial statements

Example 5.3.30
FASB example: Two-statement format – OCI components shown net of tax effects

Excerpt from ASC 220-10

• • > Two-Statement Approach

55-9 The following illustrates the statements of net income and other comprehensive income for the year ended December 31, 201X, with other comprehensive income components presented net of tax effects.

Entity XYZ
Consolidated Statement of Comprehensive Income
Year Ended December 31, 201X

Revenues	$140,000
Expenses	(65,700)
Other gains and losses	8,000
Gain on sale of securities	2,500
Income from operations before tax	84,800
Income tax expense	(21,200)
[Net income	63,600]

Entity XYZ
Statement of Consolidated Comprehensive Income
Year Ended December 31, 201X

Net income		$ 63,600
Other comprehensive income, net of tax:		
Foreign currency translation adjustments [(a)]		8,000
Unrealized gains on debt securities: [(b)]		
Unrealized holding gains arising during period	$13,000	

Less: reclassification adjustment for gains included in net income	(1,500)	11,500
Defined benefit pension plans: [c]		
Prior service cost arising during period	(1,600)	
Net loss arising during period	(1,000)	
Less: amortization of prior service cost included in net periodic pension cost	100	(2,500)
[Other comprehensive income		17,000]
[Comprehensive income		80,600]
Less: comprehensive income attributable to the noncontrolling interest		(16,120)
Comprehensive income attributable to Entity XYZ shareholders		$64,480

(a) It is assumed that there was no sale or liquidation of an investment in a foreign entity. Therefore, there is no reclassification adjustment for this period.

(b) This illustrates the gross display of amounts reclassified out of accumulated other comprehensive income. Alternatively, a net display can be used, with disclosure of the gross amounts (current-period gain and reclassification adjustment) in the notes to the financial statements.

(c) This illustrates the gross display of amounts reclassified out of accumulated other comprehensive income. Alternatively, a net display can be used, with disclosure of the gross amounts (prior service cost and net loss for the defined benefit pension plans less amortization of prior service cost) in the notes to the financial statements

Example 5.3.40

FASB example: Disclosure of related tax effects allocated to each component of OCI

Excerpt from ASC 220-10

• • > Required Disclosure of Related Tax Effects Allocated to Each Component of Other Comprehensive Income

55-8A The following table illustrates disclosure of the tax effects allocated to each component of other comprehensive income in the notes to financial statements for the year ended December 31, 201X.

Entity XYZ
Notes to Financial Statements
Year Ended December 31, 201X

	Before-Tax Amount	Tax (Expense) or Benefit	Net-of-Tax Amount
Foreign currency translation adjustments	$10,666	$(2,666)	$8,000
Unrealized gains on debt securities:			
Unrealized holding gains arising during period	17,333	(4,333)	13,000
Less: reclassification adjustment for gains realized in net income	(2,000)	500	(1,500)
Net unrealized gains	15,333	(3,833)	11,500
Defined benefit pension plans:			
Prior service cost from plan amendment during period	(2,133)	533	(1,600)
Less: amortization of prior service cost included in net periodic pension cost	133	(33)	100
Net prior service cost arising during period	(2,000)	500	(1,500)

Net loss arising during period	(1,333)	333	(1,000)
Defined benefit pension plans, net	(3,333)	833	(2,500)
Other comprehensive income	$22,666	$(5,666)	$17,000

5.4 Reporting AOCI

The total of OCI for the period is transferred to AOCI (a component of equity) at the reporting date. Those amounts remain in AOCI until an event occurs that requires them to be reclassified to net income. [220-10-45-14]

OCI

Beginning AOCI + Reclassifications out of AOCI to net income + Other current-period activity = **Ending AOCI**

Because OCI items accumulate in AOCI and components of AOCI are reclassified to net income at some point, they affect not only the statement of comprehensive income, but also the balance sheet, statement of changes in equity and notes. The following table summarizes the presentation and disclosure requirements for AOCI.

Item	Location	Commentary
AOCI balance See section 5.4.10	Balance sheet and statement of changes in equity	AOCI is reported as a separate component of equity in the balance sheet. [220-10-45-14]
Changes in each AOCI component See section 5.4.20	Statement of changes in equity or notes	An entity reports which changes are due to: [220-10-45-14A] • reclassifications out of AOCI (see section 5.4.30); and • other current-period activity (see section 5.2.20).
Reclassifications out of AOCI See section 5.4.30	Income statement or notes	If a significant amount is reclassified out of any AOCI component, the effects of the reclassification (i.e. reclassification adjustments) are identified. [220-10-45-17]

5.4.10 AOCI balance

Excerpt from ASC 220-10

• > Reporting Accumulated Other Comprehensive Income

45-14 The total of other comprehensive income for a period shall be transferred to a component of equity that is presented separately from retained earnings and additional paid-in capital in a statement of financial position at the end of an accounting period. A descriptive title such as accumulated other comprehensive income shall be used for that component of equity.

Question 5.4.10
How is AOCI presented on the balance sheet?

Interpretive response: AOCI is presented as a component of equity on the balance sheet, separate from retained earnings and paid-in capital. Example 5.4.10 illustrates how to present AOCI on the balance sheet. [220-10-45-14]

Example 5.4.10
FASB example: AOCI presentation on the balance sheet

Paragraph 220-10-55-10A illustrates how AOCI is presented on the balance sheet. See section 5.3.40 for the fact pattern underlying this example (fact pattern A).

Excerpt from ASC 220-10

• • > Statement of Financial Position

55-10A The following table illustrates the presentation of accumulated other comprehensive income in the statement of financial position, as discussed in paragraph 220-10-45-14.

Entity XYZ
Consolidated Statement of Financial Position
December 31, 201X

Assets:	
Cash	$150,000
Accounts receivable	175,000
Available-for-sale debt securities	112,000
Plant and equipment	985,000
Total assets	$1,422,000

Liabilities:	
Accounts payable	$112,500
Accrued liabilities	78,233
Liability for pension benefits	130,667
Notes payable	318,500
Total liabilities	$639,900
Equity	
Common stock	$200,000
Paid-in capital	400,000
Retained earnings	111,680
[Accumulated other comprehensive income	32,000]
Total Entity XYZ shareholders' equity	743,680
Noncontrolling interest	38,420
Total equity	782,100
Total liabilities and equity	$1,422,000

Question 5.4.20
How is AOCI presented in the statement of changes in equity?

Interpretive response: AOCI is reported in the statement of changes in equity either as one balance or disaggregated by components of AOCI. [220-10-45-14A]

Subtopic 220-10 illustrates two possible alternatives for presenting AOCI in the statement of changes in equity, using a tabular or a columnar format. In our experience, the tabular format is most commonly used; the corresponding FASB example is reproduced below in Example 5.4.20. [220-10-55-11 – 55-12]

Both alternatives present only the AOCI balance and total change in AOCI; they do not break down AOCI into its components. Therefore, an entity following either format must also disclose in the notes the changes in the balances of each component of AOCI (see Question 5.4.30). [220-10-45-14A]

Example 5.4.20
FASB example: AOCI presentation in the statement of changes in equity – tabular format

See section 5.3.40 for the fact pattern underlying this example (fact pattern A).

Excerpt from ASC 220-10

• • > Statement of Changes in Equity (Alternative 1)

55-11 The following table illustrates the presentation of accumulated other comprehensive income in the statement of changes in equity for the year ended December 31, 201X, as discussed in paragraph 220-10-45-14.

Entity XYZ
Consolidated Statement of Changes in Equity
Year Ended December 31, 201X

	Total	Retained Earnings	Accumulated Other Comprehensive Income	Common Stock	Paid-in Capital	Noncontrolling Interest
Beginning balance	$561,500	$70,800	$18,400	$150,000	$300,000	$22,300
Net income	63,600	50,880				12,720
Other comprehensive income	17,000		13,600			3,400
Common stock issued	150,000			50,000	100,000	
Dividends declared on common stock	(10,000)	(10,000)				
Ending balance	$782,100	$111,680	$32,000	$200,000	$400,000	$38,420

5.4.20 Changes in AOCI

Excerpt from ASC 220-10

• > Reporting Changes and Certain Income Tax Effects within Accumulated Other Comprehensive Income

45-14A An entity shall present, either on the face of the financial statements or as a separate disclosure in the notes, the changes in the accumulated balances for each component of other comprehensive income included in that separate component of equity, as required in paragraph 220-10-45-14. In addition to the presentation of changes in accumulated balances, an entity shall present separately for each component of other comprehensive income, current period reclassifications out of accumulated other comprehensive income and other amounts of current-period other comprehensive income. Both before-tax and net-of-tax presentations are permitted provided the entity complies with the requirements in paragraph 220-10-45-12. Paragraph 220-10-55-15 illustrates the disclosure of changes in accumulated balances for components of other comprehensive income as a separate disclosure in the notes to financial statements. (See paragraph 220-10-50-5.)

> Disclosing Changes and Certain Income Tax Effects within Accumulated Other Comprehensive Income

50-5 An entity shall present, either on the face of the financial statements or as a separate disclosure in the notes, the changes in the accumulated balances for each component of other comprehensive income included in that separate component of equity, as required in paragraph 220-10-45-14. In addition to the presentation of changes in accumulated balances, an entity shall present separately for each component of other comprehensive income, current period reclassifications out of accumulated other comprehensive income and other amounts of current-period other comprehensive income. Both before-tax and net-of-tax presentations are permitted provided the entity complies with the requirements in paragraph 220-10-45-12. Paragraph 220-10-55-15 illustrates the disclosure of changes in accumulated balances for components of other comprehensive income as a separate disclosure in the notes to financial statements. (See paragraph 220-10-45-14A.)

An entity reports which changes in each AOCI component are due to: [220-10-45-14A]

- reclassifications out of AOCI (see section 5.4.30) and
- other current-period activity (see section 5.2.20).

Question 5.4.30
How are the changes in each AOCI component reported?

Interpretive response: The changes in each AOCI component are either presented as a reconciliation in the statement of changes in equity or disclosed in the notes to financial statements. In our experience, AOCI is often reported as a total balance in the statement of changes in equity (see Question 5.4.20), in which case the changes in each AOCI components are provided in the notes. Examples 5.4.30 and 5.4.40 illustrate disclosure in the notes. [220-10-45-14A, 50-5]

Regardless of where these changes in each AOCI component are presented, an entity distinguishes between changes due to:

- current-period reclassifications out of AOCI (see section 5.4.30); and
- other current-period activity running through OCI (see section 5.2.20).

The changes can be presented before tax or net of tax, as long as the income effects of OCI are properly disclosed (see Question 5.4.50). [220-10-45-14A]

Example 5.4.30
FASB example: Disclosure of the changes in each component of AOCI

Subtopic 220-10 illustrates the disclosure of the changes in each component of AOCI, including reclassifications to net income, and several other reporting requirements for the statement of comprehensive income, OCI and AOCI.

For comparability purposes, several FASB examples are built on a single fact pattern (fact pattern B), with the following key amounts.

Caption	Amount
AOCI (beginning balance)	$(7,700)
OCI before reclassifications	3,600
Amounts reclassified from AOCI	2,250
AOCI (ending balance at December 31, 201X)	$(1,950)

Fact pattern B is also used in Example 5.4.60.

Excerpt from ASC 220-10

• • > Disclosure of Changes in Accumulated Other Comprehensive Income Balances

55-15 The following table illustrates the disclosure of changes in the balances of each component of accumulated other comprehensive income, as required by paragraph 220-10-45-14A. The amounts in this illustration correspond to the amounts in the Example in paragraph 220-10-55-17E and demonstrate the relationship between the requirements in paragraph 220-10-45-14A and the requirements in paragraph 220-10-50-6 for this entity.

Entity XYZ
Notes to Financial Statements
Changes in Accumulated Other Comprehensive Income by Component(a)
For the Period Ended December 31, 201X

	Gains and Losses on Cash Flow Hedges	Unrealized Gains and Losses on Available-for-Sale Debt Securities	Defined Benefit Pension Items	Foreign Currency Items	Total
Beginning balance	$(1,200)	$1,000	$(8,800)	$1,300	$(7,700)
Other comprehensive income before reclassifications	3,000	2,500	(3,000)	1,000	3,500
Amounts reclassified from accumulated other	(750)	(1,500)	4,500	-	2,250

comprehensive income					
Net current-period other comprehensive income	2,250	1,000	1,500	1,000	5,750
Ending balance	$1,050	$2,000	$(7,300)	$2,300	$(1,950)

(a) All amounts are net of tax. Amounts in parentheses indicate debits.

55-15B The presentation of unrealized gains and losses on available-for-sale debt securities illustrated in paragraphs 220-10-55-15 through 55-15A is aggregated for simplicity and, therefore, does not necessarily comply with all of the disclosures that may be required in Topic 320 or 326 (for example, disclosures about **available-for-sale debt securities** with an allowance for credit losses in paragraph 326-30-45-2).

Example 5.4.40

FASB example: Disclosure of the changes in each component of AOCI

Subtopic 220-10 illustrates some of the reporting requirements for the changes in AOCI, including reclassifications to net income. For comparability purposes, several FASB examples are built on a single fact pattern (fact pattern C), with the following key amounts.

Caption	Amount
AOCI (beginning balance)	$3,000
OCI before reclassifications	15,000
Amounts reclassified from AOCI	(5,250)
AOCI (ending balance at December 31, 201X)	$12,750

Fact pattern C is also used in Example 5.4.50 (sum of reclassification adjustments listed).

Excerpt from ASC 220-10

• • > Disclosure of Changes in Accumulated Other Comprehensive Income Balances

55-15A The following table illustrates the disclosure of changes in the balances of each component of accumulated other comprehensive income, as required by paragraph 220-10-45-14A. The amounts in this illustration correspond to the amounts in the Example in paragraph 220-10-55-17F.

Entity ABC
Notes to Financial Statements
Changes in Accumulated Other Comprehensive Income by Component(a)
For the Period Ended December 31, 201X

	Gains and Losses on Cash Flow Hedges	Unrealized Gains and Losses on Available-for-Sale Debt Securities	Total
Beginning balance	$(5,000)	$8,000	$3,000
Other comprehensive income before reclassifications	7,000	8,000	15,000
Amounts reclassified from accumulated other comprehensive income	(2,250)	(3,000)	(5,250)
Net current-period other comprehensive income	4,750	5,000	9,750
Ending balance	$(250)	$13,000	$12,750

(a) All amounts are net of tax. Amounts in parentheses indicate debits.

5.4.30 Reclassification of AOCI to net income

Excerpt from ASC 220-10

20 Glossary

Reclassification Adjustments

Adjustments made to avoid double counting in comprehensive income items that are displayed as part of net income for a period that also had been displayed as part of other comprehensive income in that period or earlier periods.

> Reclassification Adjustments

45-15 Reclassification adjustments shall be made to avoid double counting of items in comprehensive income that are presented as part of net income for a period that also had been presented as part of other comprehensive income in that period or earlier periods. For example, gains on investment securities that were realized and included in net income of the current period that also had been included in other comprehensive income as unrealized holding gains in the period in which they arose must be deducted through other comprehensive income of the period in which they are included in net income to avoid including them in comprehensive income twice (see paragraph 320-10-40-2). Example 3 (see paragraphs 220-10-55-18 through 55-27) illustrates the presentation of reclassification adjustments in accordance with this paragraph.

45-16 An entity shall determine reclassification adjustments for each component of other comprehensive income. The requirement for a reclassification adjustment for foreign currency translation adjustments is limited to translation gains and losses realized upon sale or upon complete or substantially complete liquidation of an investment in a foreign entity (see paragraphs 830-30-40-1 through 40-1A).

45-17 An entity shall separately provide information about the effects on net income of significant amounts reclassified out of each component of accumulated other comprehensive income if those amounts all are required under other Topics to be reclassified to net income in their entirety in the same reporting period. An entity shall provide this information together, in one location, in either of the following ways:

a. On the face of the statement where net income is presented
b. As a separate disclosure in the notes to financial statements.

Paragraph 220-10-45-17A describes the information requirements for presentation on the face of the statements where net income is presented, and paragraph 220-10-50-6 describes the information requirements for disclosure in the notes to financial statements.

45-17A If an entity chooses to present information about the effects of significant amounts reclassified out of accumulated other comprehensive income on net income, on the face of the statement where net income is presented, the entity shall present parenthetically by component of other comprehensive income the effect of significant reclassification amounts on the respective line items of net income. An entity also shall present parenthetically the aggregate tax effect of all significant reclassifications on the line item for income tax benefit or expense in the statement where net income is presented. However, if an entity chooses to use a separate line item or items in the income statement to present significant pension cost components or other postretirement benefit cost components reclassified out of accumulated other comprehensive income, it shall no longer be required to present those pension cost components or other postretirement benefit cost components parenthetically. If an entity is unable to identify the line item of net income affected by any significant amount reclassified out of accumulated other comprehensive income in a reporting period (including when all reclassifications for the period are not to net income in their entirety), the entity must follow the guidance in paragraph 220-10-50-6. Paragraph 220-10-55-17F provides an example of presentation of the effect of reclassification on the face of the statement where net income is presented.

> Disclosing Changes and Certain Income Tax Effects within Accumulated Other Comprehensive Income

50-1 An entity shall disclose a description of the accounting policy for releasing income tax effects from accumulated other comprehensive income.

50-6 If an entity chooses to disclose information about significant amounts reclassified out of accumulated other comprehensive income in the notes to financial statements or is required to do so by paragraph 220-10-45-17A, it shall disclose the significant amounts by each component of accumulated other comprehensive income and provide a subtotal of each component of comprehensive income. The subtotals for each component shall agree with the requirements in paragraph 220-10-45-14A. Both before-tax and net-of-tax presentations are permitted provided the entity complies with the requirements in paragraph 220-10-45-12. For each significant reclassification amount, the entity shall identify, for those amounts that are required under other Topics to be reclassified to net income in their entirety in the same reporting period, each line item affected by the reclassification on the statement where net income is presented. For any significant reclassification for which other Topics do not require that reclassification to net income in its entirety in the same reporting period, the entity shall cross-reference to the note where additional details about the effect of the reclassifications are disclosed. Paragraph 220-10-55-17E provides an example of a note presentation in a tabular format of the effect of reclassifications out of accumulated other comprehensive income. (See paragraph 220-10-45-17B.)

• • > Disclosure of Changes in Accumulated Other Comprehensive Income Balances

55-15C For life insurers, amounts reclassified out of accumulated other comprehensive income exclude changes in unrealized gains and losses on available-for-sale debt securities associated with direct adjustments made to policy liabilities necessary to reflect these balances as if such unrealized gains and losses were realized.

• • > Disclosure of Amounts Reclassified Out of Accumulated Other Comprehensive Income

55-17A The effect of reclassifications on the line items in the statement in which net income is presented, as described in paragraph 220-10-45-17, should be presented on either a before-tax basis or a net-of-tax basis consistent with the entity's method of presentation for the line items in the statement where net income is presented. In either case, the total for this disclosure should agree with the total amount of reclassifications for each component of comprehensive income that complies with the presentation requirements in paragraph 220-10-45-14A. The illustration in paragraph 220-10-55-17E presents the effect of reclassifications on the line items of net income on a before-tax basis, but it also shows totals for each component, which agree with the ending balances presented in paragraph 220-10-55-15, which is on an after-tax basis.

55-17B An entity with significant defined benefit pension costs reclassified out of accumulated other comprehensive income should identify the amount of each pension cost component reclassified out of accumulated other comprehensive income and make reference to the relevant pension cost disclosure that provides greater detail about these reclassifications.

55-17C A life insurer may make adjustments to unrealized gains and losses on available-for-sale debt securities for the effect on relevant assets and liabilities (as specified in paragraph 320-10-S99-2 for public entities) as if the unrealized gains and losses had been realized. In such cases, the life insurer should cross-reference to the related notes.

55-17D Some entities may not have a separate line item for realized gains/(losses) on the sale of securities and, instead, will include this amount as part of another line item, for example, other income/(expense).

The occurrence of certain events triggers the reclassification of amounts of AOCI to net income. This is to avoid double counting in comprehensive income items that are included in net income for a period that had also been included in other comprehensive income in that period or earlier periods. [220-10 Glossary]

An example of a reclassification event is the sale of available-for-sale debt securities; to avoid double counting in comprehensive income, any unrealized gains or losses in AOCI related to those securities are reclassified to net income in the period the realized gain or loss is reported in net income. [320-10-40-2]

Reclassification adjustments are determined for each component of OCI in AOCI. [220-10-45-15 – 45-16]

Reclassifications of significant amounts from AOCI requires separate presentation or disclosure (see Question 5.4.50).

Question 5.4.40

Does Subtopic 220-10 address when to reclassify items in AOCI?

Interpretive response: In general, no. Subtopic 220-10 does not specify when to reclassify (i.e. derecognize) items of AOCI, except for the one-time derecognition of tax effects of the Tax Cuts and Jobs Act on items in AOCI. Instead, derecognition of items in AOCI is based on the relevant underlying accounting literature. [220-10-35-1, 45-12A]

Question 5.4.50

How are reclassification adjustments reported?

Interpretive response: There are two aspects to reporting reclassification adjustments.

- All current-period reclassification adjustments are reported separately for each component of AOCI, either on the face of the financial statements or in the notes (see Question 5.4.30). [220-10-45-14A]
- The effects of a reclassification adjustment on individual captions in the income statement are reported if the reclassification amount is significant, either in the income statement or in the notes (see Question 5.4.60). [220-10-45-17]

Question 5.4.60
How are reclassification adjustments reported if the OCI occurred during the same reporting period?

Interpretive response: For reclassification adjustments in the same reporting period that the OCI occurred, we believe an entity can elect a policy to present:

- only the changes from the beginning balance of AOCI as reclassification adjustments – i.e. amounts added and removed from AOCI during the same period are shown net; or
- each individual change in OCI and AOCI – i.e. intra-period activity is presented gross.

The policy should be consistently applied and disclosed if material.

Question 5.4.70
How are the income statement effects of reclassification adjustments reported?

Interpretive response: When reclassifications from AOCI components represent significant amounts, the income statement effect of the reclassification adjustment are reported by either: [220-10-45-17]

- presenting the effects in parentheticals in the income statement (see Question 5.4.80); or
- disclosing the effects in the notes to financial statements (see Question 5.4.90).

An entity discloses the effects in the notes (as opposed to in the income statement) when: [220-10-45-17A, 55-17F]

- reclassifications for the period are not to net income in their entirety – e.g. when a reclassification adjustment is capitalized into inventory; or
- the entity is unable to identify the appropriate caption(s) in the income statement that are affected by the reclassifications.

Question 5.4.80
How are significant reclassification adjustments presented in the income statement?

Interpretive response: When the conditions discussed in Question 5.4.70 are met, an entity can elect to present significant reclassification adjustments out of AOCI parenthetically in the income statement on each affected caption. The amount of the effects is presented pre-tax or post-tax, consistent with whether the caption is presented pre-tax or post-tax. However, the total of the amount of the effects disclosed in this manner must agree with the totals reported for changes in AOCI balances (see Question 5.4.30). [220-10-55-17A]

Example 5.4.50 illustrates this presentation.

Example 5.4.50

FASB example: Presenting effects on net income of significant amounts reclassified out of AOCI – items reclassified in their entirety to net income

See Example 5.4.40 for the fact pattern underlying this example (fact pattern C).

Excerpt from ASC 220-10

• • > Disclosure of Amounts Reclassified Out of Accumulated Other Comprehensive Income

55-17F The following illustrates presentation of the effect on certain line items of net income of significant amounts reclassified out of each component of accumulated other comprehensive income, as required by paragraph 220-10-45-17A. The amounts in this Example agree with the amounts in the Example in paragraph 220-10-55-15A. This presentation should only be used if all significant reclassifications out of accumulated other comprehensive income are reclassified to net income in their entirety in the same reporting period.

Entity ABC
Statement of Income
For the Period Ended December 31, 201X

Revenues (includes $4,000 accumulated other comprehensive income reclassifications for net gains on cash flow hedges)	$122,500
Expenses (includes ($1,000) accumulated other comprehensive income reclassifications for net losses on cash flow hedges)	(32,000)
Other gains and losses	5,000
Gain on sale of securities (includes $4,000 accumulated other comprehensive income reclassifications for unrealized net gains on available-for-sale debt securities)	4,000
Income from operations before tax	99,500
Income tax expense (includes ($1,750) income tax expense from reclassification items)	(24,875)
Net income	$74,625

Question 5.4.90
How are significant reclassification adjustments presented in the notes?

Interpretive response: When an entity discloses the effects of significant reclassification adjustments in the notes (see Question 5.4.70), it discloses all significant adjustments. [220-10-50-6]

Note disclosures are required to: [220-10-50-6]

- identify significant amounts by each AOCI component;
- provide a subtotal of each component of comprehensive income that agrees with the subtotal reported for changes in the balances of the AOCI components (see Question 5.4.30);
- for significant amounts required to be reclassified to net income in their entirety in the same reporting period, each caption affected by the reclassification;
- for significant amounts not required to be reclassified to net income in their entirety in the same reporting period, cross reference to the disclosure with additional details about the effect of the reclassifications.

These disclosures may be presented on either a before-tax or net-of-tax basis.

Example 5.4.60 illustrates this presentation.

Example 5.4.60
FASB example: Presenting effects on net income of significant amounts reclassified out of AOCI – items reclassified in their entirety to net income

See Example 5.4.30 for the fact pattern underlying this example (fact pattern B).

Excerpt from ASC 220-10

• • > Disclosure of Amounts Reclassified Out of Accumulated Other Comprehensive Income

55-17E The following illustrates a disclosure in a tabular format of significant amounts reclassified out of each component of accumulated other comprehensive income, as required by paragraph 220-10-50-6. The amounts used in this Example correspond to those in the Example in paragraph 220-10-55-15.

Entity XYZ
Notes to Financial Statements
Reclassification Out of Accumulated Other Comprehensive Income(a)
For the Period Ended December 31, 201X

Details about Accumulated Other Comprehensive Income Components	Amount Reclassified from Accumulated Other Comprehensive Income	Affected Line Item in the Statement Where Net Income is Presented
Gains and losses on cash flow hedges		
Interest rate contracts	$1,000	Interest income/(expense)
Credit derivatives	(500)	Other income/(expense)
Foreign exchange contracts	2,500	Sales/revenue
Commodity contracts	(2,000)	Cost of sales
	1,000	Total before tax
	(250)	Tax (expense) or benefit
	$750	Net of tax
Unrealized gains and losses on available-for-sale debt securities		
	$2,300	Realized gain/(loss) on sale of securities
	(285)	Impairment expense
Insignificant items	(15)	
	2,000	Total before tax
	(500)	Tax (expense) or benefit
	$1,500	Net of tax
Amortization of defined benefit pension items		
Prior-service costs	$(2,000)[(b)]	Other income/(expense)
Transition obligation	(2,500)[(b)]	Other income/(expense)
Actuarial gains/(losses)	(1,500)[(b)]	Other income/(expense)
	(6,000)	Total before tax
	1,500	Tax (expense) or benefit
	$(4,500)	Net of tax
Total reclassifications for the period	$(2,250)	Net of tax

(a) Amounts in parentheses indicate debits to profit/loss.

(b) These accumulated other comprehensive income components are components of net periodic pension cost (see pension note for additional details).

6. Notes to financial statements

Detailed contents

Item significantly updated in this edition: #

6.1 How the standard works

The notes to financial statements (notes) supplement or explain information presented in the financial statements, and with a full set of financial statements help achieve the objective of general purpose financial reporting (see Question 2.3.10).

US GAAP provides no one-stop-shop for disclosure requirements. Each Topic in the Codification lists the required disclosure for that Topic – e.g. Topic 606 details disclosures required for revenue from contracts with customers. For registrants, SEC regulations and other guidance have additional disclosure requirements.

This Handbook discusses the following disclosure requirements in depth:

- general disclosure guidance – see section 6.2;
- accounting policies (Topic 235) – see section 6.3;
- risks and uncertainties (Topic 275) – see chapter 7;
- related parties (Topic 850) – see chapter 8;
- subsequent events (Topic 855) – see chapter 9.

For other disclosure requirements see the collection of KPMG Handbooks. In addition, KPMG Accounting Research Online subscribers can access KPMG accounting disclosure checklists.

In some cases, an entity has a choice of providing information in notes or parenthetically on the financial statements. For ease of reading, this chapter specifically refers only to notes, but the concepts discussed also apply to information disclosed parenthetically.

6.2 General disclosure guidance

Some general disclosure guidance can be found across the FASB Concepts Statements, Topic 105, Subtopic 205-10 and SEC guidance. These are summarized in this section and are generally relevant to both annual and interim financial statements, unless indicated otherwise.

Disclosure requirements do not apply to immaterial items. In contrast, disclosure beyond the specific requirements of US GAAP may sometimes be necessary to keep the disclosures from being misleading. Well-reasoned, practical judgments on financial statement disclosures are critical to providing high-quality and decision-useful information to investors and preserving disclosure effectiveness.

Question 6.2.10
What is the purpose of the notes to financial statements?

Interpretive response: The primary purpose of the notes to financial statements is to supplement, explain or amplify the information presented in the financial statements. The notes provide information about: [CON 8.D4, D12]

- financial statement captions;
- the reporting entity; and
- past events and current conditions and circumstances that have not been recognized but could affect the entity's future cash flows.

However, disclosure is not an acceptable alternative to the proper application of US GAAP. [CON 8.PR12]

Question 6.2.20
Are registrants required to make additional disclosures?

Interpretive response: Yes. Reg S-X requires several disclosures beyond the Codification. Further, throughout the Codification, entities meeting the definition of a 'public entity' or 'public business entity' are required to make additional disclosures beyond those required for nonpublic entities.

See Appendix for a full reproduction of S-X Rules 4-08, 5-02 and 5-03, which include additional disclosures required for registrants.

Question 6.2.30
Is disclosure of immaterial items required?

Interpretive response: No. The provisions of the Codification and SEC guidance are not required to be applied to immaterial items, including disclosure requirements. [105-10-05-6, S-X Rule 4-02]

In 2015, the FASB attempted but eventually decided not to incorporate a definition of materiality (legal or otherwise) separately into Topic 235 (notes to financial statements). This is because materiality is ultimately integrated into the entire financial reporting system and has implications not just for disclosure, but also for recognition and measurement in financial statements. Question 2.4.50 discusses materiality.

Question 6.2.40
Are disclosures from the prior year repeated in the current year?

Interpretive response: Yes. Disclosures from the prior year are repeated to the extent they continue to be of significance. [205-10-50-2]

Question 6.2.50
Can registrants avoid repeating in the notes financial information presented in MD&A?

Interpretive response: No. The same financial information may need to be presented in both the notes to financial statements and MD&A.

Disclosures required by the Codification must be included in the notes. A registrant cannot refer to MD&A for those required disclosures unless it is specifically permitted or required by SEC guidance or by US GAAP. For example, in the notes, a registrant cannot simply reference the income tax disclosures in MD&A to satisfy the requirements of Topic 740. [17 CFR 240.12b-23]

Conversely, a registrant can refer to the financial statements and notes in MD&A. [S-K Item 303]

Question 6.2.60
How can the effectiveness of disclosure be improved?

Background: In recent years, the SEC and the FASB have been working on a number of projects on disclosure effectiveness. For example, the FASB disclosure framework project aims at facilitating clear communication of the information material to the users of the financial statements.

Interpretive response: Financial information conveyed through the notes to financial statements must be useful to the users of the financial statements when making voting decisions or decisions about providing resources to the entity. [CON 8.D4]

For that purpose, we believe the following best practices in terms of content and format of the notes should be considered: [2015 AICPA Conf]

- avoiding boilerplate or non-entity specific information;
- removing outdated or redundant disclosures;
- eliminating immaterial disclosures;
- using tabular formats over narratives where possible;
- cross-referencing information from the face of the financial statements to the related note or between notes; and
- ordering the notes in a systematic and logical fashion – e.g. in the order that the financial statement captions are presented.

6.3 Accounting policies

6.3.10 Overview

Excerpt from ASC 235-10

05-1 The Notes to Financial Statements Topic addresses the content and usefulness of disclosure by an entity of the accounting policies judged by management to be most appropriate to fairly present the entity's financial statements.

05-2 Disclosure of accounting policies related to specific financial statement line items are addressed in the related Topics.

> Importance of Accounting Policies Disclosure

05-3 The accounting policies of an entity are the specific accounting principles and the methods of applying those principles that are judged by the management of the entity to be the most appropriate in the circumstances to present fairly financial position, cash flows, and results of operations in accordance with generally accepted accounting principles (GAAP) and that, accordingly, have been adopted for preparing the financial statements.

05-4 The accounting policies adopted by an entity can affect significantly the presentation of its financial position, cash flows, and results of operations. Accordingly, the usefulness of financial statements for purposes of making economic decisions about the entity depends significantly upon the user's understanding of the accounting policies followed by the entity.

> Entities

15-2 The guidance in the Notes to Financial Statements Topic applies to all entities.

Financial statements are typically compiled using numerous accounting policies – e.g. consolidation basis, depreciation methods, inventory cost flow assumption (e.g. first-in, first-out), transition options to adopt a new ASU. For financial statements to be useful, users need to understand these accounting policies. Therefore, all entities must disclose those accounting policies that management deems most appropriate to fairly present the financial statements. [235-10-05-1, 05-3, 15-2]

In addition, Topic 250 requires specific disclosures related to changes in accounting principles, which includes existing policies and practices as well as the adoption of new accounting standards. See chapter 3 of KPMG Handbook, Accounting changes and error corrections.

6.3.20 Accounting policies note

Excerpt from ASC 235-10

> Accounting Policies Disclosure

50-1 Information about the accounting policies adopted by an entity is essential for financial statement users. When financial statements that are issued or are available to be issued (as discussed in Section 855-10-25) purport to present fairly financial position, cash flows, and results of operations in accordance with generally accepted accounting principles (GAAP), a description of all significant accounting policies of the entity shall be included as an integral part of the financial statements. In circumstances where it may be appropriate to issue one or more of the basic financial statements without the others, purporting to present fairly the information given in accordance with GAAP, statements so presented also shall include disclosure of the pertinent accounting policies.

> What to Disclose

50-3 Disclosure of accounting policies shall identify and describe the accounting principles followed by the entity and the methods of applying those principles that materially affect the determination of financial position, cash flows, or results of operations. In general, the disclosure shall encompass important judgments as to appropriateness of principles relating to recognition of revenue and allocation of asset costs to current and future periods; in particular, it shall encompass those accounting principles and methods that involve any of the following:

a. A selection from existing acceptable alternatives
b. Principles and methods peculiar to the industry in which the entity operates, even if such principles and methods are predominantly followed in that industry
c. Unusual or innovative applications of GAAP.

> Examples of Disclosures

50-4 Examples of disclosures by an entity commonly required with respect to accounting policies would include, among others, those relating to the following:

a. Basis of consolidation
b. Depreciation methods
c. Amortization of intangibles
d. Inventory pricing
e. Recognition of **revenue** from **contracts** with **customers**
f. Recognition of revenue from leasing operations.

> Avoid Duplicate Details of Disclosures

50-5 Financial statement disclosure of accounting policies shall not duplicate details (for example, composition of inventories or of plant assets) presented elsewhere as part of the financial statements. In some cases, the disclosure of accounting policies shall refer to related details presented elsewhere as part of the financial statements; for example, changes in accounting policies during the period shall be described with cross-reference to the disclosure required by Topic 250.

> Format

50-6 This Subtopic recognizes the need for flexibility in matters of format (including the location) of disclosure of accounting policies provided that the entity identifies and describes its significant accounting policies as an integral part of its financial statements in accordance with the provisions of this Subtopic. Disclosure is preferred in a separate summary of significant accounting policies preceding the notes to financial statements (notes), or as the initial note, under the same or a similar title.

The note describing all significant accounting policies of the entity forms an integral part of the financial statements. [235-10-50-1]

Question 6.3.10#
Which accounting policies must be disclosed?

Interpretive response: All significant accounting policies must be disclosed. The term ‘accounting policy’ broadly includes accounting principles, methods and techniques. See Question 3.2.10 in KPMG Handbook, Accounting changes and error corrections, for a discussion of those terms. [235-10-50-3]

An accounting policy is ‘significant’ if it has a material impact, either quantitatively or qualitatively, on the financial statements presented. Selecting which significant accounting policies to disclose requires judgment. Particular attention is given to those accounting policies that require judgments as to their appropriateness. This includes principles relating to recognition of revenue and allocation of asset costs to current and future periods, especially when: [235-10-50-3]

- several acceptable alternatives exist;
- the principles and methods followed are industry-specific; or
- the application of GAAP is unusual or innovative.

For nonpublic entities, we believe that the selection of private company accounting alternatives should be disclosed, if applicable.

Accounting policy disclosures do not need to be included in interim financial statements with limited notes if the entity has not changed its accounting policies since the end of its preceding fiscal year.

Question 6.3.20
How are significant accounting policies disclosed?

Interpretive response: The preferred approach is to disclose significant accounting policies in a separate note preceding all other notes. However, the format and placement of the disclosure is flexible, as long as it is an integral part of the financial statements. Accounting policy disclosures do not need to be duplicated in a separate note if presented elsewhere in the financial statements. [235-10-50-5 – 50-6]

Question 6.3.30
What accounting policies does an entity disclose if it issues only one financial statement?

Interpretive response: An entity only discloses the accounting policies that are pertinent to the issued financial statement. For example, if an entity is issuing only a balance sheet, it does not need to disclose accounting policies relevant to the statement of cash flows or the income statement, unless those policies affect the balance sheet. [235-10-50-1]

6.4 Information prepared under IFRS Accounting Standards

Question 6.4.10

Can financial information prepared under IFRS Accounting Standards be included in US GAAP financial statements?

Interpretive response: It depends. US domestic registrants are not permitted to include financial information prepared under IFRS Accounting Standards in their US GAAP financial statements because this would meet the definition of a non-GAAP measure (see Question 2.4.20). However, segment information may be disclosed on an IFRS Accounting Standards basis because segment measures do not need to be provided in accordance with US GAAP. [S-K Item 10(e), 280-10-55-9]

However, for nonpublic entities, we believe it may be acceptable to include, in the notes to US GAAP financial statements, financial information prepared under IFRS Accounting Standards. This is as long as the information is not misleading or does not otherwise obscure the financial statements. [AU-C 700.A19 – A20]

If included, we believe this information should be:

- prepared using all relevant recognition and measurement principles of IFRS Accounting Standards as issued by the IASB;
- clearly labeled as such; and
- reconciled to the equivalent US GAAP metric. The reconciliation should allow the user to understand and quantify the material differences in accounting policies between US GAAP and IFRS Accounting Standards.

For example, an entity may wish to present its total of shareholders' equity or net income under IFRS Accounting Standards. This information would be best presented in a separate note with a reconciliation presented as follows:

- in tabular format;
- in sufficient detail to quantify material adjustments from US GAAP to IFRS Accounting Standards;
- accompanied by relevant explanations for the key differences in accounting policies.

7. Risks and uncertainties

Detailed contents

Item significantly updated in this edition: #

7.7.30 What are some potential disclosable risks and uncertainties related to volatile commodity prices?

7.7.40 What are some potential disclosable risks and uncertainties related to climate-related risks?

7.7.50 What are some potential disclosable risks and uncertainties related to natural disasters?

7.7.60 What are some potential disclosable risks and uncertainties related to widespread health crises?

7.7.70 What are some potential disclosable risks and uncertainties related to cybersecurity incidents? #

7.7.80 What are some potential disclosable risks and uncertainties related to foreign jurisdictions?

7.7.90 What are some potential disclosable risks and uncertainties related to reference rate reform? #

7.1 How the standard works

An entity discloses risks and uncertainties that could significantly affect the amounts reported in the financial statements in the near term or the near-term functioning of the entity. The following table summarizes the disclosures required by Topic 275.

Risk area	General disclosure requirements
Nature of operations (see section 7.3)	Describe major products or services and principal markets, including their location.
Estimates in general (see section 7.4)	Explain that the preparation of financial statements in conformity with US GAAP requires use of management's estimates.
Certain significant estimates (see section 7.5)	When it is reasonably possible that an estimate will change materially in the near term, disclose this fact and indicate the nature of the uncertainty.
Current vulnerabilities due to concentrations (see section 7.6)	Disclose concentrations in certain areas when the concentration makes the entity vulnerable to the risk of near-term severe impact and it is at least reasonably possible that events could occur to cause such severe impact.

Topic 275 disclosures are intended to complement (and sometimes overlap) disclosures already required by other Topics. Registrants are subject to more comprehensive risk disclosure requirements outside the financial statements.

7.2 Overview

Excerpt from ASC 275-10

05-1 Financial statements provide information about certain current conditions and trends that help users in predicting reporting entities' future cash flows and results of operations. The quality of users' predictions depends to a significant degree on their assessment of the risks and uncertainties inherent in entities' operations and of the information about those operations that financial reporting provides.

05-2 The central feature of this Subtopic's disclosure requirements is selectivity: specified criteria serve to screen the host of risks and uncertainties that affect every entity so that required disclosures are limited to matters significant to a particular entity. The disclosures focus primarily on risks and uncertainties that could significantly affect the amounts reported in the financial statements in the near term or the **near-term** functioning of the reporting entity. The risks and uncertainties this Subtopic addresses can stem from any of the following:

a. The nature of the entity's operations, including the activities in which the entity is currently engaged if principal operations have not commenced
b. The use of estimates in the preparation of the entity's financial statements
c. Significant concentrations in certain aspects of the entity's operations.

05-3 This Subtopic does not prohibit disclosure of matters it does not require to be disclosed either because they do not meet the specified screening criteria or because they relate to risks and uncertainties that are outside the scope of this Subtopic.

10-1 Disclosing information to help users assess major risks and uncertainties is consistent with the established objectives of financial reporting.

> Entities

15-2 The guidance in the Risks and Uncertainties Topic applies to all entities.

> Other Considerations

15-3 The guidance in the Risks and Uncertainties Topic applies to financial statements prepared in conformity with generally accepted accounting principles (GAAP) and applies to all entities that issue such statements. While the guidance in this Topic applies to complete interim financial statements, it does not apply to condensed or summarized interim financial statements. If comparative financial statements are presented, the disclosure requirements apply only to the financial statements for the most recent fiscal period presented.

15-4 The disclosure requirements do not encompass risks and uncertainties that might be associated with any of the following:

a. Management or key personnel
b. Proposed changes in government regulations
c. Proposed changes in accounting principles
d. Deficiencies in the internal control structure
e. The possible effects of acts of God, war, or sudden catastrophes.

• > Overlap with Other Topics

15-5 Certain disclosure requirements in this Topic supplement the requirements of other authoritative Topics. In many cases, however, the disclosure requirements in this Topic, particularly those relating to certain significant estimates, will be met or partly met by compliance with such other Topics.

15-6 The disclosure requirements of this Topic in many circumstances are similar to or overlap the disclosure requirements in other Topics, for example, Topic 450 and, for public entities, Subtopic 280-10. The disclosure requirements of this Topic in many circumstances also are similar to or overlap the disclosure requirements of the Securities and Exchange Commission (SEC). This Topic does not alter the requirements of any other Topic or any SEC requirement.

50-1 All of the disclosures required by this Subtopic shall be included in the basic financial statements. Reporting entities shall make disclosures in their financial statements about the risks and uncertainties existing as of the date of those statements in the following areas:

a. Nature of operations, including the activities in which the entity is currently engaged if principal operations have not commenced
b. Use of estimates in the preparation of financial statements
c. Certain significant estimates
d. Current vulnerability due to certain concentrations.

These four areas of disclosure are not mutually exclusive. The information required by some may overlap. Accordingly, the disclosures required by this Subtopic may be combined in various ways, grouped together, or placed in diverse parts of the financial statements, or included as part of the disclosures made pursuant to the requirements of other Topics.

Topic 275 requires all entities to disclose: [275-10-50-1]

- the nature of the entity's operations – see section 7.3;
- the use of estimates in preparing the financial statements – see section 7.4;
- certain significant estimates – see section 7.5; and
- current vulnerability related to certain concentrations – see section 7.6.

These disclosures are tailored to an entity's specific facts and circumstances so as to provide clear and meaningful information about how the significant risks and uncertainties may impact the entity's financial statements in the near term.

Disclosures are updated each period to reflect current circumstances. [275-10-15-3]

Question 7.2.10
What financial statements require Topic 275 disclosures?

Interpretive response: Topic 275 applies to all financial statements prepared in accordance with US GAAP except for condensed or summarized interim financial statements. When financial statements include comparative periods, Topic 275 disclosures are required only for the most recent period presented. [275-10-15-3]

Question 7.2.20
What risks and uncertainties are disclosed under Topic 275?

Interpretive response: Every entity faces risks and uncertainties. These risks may, for example, be inherent to the business in which the entity engages or linked to the environment(s) in which it operates. Certain external events might be sources of risks and uncertainties (see section 7.7).

Topic 275 focuses only on significant risks that may affect amounts reported in the financial statements in the near term or the near-term functioning of the reporting entity. Question 7.2.30 explains how near term should be interpreted. [275-10 Glossary]

The required disclosures under Topic 275 are limited to:

- the nature of entity's operations;
- the use of estimates in preparing the financial statements;
- certain significant estimates; and
- current vulnerability related to certain concentrations.

Topic 275 disclosures are intended to complement (and sometimes overlap) disclosures already required by US GAAP. For example, risks attached to the following matters are also disclosed under other Codification Topics:

- concentration of sales with major customers (Topic 280) – see section 8.5 of KPMG Handbook, Segment reporting;
- commitments (Topic 440);
- loss contingencies (Topic 450);
- unrecognized tax benefits (Topic 740) – see section 9 of KPMG Handbook, Accounting for income taxes;
- fair value measurements (Topic 820) – see section N of KPMG Handbook, Fair value measurement;
- financial instrument with concentrations of credit risk (Topic 825);
- related-party transactions (Topic 850) – see chapter 8;
- subsequent events (Topic 855) – see chapter 9;
- risk that an entity will not be able to continue as a going concern (Subtopic 205-40) – see chapter 5 of KPMG Handbook, Going concern.

Topic 275 also specifically excludes certain risks from its scope – see Question 7.2.40. However, an entity may voluntarily disclose additional risks and uncertainties outside of the requirements of Topic 275 or other US GAAP. [275-10-05-3]

Question 7.2.30

Are risks and uncertainties disclosures limited to near-term effects?

Excerpt from ASC 275-10

20 Glossary

Near Term

A period of time not to exceed one year from the date of the financial statements.

Interpretive response: Topic 275 focuses on significant risks with a near-term effect. Near term is defined as less than a year from the reporting date. [275-10 Glossary]

However, it may be appropriate to disclose risks and uncertainties with effects beyond the near-term as required by other US GAAP – e.g. loss contingencies under Topic 450 or debt maturities under Topic 470.

Question 7.2.40

What risks and uncertainties are not disclosed under Topic 275?

Interpretive response: Topic 275 disclosures do not apply to risks and uncertainties associated with any of the following: [275-10-15-4]

- management or key personnel;
- proposed changes in government regulations;
- proposed changes in accounting principles;
- deficiencies in internal control structure; and
- the possible effects of acts of God, war, or sudden catastrophes.

However, outside the financial statements (see Question 7.2.70), registrants may be required to discuss risks and uncertainties related to management or key personnel and pending legislation or regulations. [S-K Item 103, 105, 303]

Question 7.2.50
When is the assessment of risks and uncertainties performed?

Interpretive response: Topic 275 disclosures reflect facts and circumstances at the reporting date and are updated every period.

The assessment considers information known to management before the financial statements are issued (available to be issued), as defined in Topic 855 (see Question 9.3.50). Therefore, Topic 275 requires monitoring subsequent events and leverages processes and controls in place to comply with the requirements of Topic 855 (see chapter 9) and Subtopic 205-40 (see KPMG Handbook, Going concern). However, each subsequent event is assessed separately under each Topic. [275-10-50-8, 50-17]

Topic 275 only requires consideration of information known to management, rather than information of which management is reasonably expected to have knowledge. Therefore, Topic 275 disclosures are not based on information management does not readily know even if the information could be identified without significant amount of cost or effort. This contrasts with Subtopic 205-40, which requires consideration of both known and reasonably knowable conditions and events in the going concern assessment. [275-10-50-17, ASU 2014-15.BC26]

Question 7.2.60
Where are Topic 275 disclosures included in the notes?

Interpretive response: Topic 275 does not prescribe where in the notes to financial statements risks and uncertainties should be disclosed. Instead, entities select the presentation that is most meaningful for financial statement users – i.e. combined in one note or provided in multiple notes. [275-10-50-1]

Topic 275 disclosures often complement (and sometimes overlap) those in other Topics, in which case they may be provided together with disclosures made pursuant to requirements of other Topics. Information already provided elsewhere in the notes does not need to be repeated in a risks and uncertainties note if all requirements under Topic 275 have been sufficiently addressed. [275-10-15-5 – 15-6, 50-21]

Questions 7.3.10, 7.4.10, 7.5.40 and 7.6.30 discuss common placements of Topic 275 disclosures.

Question 7.2.70
Are registrants subject to any risks and uncertainties disclosure requirements outside the financial statements?

Interpretive response: Yes. A number of Reg S-K disclosures require registrants to discuss risks and uncertainties, such as:

- a description of the business, including dependence on key revenue-generating activities, products, services or customers; [S-K Item 101]
- a description of material pending legal proceedings; [S-K Item 103]
- a discussion of risk factors. The focus is on material factors that make an investment in the registrant or offering speculative or risky; [S-K Item 105]
- management's discussion and analysis of financial condition and results of operations. The focus is on material events and uncertainties known to management that are reasonably likely to cause reported financial information not to be necessarily indicative of future operating results or of future financial condition; [S-K Item 303]
- critical accounting estimates. The focus is on estimates involving significant estimation uncertainty that have had or are reasonably likely to have a material impact on financial condition or results of operations; [S-K Item 303]
- quantitative and qualitative disclosures about market risk. [S-K Item 305]

Therefore, registrants may be required to provide information outside the financial statements that is similar to or consistent with information disclosed in the notes to financial statements. However, the SEC does permit Reg S-K disclosures to hyperlink or cross-reference information disclosed in the notes, rather than repeat it, provided that the Reg S-K disclosures integrate the substance of the notes in a manner that informs readers of the significance of the information. [S-K Item 103, 105, 303]

In our experience, when identifying potential risks and uncertainties for Topic 275 disclosures, registrants often leverage their processes for complying with the above disclosure requirements in Reg S-K.

Question 7.2.80
What are the implications if future actual events differ from disclosed risks and uncertainties?

Excerpt from ASC 275-10

> Application of Disclosure Criteria

50-23 An assessment of whether a disclosure is required should not be found to be in error simply as a result of future events. For example, reporting a concentration not followed by a severe impact does not imply that the disclosure should not have been made, because something that has only a reasonably possible chance of occurring obviously might not occur. Similarly, the occurrence of a severe impact related to a concentration not disclosed in the prior-year financial statements would not suggest noncompliance with the requirements of this Subtopic if an appropriate judgment had been made that a near-term severe impact was not at least reasonably possible at the prior reporting date. In addition, a severe impact may arise from a concentration of which management did not have knowledge at the time the financial statements were issued.

Background: Such a situation may arise when, for example:

- an entity concluded that a potential event created a disclosable risk or uncertainty but the event did not subsequently occur;
- an entity concluded that a potential event did not create a disclosable risk or uncertainty but the event subsequently occurred;
- the timing or magnitude of a potential event was different than what the entity predicted.

Interpretive response: Such differences require no corrective action as long as risks and uncertainties disclosures were made using appropriate judgment at the time. However, an entity will have to alter its disclosures prospectively for the new information. [275-10-50-23]

Nevertheless, if an entity incorrectly applied the disclosure requirements or overlooked information that it should have considered, then corrective action may be needed. [250-10 Glossary]

7.3 Nature of operations

7.3.10 Overview

Excerpt from ASC 275-10

> Nature of Operations

05-4 Disclosure of the locations of a business entity's or not-for-profit entity's (NFP's) principal markets provides information useful in assessing risks and uncertainties related to the environments in which the entity operates. The risks and the uncertainties associated with selling products and services in various regions in the United States may differ significantly. And they do differ significantly from the risks and the uncertainties in selling products and services outside the United States. Knowing those environments in which an entity sells its products or provides services helps users of financial statements to assess certain risks based on day-to-day national and world events.

05-5 Information about the nature of operations is helpful because the various kinds of businesses in which reporting entities operate have diverse degrees and kinds of risks. Certain of these risks are inherent to the business in which an entity is engaged. By knowing the nature of an entity's business and the principal markets for its products or services, a financial statement user is alerted, indirectly, about the risks common to that business.

> Nature of Operations/Activities

50-2 If an entity has commenced planned principal operations, the entity's financial statements shall include a description of the major products or services the reporting entity sells or provides and its principal markets, including the locations of those markets. If the entity operates in more than one business, the disclosure also shall indicate the relative importance of its operations in each business and the basis for this determination—for example, assets, revenues, or earnings. Not-for-profit entities' (NFPs') disclosures should briefly describe the principal services performed by the entity and the revenue sources for the entity's services. Disclosures about the nature of operations or activities need not be quantified; relative importance could be conveyed by use of terms such as predominately, about equally, or major and other.

50-2A An entity that has not commenced principal operations shall provide disclosures about the risks and uncertainties related to the activities in which the entity is currently engaged and an understanding of what those activities are being directed toward.

50-3 See Examples 1 through 2 (paragraphs 275-10-55-2 through 55-5) for illustrations of disclosure requirements for nature of operations.

Topic 275 requires a general description of the entity's major products or services and principal markets. Section 7.3.20 illustrates this disclosure. [275-10-05-4]

Question 7.3.10
What disclosures are required about the nature of an entity's operations?

Interpretive response: What is disclosed depends on the entity's circumstances. [250-10-50-2 – 50-2A]

Circumstance	Disclose
Entity has begun planned principal operations	• Description of major products or services • Principal markets including locations of those markets • If the entity operates in more than one business: – the relative importance of each business to overall operations; and – the basis for determining relative importance (e.g. assets, revenues, earnings)
Entity has not begun planned principal operations	• Risks and uncertainties related to current activities • Purpose of those activities
NFP	• Principal services performed • Revenue sources

Topic 275 does not require these disclosures to be quantified. It is sufficient to describe relative importance in other terms, such as 'predominantly', 'equally', 'major'. [250-10-50-2]

Further, Topic 275 does not prescribe where the disclosures should be presented (see Question 7.2.60). The nature of operations is generally disclosed in the beginning of the notes to financial statements or with segment disclosures (for registrants). [250-10-50-2]

7.3.20 Example disclosures

FASB Examples 1 and 1A illustrate the disclosure of an entity's nature of operations when planned activities have commenced and have not yet commenced, respectively. FASB Example 2 (reproduced in section 7.6.20) illustrates a combined disclosure of risks and uncertainties concerning both nature of operations and customer concentration.

Following the FASB excerpt, an additional example illustrates disclosures for a retailer whose planned activities have commenced.

Excerpt from ASC 275-10

• > Example 1: Nature of Operations/Activities—Planned Principal Operations Have Commenced

55-2 This Example illustrates the disclosures required by paragraph 275-10-50-2. Conglomerate, Inc. is a U.S.-based multinational entity. Conglomerate's principal lines of business are automotive products, aerospace products and technologies, textiles, and nonprescription health-care products. The principal markets for Conglomerate's automotive and aerospace products and technologies are European- and Far East-based industrial concerns. Textiles are sold primarily to U.S. clothing manufacturers, while nonprescription health-care products are sold to wholesale and retail distributors worldwide. The operations of Conglomerate in any one country are not significant in relation to its overall operations. The following illustrates disclosure of the nature of operations required by this Subtopic.

> Conglomerate, Inc. is a multinational manufacturer and engineering concern. The entity's principal lines of business are automotive products, aerospace products and technologies, textiles, and nonprescription health-care products, all of which are about equal in size based on sales. The principal markets for the automotive and aerospace products and technologies are European- and Far East-based industrial concerns. Textiles are sold primarily to domestic clothing manufacturers, while nonprescription health-care products are sold primarily to wholesale and retail distributors worldwide.

55-3 This disclosure provides all of the following:

a. Information necessary for users not familiar with the operations of Conglomerate to identify and consider the broad risks and uncertainties associated with the businesses and markets in which it operates and competes. From the disclosures provided, financial statement users having a general knowledge of business matters should be able to assess that Conglomerate's product lines are subject to different and varied risks. Those financial statement users familiar with the businesses recognize the general risks associated with each of these businesses and their related markets.
b. Information that facilitates the overall understanding of the financial information presented. This kind of disclosure could provide users with a basis for comparing an entity's financial information with that of competitors or with applicable industry statistics.
c. Insight into the location of Conglomerate's principal markets, although on a broad scale. Because Conglomerate's markets are so diverse, it likely would not be useful to enumerate the specific locations of the entity's markets. For this reason, the manner in which the information is disclosed in the illustrative disclosure is sufficient to meet the broad objectives of this Subtopic.

• > Example 1A: Nature of Operations/Activities—Planned Principal Operations Have Not Commenced

55-3A This Example illustrates one way to comply with the disclosures required by paragraph 275-10-50-2. NewCompany, Inc. (Company) is a business that has not commenced planned principal operations. The Company is designed to develop and manufacture specialized environmental test equipment for measuring air quality. The Company's first product is a rapid-result test kit to identify certain airborne contaminants in high-risk environments. The Company's activities since inception have consisted principally of acquiring technology patents, raising capital, and performing research and development activities. The following illustrates disclosure required by this Subtopic of the nature of activities for an entity that has not commenced principal operations.

> NewCompany, Inc. (Company) is a business whose planned principal operations are the design, engineering, and manufacturing of air quality test equipment. The Company is currently conducting research and development activities to operationalize certain patented technology that the Company owns so it can manufacture rapid-result test kits for certain airborne contaminants in high-risk environments.
>
> During the last year, the Company secured a research facility in Norwalk, Connecticut, which houses all of its employees and research and development activities. The Company also is in the process of raising additional equity capital to support the completion of its development activities to begin manufacturing the test kits as soon as possible.
>
> The Company's activities are subject to significant risks and uncertainties, including failing to secure additional funding to operationalize the Company's current technology before another company develops similar technology and test kits.

55-3B The disclosure in paragraph 275-10-55-3A provides all of the following:

a. Information necessary for financial statement users not familiar with the activities of the Company to identify and consider the broad risks and uncertainties associated with businesses that have activities that are similar to those in which the Company is engaged. From the disclosures provided, financial statement users that have a general knowledge of business matters should be able to assess both of the following:
   1. That the Company's activities are subject to different and varied risks, including the risk that the entity may be affected by the rapidly changing and intensely competitive technology market
   2. That the Company is dependent on additional capital resources for the continuation and expansion of its business activities.

b. Information that facilitates the overall understanding of the financial information provided. That kind of disclosure could provide users with a basis for understanding the Company's financial information and comparing that information with similar entities or other relevant statistics.

Example 7.3.10
Nature of operations/activities – retailer whose planned principal operations have commenced

Facts

Retailer is a mid-priced department store. Demand for its merchandise fluctuates significantly based on a number of factors, including levels of consumer discretionary income. Retailer is required to mark down merchandise to keep its inventories current. The level of markdowns taken can significantly affect Retailer's overall profitability. Retailer is profitable in Year 1.

Disclosure

Retailer is an omnichannel apparel, accessories and home products retailer operating an e-commerce site and 192 retail department stores primarily in the northeastern areas of the US. Retailer's competitors include department stores, specialty stores, mass merchandisers, discount stores and other retail channels.

Retailer's operations are affected by consumer spending levels, which are affected by general economic conditions, consumer confidence, employment levels, availability of consumer credit and interest rates on that credit, consumer debt levels, costs of consumer staples including food and energy, costs of other goods, adverse weather conditions, and other factors over which Retailer has little or no control.

7.4 Use of estimates

7.4.10 Overview

Excerpt from ASC 275-10

> Use of Estimates in the Preparation of Financial Statements

05-6 There is a need to communicate explicitly to users of financial reports that the inescapable use of estimates in the preparation of financial information, including the estimation of **fair values** for assets carried at such a basis, results in the reporting of values that are approximations rather than exact amounts. If users understand better the inherent limitations on precision in financial statements, they will be better able to make decisions.

05-7 Estimates inherent in the current financial reporting process inevitably involve assumptions about future events. For example, estimating and constraining estimates of variable consideration to be included in the **transaction price** for a **contract** with a **customer** in accordance with paragraphs 606-10-32-5 through 32-14 and measuring progress toward complete satisfaction of a **performance obligation** in accordance with paragraphs 606-10-25-31 through 25-37. For another example, carrying inventories measured using first-in, first-out (FIFO) at the lower of cost and **net realizable value** is based on an assumption that there will be sufficient demand for that product in the future to be able to sell the quantity on hand without incurring losses on the sales or, if net realizable value is used, that it can be estimated. Making reliable estimates for those matters is often difficult even in periods of economic stability; it is more so in periods of economic volatility. Although many users of financial statements are aware of that aspect of financial reporting, others often assume an unwarranted degree of reliability in financial statements. The disclosure required by this Subtopic should help dispel any of those erroneous assumptions.

> Use of Estimates in the Preparation of Financial Statements

50-4 Financial statements shall include an explanation that the preparation of financial statements in conformity with generally accepted accounting principles (GAAP) requires the use of management's estimates.

Topic 275 requires a generic explanation regarding the use of estimates. The explanation is intended to alert the reader that the financial statements are prepared using certain estimates and actual results could differ. Section 7.4.20 illustrates this disclosure. [275-10-05-6]

Question 7.4.10
How does an entity disclose its use of estimates?

Interpretive response: Topic 275 requires an entity to disclose that the preparation of financial statements in conformity with US GAAP requires the use of management's estimates. The disclosure generally includes a generic statement that actual results may differ from such estimates. Entities may also consider tailoring this disclosure to specify which accounting policies are subject to estimates. See section 6.2 for further guidance on accounting policy disclosures.

Topic 275 does not prescribe where in the notes the disclosure of the use of estimates should be included (see Question 7.2.60). The disclosure is generally included within the basis of presentation note.

7.4.20 Example disclosure

The following FASB example illustrates the disclosure of the use of estimates in preparing financial statements.

Excerpt from ASC 275-10

• > Example 3: Use of Estimates in the Preparation of Financial Statements

55-6 The following illustrates disclosure of the pervasiveness of estimates in the financial statements of all reporting entities as required by paragraph 275-10-50-4.

> The preparation of financial statements in conformity with generally accepted accounting principles (GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

55-7 This disclosure is intended to inform users of the inherent uncertainties in measuring assets and liabilities and related revenues and expenses and contingent assets and liabilities, and that subsequent resolution of some matters could differ significantly from the resolution that is currently expected. Such disclosure alerts users that uncertainties are present in the financial statements of all reporting entities.

7.5 Significant estimates

7.5.10 Overview

Excerpt from ASC 275-10

20 Glossary

Reasonably Possible

The chance of the future event or events occurring is more than remote but less than likely.

> Certain Significant Estimates

50-6 This Subtopic requires discussion of estimates when, based on known information available before the financial statements are issued or are available to be issued (as discussed in Section 855-10-25), it is **reasonably possible** that the estimate will change in the **near term** and the effect of the change will be material. The estimate of the effect of a change in a condition, situation, or set of circumstances that existed at the date of the financial statements shall be disclosed and the evaluation shall be based on known information available before the financial statements are issued or are available to be issued (as discussed in Section 855-10-25).

50-7 Various Topics require disclosures about uncertainties addressed by those Topics. In particular, Subtopic 450-20 specifies disclosures to be made about contingencies that exist at the date of the financial statements. In addition to disclosures required by Topic 450 and other accounting Topics, this Subtopic requires disclosures regarding estimates used in the determination of the carrying amounts of assets or liabilities or in disclosure of gain or loss contingencies, as described below.

50-8 Disclosure regarding an estimate shall be made when known information available before the financial statements are issued or are available to be issued (as discussed in Section 855-10-25) indicates that both of the following criteria are met:

a. It is at least reasonably possible that the estimate of the effect on the financial statements of a condition, situation, or set of circumstances that existed at the date of the financial statements will change in the near term due to one or more future confirming events.
b. The effect of the change would be material to the financial statements.

50-9 The disclosure shall indicate the nature of the uncertainty and include an indication that it is at least reasonably possible that a change in the estimate will occur in the near term. If the estimate involves a loss contingency covered by Subtopic 450-20, the disclosure also shall include an estimate of the possible loss or range of loss, or state that such an estimate cannot be made. Disclosure of the factors that cause the estimate to be sensitive to change is encouraged but not required. The words reasonably possible need not be used in the disclosures required by this Subtopic.

50-10 Many entities use risk-reduction techniques to mitigate losses or the uncertainty that may result from future events. If the entity determines that the criteria in paragraph 275-10-50-8 are not met as a result of risk-reduction techniques, the disclosures described in the preceding paragraph and disclosure of the risk-reduction techniques are encouraged but not required.

50-11 This Subtopic's disclosure requirements are separate from and do not change in any way the disclosure requirements or criteria of Topic 450; rather, the disclosures required under this Subtopic supplement the disclosures required under that Topic as follows:

a. If an estimate (including estimates that involve contingencies covered by Topic 450) meets the criteria for disclosure under paragraph 275-10-50-8, this Subtopic requires disclosure of an indication that it is at least reasonably possible that a change in the estimate will occur in the near term; Topic 450 does not distinguish between near-term and long-term contingencies.
b. An estimate that does not involve a contingency covered by Topic 450, such as estimates associated with long-term operating assets and amounts reported under profitable long-term contracts, may meet the criteria in paragraph 275-10-50-8. This Subtopic requires disclosure of the nature of the estimate and an indication that it is at least reasonably possible that a change in the estimate will occur in the near term.

50-12 If a loss contingency meets the criteria for disclosure under both Topic 450 and paragraph 275-10-50-8, this Subtopic requires disclosure that it is at least reasonably possible that future events confirming the fact of the loss or the change in the estimated amount of the loss will occur in the near term.

50-13 The requirements of paragraph 275-10-50-8 are applicable to long-lived assets whose value may become impaired in the near term (see Subtopic 360-10).

50-14 Whether an estimate meets the criteria for disclosure under this Subtopic does not depend on the amount that has been reported in the financial statements, but rather on the materiality of the effect that using a different estimate would have had on the financial statements. Simply because an estimate resulted in the recognition of a small financial statement amount, or no amount, does not mean that disclosure is not required under this Subtopic.

• > Estimated Useful Life of an Intangible Asset

50-15A In determining whether disclosure about an estimate of the useful life of an intangible asset is required under paragraph 275-10-50-8, the criterion in item (b) of that paragraph shall be considered met if the effect of either of the following would be material to the financial statements, either individually or in aggregate by major intangible asset class:

a. A change in the useful life of an intangible
b. A change in the expected likelihood of renewal or extension of an intangible asset.

The risks and uncertainties related to an estimate must be disclosed if the following two criteria are met. [275-10-50-8]

Criterion 1: near-term change is reasonably possible	It is reasonably possible (i.e. more than remote) that the estimate of the effect on the financial statements of a condition, situation or set of circumstances will change in the near term.
Criterion 2: materiality	The effect of the change would be material to the financial statements.

In this chapter, estimates that meet these two criteria are referred to as 'significant estimates'. Section 7.5.20 provides examples of estimates. Section 7.5.30 illustrates relevant disclosures. Section 7.7 illustrates how certain external events may affect significant estimates.

Question 7.5.10

How does an entity assess if an estimate is significant for disclosure purposes?

Interpretive response: Assessing whether an estimate is significant requires judgment. The assessment takes into consideration information known to management before the financial statements are issued (available to be issued). See Question 7.2.50.

Criterion 1: near-term change is reasonably possible

Criterion 1 sets a low bar to identify potential changes in estimated amounts. Reasonably possible means that the likelihood of the change is more than remote – i.e. it can be less than likely. However, the focus is on near-term potential changes (see Question 7.2.30). [275-10-50-8, 275-10 Glossary]

Criterion 2: materiality

If Criterion 1 is met, the entity then assesses whether the potential change in the estimated amount could be material. See Question 2.4.50 for a general discussion of materiality in the financial statements. Materiality in the context of this question is evaluated based on the effect that using a different estimate would have had on the financial statements. This means the amount actually reported in the financial statements is not relevant to this evaluation; only the amount by which the financial statements would be affected by a change in estimate is relevant. [275-10-50-8, 50-14]

It follows that even estimates that are not recognized may require disclosure – e.g. an asset is not impaired but a change in circumstance could cause a near-term material impairment loss. [275-10-50-13]

Question 7.5.20

Can risk-reduction techniques be considered in evaluating whether an estimate is significant?

Background: Entities may use a variety of risk-reduction techniques to minimize risks to which they are exposed. For example, an entity that is party to derivative contracts may require counterparties to post additional collateral based on changes in fair value. The entity may determine that this policy reduces the likelihood or effect of a potential default on its outstanding receivables. Another example of a risk-reduction technique is obtaining insurance.

Interpretive response: Yes. An entity that uses risk-reduction techniques generally may consider those techniques when evaluating if an estimate is significant. If the entity concludes that its risk-reduction techniques reduce the estimate volatility so that the effect of a potential change is no longer material, the entity need not make the significant estimate disclosures outlined in Question 7.5.40. However, Topic 275 encourages entities to make those disclosures, together with information about the risk-reduction techniques. [275-10-50-10]

Question 7.5.30

How is Criterion 2 for significant estimates applied to the estimate of an intangible or long-lived asset's useful life?

Interpretive response: An entity needs to evaluate whether the estimated useful life of an intangible asset meets the criteria for disclosure as a significant estimate. We believe this requirement applies equally to long-lived assets. In applying Criterion 2 (materiality criterion), an entity considers whether the effect of either of the following potential changes would be material: [275-10-50-15A]

- a change in the asset's useful life; or
- a change in the expected likelihood of renewal or extension of the asset.

This assessment is made both on an individual asset-by-asset basis and in the aggregate by major asset class. [275-10-50-15A]

Question 7.5.40

What disclosures are required for significant estimates including loss contingencies?

Interpretive response: As explained in Question 7.2.20, other Topics may require specific disclosures for estimates in their scope. Topic 275 disclosures complement these requirements and vary slightly based on the nature of the estimate as summarized below. [275-10-50-9, 50-11]

	Loss contingencies disclosed under Topic 450 (i.e. unrecognized)	Other loss contingencies in scope of Topic 450	Other estimates
Nature of the uncertainty [275-10-50-9]	✔	✔	✔
Nature of the estimate [275-10-50-11]	N/A	N/A	✔
Quantitative disclosure [275-10-50-9]	Estimate of the possible loss or range of loss or, if applicable, a statement that such an estimate cannot be made.	Estimate of the possible loss or range of loss or, if applicable, a statement that such an estimate cannot be made.	Estimate of the effect of the reasonably possible change.
Indication that: (but the words 'reasonably	It is at least reasonably possible that future events confirming the fact of the loss or the	It is at least reasonably possible that a change in the estimate will	It is at least reasonably possible that a change in the

	Loss contingencies disclosed under Topic 450 (i.e. unrecognized)	Other loss contingencies in scope of Topic 450	Other estimates
possible' need not be used) [275-10-50-9, 50-12]	change in the estimated amount of the loss will occur in the near term.	occur in the near term.	estimate will occur in the near term.

Topic 450 does not distinguish between short-term and long-term contingencies. Therefore, loss contingencies disclosed under Topic 450 may still require disclosure under Topic 275, if a material change in the loss contingency is reasonably possible in the near term. [275-10-50-11, 50-12]

Disclosure of factors that cause the estimate to be sensitive to change is encouraged but is not required. [275-10-50-9]

Topic 275 does not prescribe where in the notes the disclosure of significant estimates should be included (see Question 7.2.60). Each significant estimate is generally disclosed in the note disclosure made pursuant to requirements of other Topics addressing the estimate. For example, risks and uncertainties related to the net realizable value of inventory would generally be placed in the inventory note.

7.5.20 Examples of estimates

Excerpt from ASC 275-10

> Certain Significant Estimates

50-15 The following are examples of assets and liabilities and related revenues and expenses, and of disclosure of gain or loss contingencies included in financial statements that, based on facts and circumstances existing at the date of the financial statements, may be based on estimates that are particularly sensitive to change in the near term:

a. Inventory subject to rapid technological obsolescence
b. Specialized equipment subject to technological obsolescence
c. Valuation allowances for deferred tax assets based on future taxable income
d. Capitalized motion picture film production costs
e. Capitalized computer software costs
f. Deferred policy acquisition costs of insurance entities
g. Valuation allowances for commercial and real estate loans
h. Environmental remediation-related obligations
i. Litigation-related obligations
j. Contingent liabilities for obligations of other entities
k. Amounts reported for long-term obligations, such as amounts reported for pensions and postemployment benefits

l. Estimated net proceeds recoverable, the provisions for expected loss to be incurred, or both, on disposition of a business or assets

m. Amounts reported for long-term contracts.

The above list is not intended to be all-inclusive. See Section 275-10-60 for links to illustrations of the disclosure requirements that are contained in other Topics.

The above FASB excerpt provides examples of estimates that may be particularly sensitive to change in the near term. Other examples are included below (not exhaustive). The nature and extent of risks and uncertainties disclosures will depend on the entity's specific facts and circumstances.

Topic	Estimate examples
Investments	• Fair value of financial instruments including fair value measurements that involve significant unobservable inputs – e.g. measurements that fall within Level 3 of the fair value hierarchy in Topic 820 (fair value measurement). See KPMG Handbook, Fair value measurement. • Impairment of equity investments without readily determinable fair values. See section 2.3.40 of KPMG Handbook, Investments. • Allowance for credit losses for debt securities, including estimates of the timing and amount of cash flows and the extent of deterioration in the issuer's creditworthiness (post-adoption of ASU 2016-13). See chapter 19 of KPMG Handbook, Credit impairment.
Loans, accounts receivables and related allowances	• Allowance for credit losses for accounts and loans receivable. See KPMG Handbook, Credit impairment. • Fair value of the collateral when the collateral dependent practical expedient is applied – e.g. loans secured by real estate for which foreclosure is probable. See chapter 10 of KPMG Handbook, Credit impairment.
Inventory	• Costing estimates – e.g. merchandise accounted for under the retail method • Net realizable value
Derivatives and hedging	• Likelihood of a forecasted transaction occurring in a cash flow hedging relationship and the effect on the continuation of hedge accounting and potential reclassification of amounts from AOCI into earnings. See sections 9.3 and 10.5 of KPMG Handbook, Derivatives and hedging. • Effects of counterparty credit risk and the entity's own nonperformance risk in the measurement of fair value of derivative instruments and on the assessment of hedge effectiveness. See section O of KPMG Handbook, Fair value measurement and

Topic	Estimate examples
	section 13.2 of KPMG Handbook, Derivatives and hedging. • For fair value hedges of unrecognized firm commitments, assessment of whether performance of the firm commitment remains probable and the effects on the continuation of hedge accounting. See section 7.3.20 of KPMG Handbook, Derivatives and hedging.
Income taxes	• Entity's ability to leave undistributed earnings indefinitely invested in a foreign subsidiary – i.e. the indefinite reversal criterion in paragraph 740-30-25-17. See section 7 of KPMG Handbook, Accounting for income taxes. • Outcome of income taxes uncertainties (i.e. tax positions) under paragraphs 740-10-25-5 to 25-17 and 740-10-30-7. See section 3 of KPMG Handbook, Accounting for income taxes. • Future taxable income when assessing the need for a valuation allowance. See section 4 of KPMG Handbook, Accounting for income taxes.
Long-lived assets	• Useful life (see Question 7.5.30) • Residual value • Estimates of whether the carrying amount of a long-lived asset (asset group) is recoverable based on entity-specific estimated future cash flows (Step 1 of the impairment test). See chapter 7 of KPMG Handbook, Impairment of nonfinancial assets. • Fair value of a long-lived asset (asset group), which reflects market participant assumptions (Step 2 of the impairment test). See chapter 8 of KPMG Handbook, Impairment of nonfinancial assets. • Risk that an impairment triggering event will occur in the near term. See chapter 4 of KPMG Handbook, Impairment of nonfinancial assets.
Goodwill and indefinite-lived intangible assets	• Fair value used in impairment tests. See chapter 8 of KPMG Handbook, Impairment of nonfinancial assets. • Qualitative assessments of goodwill and indefinite-lived intangible assets. See chapter 6 of KPMG Handbook, Impairment of nonfinancial assets. • Risk that an impairment triggering event will occur in the near term. See chapter 4 of KPMG Handbook, Impairment of nonfinancial assets.
Pension assets and obligations	• Fair value measurements of financial assets in an inactive market, including measurements using significant unobservable inputs (e.g. Level 3 inputs). See section M of KPMG Handbook, Fair value measurement.

Topic	Estimate examples
	• Discount rates, expected return on plan assets and other actuarial assumptions. See chapters 7 and 8 of KPMG Handbook, Employee benefits. • Uncertainties affecting plan and plan sponsor liquidity, including potential requirements for additional contributions.
Debt	• Fair value measurements of an entity's own debt for Subtopic 825-10 disclosure purposes or in the financial statements if the fair value option is elected under Subtopic 825-10. See chapter 3 of KPMG Handbook, Investments.
Revenue	• Collectibility of payments. See section 3.3 of KPMG Handbook, Revenue recognition. • Estimates of transaction price, including amount and constraining of variable consideration, price concessions, effect of right of return, non-cash consideration. See chapter 5 of KPMG Handbook, Revenue recognition. • Costs to be incurred under a cost-to-cost method or other measures of progress. See section 7.4 of KPMG Handbook, Revenue recognition. • Recoverability of capitalized costs and their amortization period. See chapter 12 of KPMG Handbook, Revenue recognition.
Leases	• Collectibility of lease payments (and any amount necessary to satisfy a residual value guarantee). See section 7.5 of KPMG Handbook, Leases. • Residual value of leased assets. See section 5.4.6 of KPMG Handbook, Leases.
Other	• Estimates of liabilities from joint and several obligations under Subtopic 405-40 • Self-insurance reserves • Insurance recoveries – e.g. for business interruption • Assumptions in measuring the fair value of share-based payments. See section 2 of KPMG Handbook, Share-based payment. • Bonus plans and share-based payment arrangements based on achieving certain targets. See section 2 of KPMG Handbook, Share-based payment. • Determination of whether a reconsideration event has occurred that requires an evaluation of (1) whether an entity is a variable interest entity and (2) the identity of the primary beneficiary under Subtopic 810-10 (consolidation). See section 4.8 of KPMG Handbook, Consolidation. • Estimates of potential liabilities associated with recourse obligations

7.5.30 Example disclosures

Topic 275 does not illustrate the disclosure of significant estimates but refers to other places in the Codification where illustration is provided. The following table summarizes the fact patterns illustrated by example FASB significant estimate disclosures and the corresponding implementation guidance. [275-10-60-3 – 60-11]

Significant estimate	Fact pattern illustrated
Inventory net realizable value [330-10-55-8]	Potentially excess quantities of inventory at the reporting date and reasonable possibility that management's plan to liquidate its excess inventory without a loss will be less than fully successful.
Environmental remediation liabilities [410-30-55-11]	Soil contamination problem at the reporting date and indication that the liability is susceptible to change in the near term.
Contingent litigation loss [450-20-55-36]	A suit filed against the entity at the reporting date that could be resolved within one year with a loss in excess of that accrued.
Guarantee of third-party debt [460-10-55-25]	Written guarantee at the reporting date and reasonable possibility that the third party will default on its debt payment and that the entity will become responsible for a portion of the amounts due. See also Example 7.5.20.
Realizability of deferred tax asset [740-10-55-220]	Deferred tax asset for loss carryforwards considered realizable at the reporting date that could be reduced in the near term if estimates of future taxable income during the carryforward period are reduced. See also paragraph 9.113 of KPMG Handbook, Accounting for income taxes.
Capitalized software costs amortization [985-20-55-23]	Capitalized software costs amortized using future gross revenues and remaining estimated economic life for that software product and reasonable possibility that these estimates could be reduced significantly in the near term, thereby reducing the carrying amount of the asset.

Example 7.5.10
Significant estimates – Recoverability of property and equipment

This example only illustrates Topic 275 significant estimate disclosure incremental to the disclosures required by Topic 360 (property, plant and equipment).

Facts

OilCo is an oilfield services company. One of OilCo's asset groups consists of manufacturing operations for offshore drilling rigs and platforms. The asset group has a net book value of $XX million at December 31, Year 1. Due to an oversupply of offshore drilling rigs throughout the second half of Year 1, the demand for and prices of new-build offshore drilling rigs and platforms have fallen dramatically, resulting in an underutilization of OilCo's manufacturing capacity. This underutilization was deemed a triggering event for evaluating the asset group for impairment.

Based on the impairment test performed during the Q4 of Year 1, OilCo did not record impairment charges related to this asset group. However, it is at least reasonably possible that continued excess supply of new-build rigs could significantly affect OilCo's future impairment estimates.

Disclosure

The total net book value of the drilling rig manufacturing asset group is $XX million at December 31, Year 1. Due to an excess supply of rigs in the offshore drilling market and resulting decreased demand for new-build rigs, OilCo assessed the recoverability of the asset group during Q4 of Year 1. OilCo recorded no impairment charges on this asset group in Year 1.

However, it is reasonably possible that OilCo's determination that this equipment is not impaired could change in the near term should the oversupply of offshore drilling rigs persist.

Example 7.5.20
Significant estimates – Guarantee of debt

This example is based on Example 1 in Topic 460. In Example 1, the guarantee has been accrued at the reporting date. By contrast, this example illustrates the disclosure when no liability has been accrued. This example only illustrates Topic 275 significant estimate disclosure incremental to the disclosures required by Topic 460 (guarantees). [460-10-55-25 – 55-27]

Facts

ABC Corp operates a shipping center in Local City. In Year 1, ABC decided to raise money to modernize its facilities through a debt offering. To enable the offering, Manufacturer agreed to guarantee the debt issued by ABC.

In October, Year 5 (four years after issuance, when the bonds had an outstanding balance of $XX million), ABC loses two of its major shipping customers, constituting 35% of its prior-year revenues, due to business failures brought about by a recession. At December 31, Year 5, ABC is directing substantial efforts toward finding new customers. However, it is reasonably possible that ABC will not replace the lost revenue in time to pay debt service installments at June 30 and December 31, Year 6, totaling $X million.

Disclosure by Manufacturer in its Year 5 notes to financial statements

In Year 1, Manufacturer guaranteed the Series AA debt of ABC Corp, which operates a shipping center in Local City. Manufacturer continues as guarantor of this debt, totaling $XX million at December 31, Year 5. During Year 5, ABC has experienced substantial reductions in revenue due to the current economic environment.

It is at least reasonably possible that ABC will be unable to replace lost revenues sufficient to make its June and December, Year 6, debt service payments totaling $X million. In that event, Manufacturer would become responsible for repaying at least a portion of that amount and possibly additional amounts over the debt term. Other than the stand-ready guarantee obligation that was recognized at inception of the guarantee, no additional liability has been reported in Manufacturer's financial statements at December 31, Year 5 because it is not considered probable that ABC will be unable to make required Year 6 debt payments.

Example 7.5.30
Significant estimates – Fair value of financial instruments

This example only illustrates Topic 275 significant estimate disclosure incremental to the disclosures required by Topic 820 (fair value measurement), and Subtopic 825-10 (financial instruments).

Facts

ABC Corp holds debt securities classified as available-for-sale for which limited or no observable market data is available.

Disclosure

Fair value estimates are made at a point in time, based on relevant market data and the best information available about the debt securities. Illiquid credit markets have resulted in inactive markets for certain of ABC's debt securities. As a result, there is no, or limited, observable market data for these assets.

Fair value estimates for debt securities for which no, or limited, observable market data is available are based on judgments about current economic conditions, liquidity discounts, currency, credit and interest rate risks, loss experience, and other factors. These estimates involve significant uncertainties and judgments and cannot be determined with precision. As a result, such fair value estimates may not be realizable in a current sale or immediate settlement of the securities.

In addition, changes in the underlying assumptions used in the fair value measurement technique, including discount rates, liquidity risks and estimates of future cash flows, could significantly affect these fair value estimates in the near term.

Estimates of the fair value of ABC's debt securities are presented in the accompanying tables [not included].

7.6 Vulnerability from certain concentrations

7.6.10 Overview

Excerpt from ASC 275-10

20 Glossary

Severe Impact

(Used in reference to current vulnerability due to certain concentrations.) A significant financially disruptive effect on the normal functioning of an entity. Severe impact is a higher threshold than material. Matters that are important enough to influence a user's decisions are deemed to be material, yet they may not be so significant as to disrupt the normal functioning of the entity. Some events are material to an investor because they might affect the price of an entity's capital stock or its debt securities, but they would not necessarily have a severe impact on (disrupt) the entity itself. The concept of severe impact, however, includes matters that are less than catastrophic. Matters that are catastrophic include, for example, those that would result in bankruptcy.

> Current Vulnerability Due to Certain Concentrations

50-16 Vulnerability from concentrations arises because an entity is exposed to risk of loss greater than it would have had it mitigated its risk through diversification. Such risks of loss manifest themselves differently, depending on the nature of the concentration, and vary in significance. Financial statements shall disclose the concentrations described in paragraph 275-10-50-18 if, based on information known to management before the financial statements are issued or are available to be issued (as discussed in Section 855-10-25), all of the following criteria are met:

a. The concentration exists at the date of the financial statements.
b. The concentration makes the entity vulnerable to the risk of a near-term **severe impact**.
c. It is at least reasonably possible that the events that could cause the severe impact will occur in the near term.

50-17 This Subtopic requires disclosure of certain defined concentrations known to management rather than a wider range of concentrations based on information of which management is reasonably expected to have knowledge.

50-18 Concentrations, including known group concentrations, described below require disclosure if they meet the criteria of paragraph 275-10-50-16. (Group concentrations exist if a number of counterparties or items that have similar economic characteristics collectively expose the reporting entity to a particular kind of risk.) Some concentrations may fall into more than one of the following categories:

a. Concentrations in the volume of business transacted with a particular customer, supplier, lender, grantor, or contributor. The potential for the severe impact can result, for example, from total or partial loss of the business relationship. For purposes of this Subtopic, it is always considered at least reasonably possible that any customer, grantor, or contributor will be lost in the near term.
b. Concentrations in revenue from particular products, services, or fund-raising events. The potential for the severe impact can result, for example, from volume or price changes or the loss of patent protection for the particular source of revenue.
c. Concentrations in the available sources of supply of materials, labor, or services, or of licenses or other rights used in the entity's operations. The potential for the severe impact can result, for example, from changes in the availability to the entity of a resource or a right.
d. Concentrations in the market or geographic area in which an entity conducts its operations. The potential for the severe impact can result, for example, from negative effects of the economic and political forces within the market or geographic area. For purposes of this Subtopic, it is always considered at least reasonably possible that operations located outside an entity's home country will be disrupted in the near term.

50-19 Concentrations of financial instruments, and other concentrations not described in the preceding paragraph, are not addressed in this Subtopic. However, these other concentrations may be required to be disclosed pursuant to other Topics, such as Subtopic 825-10.

50-20 Disclosure of concentrations meeting the criteria of paragraph 275-10-50-16 shall include information that is adequate to inform users of the general nature of the risk associated with the concentration. For those concentrations of labor (see paragraph 275-10-50-18(c)) subject to collective bargaining agreements and concentrations of operations located outside of the entity's home country (see paragraph 275-10-50-18(d)) that meet the criteria in paragraph 275-10-50-16, the following specific disclosures are required:

a. For labor subject to collective bargaining agreements, disclosure shall include both the percentage of the labor force covered by a collective bargaining agreement and the percentage of the labor force covered by a collective bargaining agreement that will expire within one year.
b. For operations located outside the entity's home country, disclosure shall include the carrying amounts of net assets and the geographic areas in which they are located.

This Subtopic does not, however, prohibit entities from also stating in disclosures of concentrations related to customers, grantors, or contributors or operations located outside the entity's home country that the entity does not expect that the business relationship will be lost or does not expect that the foreign operations will be disrupted if such is the case.

50-21 Adequate information about some concentrations may already be presented in other parts of the financial statements. For example, adequate information about assets or operations located outside the entity's home country may be included in disclosures made to comply with Subtopic 280-10. In accordance with the guidance in this Subtopic, such information need not be repeated.

50-22 See Examples 2 and 4 through 8 (paragraphs 275-10-55-4 and 275-10-55-8 through 55-19) for illustrations of the disclosure requirements for current vulnerability due to certain concentrations.

Vulnerability from concentrations may arise when an entity is exposed to risk of loss greater than it would have been exposed to had it mitigated its risk through diversification. This may be the case when an entity's supply chain, workforce or customer base depends on a particular geography or market. For example, when an entity sells a third of its product to a single distributor, the loss of that distributor can have a significant impact on the entity's revenue, profit and cash flows.

Vulnerability from certain concentrations is disclosed if the following criteria are met. [275-10-50-16]

Criterion 1: current concentration	The concentration exists at the reporting date.
Criterion 2: materiality	The concentration makes the entity vulnerable to the risk of a near-term 'severe impact'.
Criterion 3: near-term reasonable possibility	It is at least reasonably possible that the events that could cause the severe impact will occur in the near term.

In this chapter, concentrations that meet these three criteria are referred to as 'significant concentrations'. Section 7.6.20 illustrates relevant disclosures. Section 7.7 illustrates how certain external events may affect significant concentrations.

Question 7.6.10

What types of concentrations are in the scope of Topic 275?

Interpretive response: There are four types of concentrations in the scope of Topic 275, meaning such concentrations must be evaluated using the disclosure criteria for significant concentrations. [275-10-50-18]

Volume-based	Revenue-based
Concentrations in the volume of business transacted with a particular customer, supplier, lender, grantor or contributor.	Concentrations in revenue from particular products, services or fundraising events.

Supply-based	Market and geography-based
Concentrations in the available sources of materials, labor or services, or of licenses or other rights used in the entity's operations.	Concentrations in the market or geographic area in which the entity operates.

Concentrations of financial instruments and other concentrations are not subject to disclosure under Topic 275 but may have to be disclosed under other Topics. For example, Topic 825 requires disclosure of all concentrations of credit risk in financial instruments, even if they do not make the entity vulnerable to the risk of a near-term severe impact. [275-10-50-19, 825-10-50-20 – 50-22]

Question 7.6.20

When is a concentration significant for disclosure purposes?

Interpretive response: Assessing whether a concentration that exists at the reporting date is significant and needs to be disclosed under Topic 275 requires judgment. The assessment takes into consideration information known to management before the financial statements are issued (available to be issued). See Question 7.2.50.

Criterion 2: materiality

Criterion 2 is met if the concentration makes the entity vulnerable to the risk of a near-term severe impact. Severe impact in this context means a significant financially disruptive effect on an entity's normal functioning. Severe impact is a threshold higher than material but includes matters that are less than catastrophic. [275-10-50-16(b), 275-10 Glossary]

For example, the potential loss of a large supplier may materially impact an entity's results due to price increases but not disrupt the entity's normal functioning because the entity is able to identify and secure agreements with alternative suppliers on a timely basis. In that case, the concentration would not meet the severe impact threshold for disclosure under Topic 275. [275-10-50-16(b)]

Topic 275 does not provide quantitative thresholds for evaluating severe impact; therefore, entities need to exercise judgment when applying the term. [275-10 Glossary]

Criterion 3: near-term reasonable possibility

Criterion 3 sets a low bar to identify potential events that could cause the concentration to have a severe impact. Reasonably possible means that the likelihood of the event is more than remote – i.e. it can be less than likely. However, the focus is on near-term potential events (see Question 7.2.30). [275-10-50-16, 275-10 Glossary]

The entity assesses how it is positioned to handle the risks and uncertainties associated with concentration. For example, if the entity's supply of materials is concentrated in a single supplier, could the entity readily shift to alternative sources in the next 12 months without a significant impact to costs? If so, the entity may determine that the concentration will not produce a reasonably possible severe impact in the upcoming year. [275-10-55-12]

However, this criterion is automatically met for: [275-10-50-16, 50-18]

- volume concentrations involving customers, grantors or contributors because it is always considered at least reasonably possible that any customer, grantor or contributor will be lost in the near term;
- geographic concentrations involving foreign operations because it is always considered at least reasonably possible that operations located outside an entity's home country will be disrupted in the near term.

This means that Criterion 3 is deemed met in these two instances and disclosure is required if Criterion 2 is also met (see Question 7.6.30).

Question 7.6.30
What disclosures are required for significant concentrations?

Interpretive response: The general disclosure requirement applicable to all significant concentrations, and the additional disclosures required for two types of significant concentrations are listed in the following table. [275-10-50-20]

General disclosure requirement	Information that is adequate to inform users of the general nature of the risk associated with any concentration that meets the disclosure criteria.
Labor concentrations subject to collective bargaining agreements	• The percentage of the labor force covered by a collective bargaining agreement. • The percentage of the labor force covered by a collective bargaining agreement that will expire within one year.
Operations located outside of an entity's home country	• Carrying amounts of net assets. • The geographic areas in which the assets are located. However, the entity may also state that it does not expect that the foreign operations will be disrupted.

However, if the entity does not believe that business relationships will be lost or foreign operations will be disrupted, disclosures of concentrations involving customers, grantors or contributors or foreign operations can include a statement to that effect. [275-10-50-20]

Topic 275 does not prescribe where in the notes the disclosure of significant concentrations should be included (see Question 7.2.60). Certain concentrations may already be disclosed elsewhere in the financial statements, as required under other Topics. For example, entities in scope of Topic 280 may disclose market- or geography-based concentrations in the segment reporting note (see chapters 6 and 8 of KPMG Handbook, Segment reporting). Revenue disaggregation disclosures required under Topic 606 may also help address the revenue-based concentration disclosure under Topic 275 (See section 15.3 of KPMG Handbook, Revenue recognition). Such information would not need to be repeated in a risks and uncertainties note if all requirements under Topic 275 have been sufficiently addressed. [275-10-50-19, 50-21, 606-10-55-89 – 55-91, 606-10-55-296 – 55-297]

7.6.20 Example disclosures

The following FASB excerpts provide examples of how to apply the disclosure criteria for significant concentrations to specific facts. Where the example concludes that disclosure is necessary, it also gives sample disclosure language. Example 2 illustrates how the disclosure for both customer concentration and nature of operations may be combined.

Following the FASB excerpts is an example of concentration disclosures involving inventory, revenue and accounts receivable.

Excerpt from ASC 275-10

• > Example 2: Combined Disclosure—Nature of Operations and Customer Concentration

55-4 This Example illustrates the disclosures required by paragraphs 275-10-50-2 and 275-10-50-16. Smith Corporation, formerly Smith Munitions Corporation, was founded in 1940. At that time, Smith's principal business was the design and manufacture of artillery ammunition and other explosives. In 1959, commensurate with the evolution of its principal business to the design, engineering, and manufacture of military aircraft for sale to the U.S. government, Smith changed its name to Smith Corporation. Smith has one factory, located in New York. The following illustrates disclosure of the nature of operations required by this Subtopic.

> Smith Corporation is engaged principally in the design, engineering, and manufacturing of military aircraft and related peripheral equipment for sale primarily to the U.S. government.

55-5 This disclosure provides all of the following:

a. Information needed by users who are not familiar with the operations of Smith Corporation to identify and consider the broad risks and uncertainties faced by all or most entities operating in a specific business or market, which in this case is the defense contracting business. From this disclosure, financial statement users having a general knowledge of business matters should know that Smith's business may be heavily affected by future changes in U.S. defense and foreign policies.
b. Information that aids in the overall understanding of the other financial information presented. Certain accounting procedures involving estimation may apply only to particular industries or may be relevant in comparing a business entity's financial statements with those of business entities in other industries.
c. Insight into the location of Smith's principal product markets and information about its current vulnerability due to concentrations. Users would be able to recognize and assess Smith's dependency on sales to the U.S. government (assuming the loss of the government as a customer would result in a **near-term severe impact** to Smith Corporation).

• > Example 4: Supplier or Sources of Supply—Electronic Equipment

55-8 This Example illustrates the disclosures required by paragraph 275-10-50-16. Hi-Tech Corporation is a manufacturer of electronic equipment in which integrated circuits are an important component. Substantially all of Hi-Tech's customers require that only those vendors that meet quality criteria be used as sources for integrated circuits. Hi-Tech currently buys all of its integrated circuits from one manufacturer in the Far East, and no long-term supply contract exists. There are only a limited number of manufacturers of these particular integrated circuits, and a change of supplier could significantly disrupt the business due to the time it would take to locate and qualify a new vendor. The following illustrates the disclosure required by this Subtopic.

> The entity currently buys all of its integrated circuits, an important component of its products, from one supplier. Although there are a limited number of manufacturers of the particular integrated circuits, management believes that other suppliers could provide similar integrated circuits on comparable terms. A change in suppliers, however, could cause a delay in manufacturing and a possible loss of sales, which would affect operating results adversely.

55-9 Although other sources of supply of this particular kind of integrated circuit are currently available, the limited number of such sources and the time it takes to qualify new vendors makes Hi-Tech currently vulnerable to the risk of a near-term severe impact. Disclosure is required because it is considered at least **reasonably possible**, based on information known to management before the financial statements are issued or are available to be issued (as discussed in Section 855-10-25), that the events that could cause the severe impact will occur.

• > Example 5: Supplier or Sources of Supply—Wheat

55-10 This Example illustrates the disclosures required by paragraph 275-10-50-16. Minnesota Company manufactures various products in which wheat is an important raw material. It currently buys 80 percent of its wheat from one supplier, but numerous alternate sources of supply are readily available on comparable terms.

55-11 No disclosure is required.

55-12 The concentration exists at the date of the financial statements, and an inability to obtain wheat could result in a near-term severe impact. No disclosure is required, however, because numerous alternative suppliers are available and, therefore, it is not considered at least reasonably possible that events that could cause a near-term severe impact will occur.

• > Example 6: Patent Expiration

55-13 This Example illustrates the disclosures required by paragraph 275-10-50-16. Felt Pharmaceutical Company is a national pharmaceutical manufacturer headquartered in Atlanta, Georgia. Felt markets a wide range of pharmaceutical products. One of its better-known name-brand products, a significant source of profits and cash flow, is an antibiotic on which there is a patent that will expire in six months. Competitors are preparing to enter the market with generic alternatives when Felt's patent expires, and the concentration therefore has the potential for a severe impact. The following illustrates the disclosure required by this Subtopic.

> Felt Pharmaceutical Company is a national pharmaceutical manufacturer with sales throughout the United States. The patent on one of its major products expires next year. This product accounts for approximately one-third [or "a significant portion"] of the entity's revenues and a higher percentage of its gross profit.

55-14 The disclosure focuses on the nature of the business and on Felt's current vulnerability due to a concentration of its patented products. Disclosure is required because the concentration exists at the date of the financial statements, because the effect on Felt's cash flows and profitability of competitors entering the market when the patent expires could be a severe impact, and because it is considered at least reasonably possible that the events that could cause the severe impact will occur in the near term. Because the risk is evident from the description of the concentration, no further explanation of the risk is necessary.

• > Example 7: Source of Supply of Labor

55-15 This Example illustrates the disclosures required by paragraph 275-10-50-16. Team Company is a manufacturer of industrial hardware. The contract with the union representing Team's labor force is due to expire in the coming year. Over the past 30 years, Team has, in rare instances, been affected by work stoppages in the course of contract negotiations; the stoppages have always been of short duration, and none has had a significant effect on Team's financial statements. Although management expects that there will initially be some differences between its offer to the union and union demands, based on preliminary discussions with union leaders, management believes it is very unlikely that those differences will result in a protracted conflict.

55-16 No disclosure is required.

55-17 Although the concentration of labor exists at the date of the financial statements and it could result in a severe impact in the near term due to the potential of a protracted work stoppage, no disclosure is required because it is not considered at least reasonably possible in the light of past experience and current conditions that a protracted work stoppage will take place.

• > Example 8: Geographic Area of Operations

55-18 This Example illustrates the disclosures required by paragraph 275-10-50-16. Offshore Productions, Inc., a Delaware corporation, designs and manufactures optical lenses, which it markets throughout the United States. Substantially all of its manufacturing operations are carried out in a single facility, which is located in Switzerland and which is owned by Offshore's subsidiary. Offshore does not carry insurance for risks of loss. Offshore's consolidated balance sheet includes $20 million representing the net assets of those operations. The following illustrates the disclosure required by this Subtopic.

> Included in the entity's consolidated balance sheet at December 31, 20X4, are the net assets of the entity's manufacturing operations, all of which are located in a single facility in Switzerland and which total approximately $20 million.

55-19 All of Offshore's specialized manufacturing capacity is concentrated in a single facility. As noted in paragraph 275-10-50-18, it is always considered at least reasonably possible that the use of a facility located outside of an entity's home country could be disrupted in the near term. Due to the specialized nature of the assets, it would not be possible to find replacement capacity quickly. Accordingly, loss of the facility could produce a near-term severe impact to Offshore. This disclosure informs financial statement users of that concentration of operations in a particular geographic area and informs them of the risks and uncertainties associated with the concentration. Because the concentration is one of operations located outside of Offshore's home country, the disclosure also sets forth the carrying amount of the net assets, as required by this Subtopic.

Excerpt from ASC 958-605

• > Example 12: Reliance on a Major Donor

55-69 This Example illustrates the disclosure requirements of paragraphs 275-10-50-16.

55-70 Zebra Zoo is supported by contributions from the public. In the current year, 2 contributors provided 35 percent of Zebra Zoo's combined revenues. The following disclosure is required (see paragraph 275-10-50-16) because the two contributors provided a significant portion of Zebra Zoo's revenues. It is always considered reasonably possible that a customer, grantor, or contributor will be lost in the near term.

> Approximately 35 percent of Zebra Zoo's combined revenues were provided by 2 contributors.

Example 7.6.10
Concentrations of inventory, revenue and accounts receivable

This example illustrates how the disclosure of significant concentrations and significant estimates required under Topic 275 can be combined with the disclosure of concentration of credit risk in accounts receivables under Topic 825.

Facts

Manufacturer manufactures parts used to produce automobiles and parts for sale to the automotive aftermarket. It derives approximately 45% of its Year 1 revenues from automobile manufacturing product line sales to one customer, MotorCo. During Year 1, sales of MotorCo's automobiles decreased significantly due to the inability of MotorCo's own customers to obtain credit and the general slowdown in consumer spending.

At December 31, Year 1, Manufacturer has sufficient inventory to fulfil MotorCo's inventory needs in the near term at the decreased Year 1 production levels brought about by the lower sales. This inventory ($XX million) represents approximately 50% of Manufacturer's total inventory at that date. The remaining 50% of inventory consists of products not affected by MotorCo's decreased production of automobiles.

MotorCo has approximately $XX million of outstanding accounts receivable not past due at December 31, Year 1. Currently, MotorCo continues to pay Manufacturer.

Disclosure by Manufacturer (post-adoption of ASU 2016-13 regarding credit losses)

At December 31, Year 1, approximately $XX million or 50% of Manufacturer's inventory represents parts manufactured specifically for one customer, and accounts receivable from that customer approximate $XX million. Year 1 revenues and gross profit from sales to the customer represent 45% and 40% of revenue and gross margin, respectively.

Manufacturer's December 31, Year 1 inventory level is sufficient to supply this customer's Year 2 production needs based on demand levels experienced during the last half of Year 1. These inventories are measured at the lower of cost or net realizable value. Estimates relating to the net realizable value of these inventories are based on the assumption that this customer's production will continue at or near these reduced levels.

Similarly, the allowance for credit loss on this customer's accounts receivables is based on the customer's current payment patterns, current aging of receivables, the amount of accounts receivable in dispute, and historical collection percentages, adjusted to take into account asset specific risk characteristics, current market conditions, reasonable and supportable expectations of future considerations and the customer's current financial situation.

Recent economic conditions during Year 1 have changed consumers' demand for certain of the products that this customer produces. In addition, credit market tightening has reduced the availability of financing for many consumers. These factors, combined with the general slowdown in consumer spending caused by uncertainty about future market conditions, continue to adversely affect this customer's profits and cash flows.

As such, it is reasonably possible that the customer's production levels will decrease significantly from the current levels in the near term. The inventory, accounts receivable, and revenue losses resulting from this customer's further production cuts may have a severe effect on Manufacturer's operations.

7.7 Impact of external events on risks and uncertainties disclosures

Over the years, the SEC staff has commented on the risks and uncertainties entities may face as a result of certain large-scale external events such as financial crises, Brexit, reference rate (LIBOR) reform, COVID-19, climate change and cyber threats.

These global events may impact risks and uncertainties disclosures. The nature and extent of risks and uncertainties disclosures will depend on the entity's specific facts and circumstances.

Registrants should also consider how these events impact their risk factors and other risks and uncertainties disclosures outside the financial statements.

Question 7.7.10
How can external events impact the functioning of an entity?

Interpretive response: The following matrix illustrates potential impacts of external events on the functioning of an entity. The nature and extent of such impacts depends on the entity’s specific facts and circumstances.

Risk category	Impact examples
Customer demand	• Reduced customer spending • Change in customer behaviors and expectations • Pricing pressures
Supply chain	• Shortages in machinery, key components or raw materials • Lack of alternative sourcing arrangements • Regulatory or practical restrictions on imports/exports due to borders closing or customs • Extended shipment or production times • Rising material costs – e.g. raw materials, commodities or freight costs
Operations	• Production delays or shortages • Plant or office closures or relocation • Rising operating costs – e.g. health and safety or repairs
People	• Labor shortages or talent recruitment and retention challenges • Rising compensation costs • Degraded labor relations
Assets	• Damage to brand reputation • Loss of assets – e.g. through physical destruction, abandonment, theft, seizing or change in regulation • Loss in assets' value – e.g. obsolescence, reduced fair value, reduced residual value or reduced useful life • Rising protection or remediation costs
Credit/ liquidity	• Illiquid credit markets • Rising costs of debt or capital • Customer and other debtor's defaults • Exchange control – e.g. restrictions on cash repatriation from foreign jurisdictions
Market	• Volatile or depressed stock, currency, debt, commodities markets • Rising inflation or hyperinflation
Regulatory/ compliance	• Unstable or unfavorable regulations – e.g. capital regimes, employment laws, carbon emissions schemes, income tax regimes, tariffs • Changing contract terms • Increased litigation

7.7.10 Uncertain environments

COVID-19, natural disasters, geopolitical events and inflation are just some of the major issues driving global economic uncertainty today.

Question 7.7.20

What are some potential disclosable risks and uncertainties related to uncertain economic conditions or downturns?

Interpretive response: Uncertain economic conditions or economic downturns may create conditions such as illiquid credit markets; volatile equity, foreign currency and energy markets; and reduced consumer spending. As a consequence, entities may face the near-term prospect of declining profitability, negative operating cash flows, credit agreement defaults, regulatory capital pressures, changes to trade credit arrangements with vendors, and a general lack of available commercial credit.

These risks might particularly affect estimates that involve fair value measurements, projected growth assumptions used in asset impairment tests, expected credit losses on loans and receivables, and recoverability tests of deferred tax assets. The going concern assumption may also be at risk; see KPMG Handbook, Going concern. Fair value disclosures required by Topic 820 should also be considered; see section N of KPMG Handbook, Fair value measurement.

Question 7.7.30

What are some potential disclosable risks and uncertainties related to volatile commodity prices?

Interpretive response: Volatile commodity prices (e.g. oil and gas, grains, metals) may cause entities that operate or invest (including loans) in such markets to experience near-term fluctuations in their reserve estimates, impairments of certain properties and decreases in the fair value of their investments. Entities that consume these commodities may face volatile production and operating costs (e.g. rising freight costs due to increased oil prices), which they may they not be able to pass down to their customers, in turn potentially affecting their profitability in the near term.

These risks might particularly affect estimates that involve fair value measurements, projected cash flows used in asset impairment tests, hedging strategies and recoverability tests of deferred tax assets. The going concern assumption may also be at risk; see KPMG Handbook, Going concern. Fair value disclosures required by Topic 820 should also be considered; see section N of KPMG Handbook, Fair value measurement.

7.7.20 Climate change and natural disasters

Question 7.7.40
What are some potential disclosable risks and uncertainties related to climate-related risks?

Background: KPMG Handbook, Climate risk in the financial statements, discusses in-depth how climate risk can impact the financial statements. The following is a summary of the types of climate risk. [TCFD]

Transition risks arise from transitioning to a lower-carbon economy	
Policy and legal risks	Arise from regulatory and legal actions that attempt to constrain adverse effects of climate change or promote adaptation. **Examples:** carbon taxes, emissions reporting obligations, exposure to litigation
Technology risk	Arises from emerging technologies and the resulting demands and disruptions. **Examples:** substitution for lower emissions products and services, unsuccessful investment in new technologies, costs to transition to lower emissions technology
Market risk	Arises from shifts in supply and demand as consumers react to climate change. **Examples:** changes in consumer behavior, increased costs of raw materials, uncertainty in market signals
Reputation risk	Arises from stakeholder perceptions and expectations about an organization's climate-related action or inaction. **Examples:** shifts in consumer preferences, sector-specific stigmatization, increased stakeholder concern

Physical risks arise from discrete weather events and longer-term shifts in climate patterns	
Acute risk	Arises from discrete weather events including increased severity of extreme events. **Examples:** cyclones, hurricanes, floods
Chronic risk	Arises from longer-term shifts in climate patterns. **Examples:** rising sea-levels, increase in mean temperatures, drought

Interpretive response: Typically, climate-related risks have implications beyond the near-term focus of Topic 275 disclosures; however, not all effects are long term and disclosures under other Topics such as Topic 440 (commitments) or Topic 450 (contingencies) are not limited in time.

Climate risk might affect estimates such as long-lived assets' useful lives, lease renewal assumptions, asset retirement obligations and environmental remediation liabilities. For entities with operations exposed to extreme weather events, increased operating costs may affect cash flow projections. Existing concentrations may newly expose the entity to severe loss in the near term or new concentrations may emerge as the entity adapts its supply chain and operations. Because Topic 275 scopes out proposed changes in government regulations, disclosures should focus on the effect of enacted regulations.

Registrants: Reg S-K disclosures outside the financial statements

In September 2021, an illustrative comment letter provided example comments that the SEC staff is sending to companies regarding climate-related disclosures.

More than two years later, the staff continues to probe disclosures. As of mid-November 2023, the staff had sent over 70 letters (and nearly 500 comments) to issuers since the example comment letter was issued. The staff has had follow-up questions on more than half of the comments.

When an issuer has indicated to the SEC staff that disclosures are not material, the staff has often subsequently requested that a quantitative materiality analysis be provided. Disclosure topics where analyses have been requested include carbon credits, the effect of climate change on insurance premiums, and climate-related capital expenditures and compliance costs. In some cases, issuers have agreed to update risk language in their Form 10-K after back-and-forth with the staff.

We recommend using the questions in the illustrative letter to assess planned disclosures. This assessment will help to highlight areas in which disclosures could be strengthened to meet staff expectations. Recent public comment letters to issuers have closely aligned with the illustrative letter questions provided by the SEC staff, including questions on business trends, issuers' sustainability reports versus Form 10-K disclosures, and capital expenditures related to climate-related projects.

See KPMG web article, SEC staff questions quality of climate disclosures.

Future developments

Registrants: Proposed climate-related disclosures

In March 2022, the SEC released a proposed rule intended to provide more consistent, comparable and reliable information so investors can better evaluate the impact of climate-related matters on a registrant. The comment period closed in June 2022. [SEC Rel 33-11042, 34-94478]

The proposed rule would require a registrant to disclose information such as:

- quantitative and qualitative impacts of climate-related events, conditions and transition activities in the notes to financial statements;
- how climate-related risks have had or are likely to have a material impact on the business;

- greenhouse gas emissions metrics; and
- governance of climate-related risks and relevant risk management processes.

For additional discussion on the proposed rules, see KPMG talk book, Understanding the SEC's climate proposal, and KPMG analysis, Responses to the SEC's climate proposal.

Question 7.7.50
What are some potential disclosable risks and uncertainties related to natural disasters?

Interpretive response: Natural disasters might impact the near-term functioning of the entity in the affected areas due to physical damage to property, site closures, etc. In addition, Question 7.7.10 provides potential downstream impacts of external events such as natural disasters. While property damages or lost revenue from natural disasters may be partially insured, insurance costs might increase as a result.

These events might particularly affect estimates such as long-lived assets' useful lives, impairment assessments, insurance recoveries. Specific disclosures required by other Subtopics may also apply – e.g. Subtopics 410-30 (environmental obligations) and 450-20 (loss contingencies).

Registrants: Reg S-K disclosures outside the financial statements

Reg S-K requires disclosure of material financial and statistical data that will enhance a user's understanding of the registrant's financial condition, cash flows and other changes in financial condition and results of operations. As such, it may be appropriate to provide summarized financial information related to significant operations that have been affected by natural disasters in MD&A. [S-K Item 303(a)]

Natural disasters may also impact disclosures in other periodic reports and registration statement items such as the description of business, which includes a description of human capital resources, property, legal proceedings and risk factors. [S-K Items 101, 102, 103, 105]

7.7.30 Widespread health crises

Question 7.7.60
What are some potential disclosable risks and uncertainties related to widespread health crises?

Background: The ongoing effects of COVID-19 may significantly affect an entity's financial statement estimates, as well as its vulnerability to certain significant concentrations, triggering a need for Topic 275 disclosures.

Interpretive response: As seen with COVID-19, widespread health crises first affect people's health, but may also trigger necessary preventive measures, such as lockdowns or travel restrictions. These crises might create labor shortages in the near term with long-lasting repercussions on operations and supply chains. Operating costs may rise as a result of increased sanitary protocols. Certain revenue sources may be temporarily lost, without possible insurance recovery. Prolonged effects of a health crisis also affect customer behavior in the long run and have the potential to destabilize the economic environment (see Question 7.7.20).

These risks might particularly affect estimates that involve fair value measurements, projected cash flows used in asset impairment tests, hedging strategies and recoverability tests of deferred tax assets. The going concern assumption may also be at risk; see KPMG Handbook, Going concern.

See the dedicated KPMG Financial Reporting View page, Financial reporting impacts of COVID-19, for more specific and up-to-date information about the financial reporting impacts of COVID-19, including SEC disclosure guidance.

Registrants: Reg S-K disclosures outside the financial statements

Through various issued disclosure guidance, statements and speeches, the SEC staff has stated the importance of providing timely, sufficient and accurate information to investors about the effects COVID-19 has and is expected to have on a registrant's business and financial condition, including results of operations, liquidity and capital resources.

Specifically, the SEC's Division of Corporation Finance (Corp Fin) released CF Disclosure Guidance: Topics No. 9 (March 2020) and 9A (June 2020) to address these issues. Further, the Corp Fin staff has cautioned registrants against using boilerplate disclosures without meaningful entity-specific considerations and responses to COVID-19 and failing to discuss the longer-term risks and effects of COVID-19. Disclosure of these risks may be necessary or appropriate in MD&A, business section, risk factors and legal proceedings. Corp Fin has also stressed disclosure surrounding significant judgments and estimates. [2020 AICPA Conf]

7.7.40 Cybersecurity

Question 7.7.70#
What are some potential disclosable risks and uncertainties related to cybersecurity incidents?

Interpretive response: Entities' operations are increasingly exposed to cyber threats. This may disproportionately affect entities that lack sufficient security infrastructure and resources.

In relation to disclosure requirements under Topic 275, we believe entities should consider the following potential financial statement impacts due to an actual or reasonably possible cybersecurity incident. The materiality of cybersecurity risks and incidents depends on a number of factors, from the nature and extent of a security breach to the range of harm caused by the incident. As such, management will need to exercise judgment and carefully evaluate relevant facts and circumstances to determine appropriate disclosures.

- **Remediation costs** including ransomware payments, incentives to customers and business partners, repairs of system damage, increased insurance premiums, public relations support, acquiring new customers, and liability for stolen assets or information
- **Costs related to operational disruption and downtime**
- **Cybersecurity protection costs** including deployment of additional personnel and/or third-party experts, organizational changes, and training
- **Revenue loss** including diminished future cash flows
- **Impairment of assets** due to loss of intellectual property or diminished future cash flows, which can impact goodwill, customer-related intangible assets, trademarks, patents, capitalized software or other long-lived assets associated with hardware or software, and inventory
- **Losses from asserted and unasserted claims** including those related to warranties, breach of contract, product recall and replacement, and indemnification of counterparty losses
- **Litigation and regulatory action** including resulting contingent liabilities from lawsuits and violation of governmental and/or industry-specific regulations
- **Reputational damage**, which can have a wide range of financial statement impacts including loss of current and future customer contracts and decreased credit ratings/increase in cost to raise debt

Registrants: Reg S-K disclosures outside the financial statements

In 2023, the SEC released a rule that increases the timeliness and prominence of required disclosure of cybersecurity incidents in several corporate filings, including annual and quarterly filings and current reports. This guidance codifies some aspects of the SEC guidance released in 2011 and 2018 and requires incremental disclosures. [CFDG 2, SEC Rel 33-10459, 33-11038]

For further discussion, see KPMG Defining Issues, Enhancing cybersecurity disclosures.

7.7.50 Foreign jurisdictions

Question 7.7.80

What are some potential disclosable risks and uncertainties related to foreign jurisdictions?

Interpretive response: Doing business in certain foreign jurisdictions may expose entities to risks disproportionate to the relative size of the foreign operations. Such risks might include currency fluctuations (e.g. hyperinflation or currency devaluation), economic sanctions, political destabilization, armed conflicts, adverse business climates (e.g. corruption) and taxation matters. [2010 AICPA Conf]

When describing the nature of their operations, entities are required to state the locations of their principal markets. This information helps understand how existing geographical concentrations may expose an entity to severe loss in the near term. Also see section 7.7.10 for further guidance on uncertain environments.

Registrants: Reg S-K disclosures outside the financial statements

Registrants should consider disclosing separate financial information about foreign operations at risk (e.g. income, cash flows), qualitative information about business and financial risks, effect of price controls, recent or expected changes in business practices, exchange rates and restrictions on repatriation of funds.

Within MD&A, a registrant is specifically required to disclose reportable segment and other subdivision (e.g. geographic areas) information when necessary to understand its business. In particular, disclosures of material risks and uncertainties may be appropriate when these risks may result in a financial statement impact disproportionate to the relative size of the foreign operations. For example, registrants with operations in highly inflationary environments may need to discuss the impact of inflation if it is part of a known trend or uncertainty that has had or is reasonably likely to have a material impact on financial results. [2010 AICPA Conf, S-K Item 303(b)]

In addition, registrants are required to provide quantitative and qualitative disclosures regarding market risk sensitive instruments. Such disclosures may include a tabular presentation, sensitivity analysis or value at risk analysis of foreign currency exchange rate risk, among other price risks. [S-K Item 305]

7.7.60 Regulatory environment and other

As discussed in Question 7.2.40, only enacted changes in government regulations and issued accounting standards updates are in the scope of Topic 275 disclosures.

Other scenarios discussed in section 7.7, such as climate-related risks and cybersecurity, may also have risks and uncertainties related to enacted regulations. This section discusses potential risks and uncertainties related to regulatory and other events not covered in previous sections.

Question 7.7.90#

What are some potential disclosable risks and uncertainties related to reference rate reform?

Background: The term ‘reference rate reform’ refers to the efforts undertaken by regulators and market participants in various jurisdictions to eliminate certain reference rates and introduce new reference rates that are based on a larger and more liquid population of observable transactions. Most notably, LIBOR has historically been used extensively in the US and globally as a ‘benchmark’ or ‘reference rate’ for various commercial and financial contracts, including corporate and municipal bonds and loans, floating rate mortgages, asset-backed securities, consumer loans, and interest rate swaps and other derivatives.

ICE Benchmark Administration Limited (LIBOR’s administrator) no longer publishes LIBOR settings based on its historical panel methodology; although it publishes certain LIBOR settings using a synthetic methodology, those are expected to cease by the end of 2024. In the US, rates including those based on the Secured Overnight Financing Rate (SOFR) had largely replaced LIBOR as of July 2023. Other interest rates, including some rates prevalent internationally, are also being discontinued. As regulators and market participants seek to avoid business and market disruptions during this period of transition, implementing alternative reference rates has taken on increased urgency.

See KPMG Handbook, Reference rate reform, for further guidance.

Interpretive response: Reference rate reform may require changing the terms of debt, hedging or lease contracts that are indexed to LIBOR. These mitigation efforts may be particularly onerous for entities with large LIBOR-based portfolios (e.g. financial institutions) and could expose them to commercial disputes. The discontinuation of LIBOR may also impact the functioning, liquidity and value of investments in floating rate debt, bank loans, LIBOR-linked derivatives and certain asset-backed securities.

Topic 848 provides relief in accounting for certain aspects of reference rate reform. Its relief is generally available to be applied to eligible contracts and transactions through December 31, 2024. However, it does not address risk disclosures.

The reference rate might particularly affect near-term estimates of investment fair values. It may also impact future discounted cash flows (e.g. increased operating costs induced by the remediation efforts, change in future interest payments when currently indexed to LIBOR, change in discount rate used in valuation models).

Registrants: Reg S-K disclosures outside the financial statements

In a 2019 speech, former SEC Chief Accountant Sagar Teotia explained the consequences and complexity of reference rate reform. [2019 AICPA Conf]

Further, in July 2019 and December 2021, the SEC staff stated that reference rate reform will affect both nonfinancial and financial entities and that it expects registrants to make appropriate disclosures about the effect of reference rate reform, status of LIBOR transition activities and related risks. This may include quantitative disclosures, such as the notional value of contracts referencing LIBOR and extending past 2021. The SEC staff expects these disclosures to evolve over time to reflect continued transition efforts and changes to broader market and regulatory landscapes.

8. Related parties

Detailed contents

New item added in this edition: **
Item significantly updated in this edition: #

8.6 Disclosures of related-party transactions

Questions

8.1 How the standard works

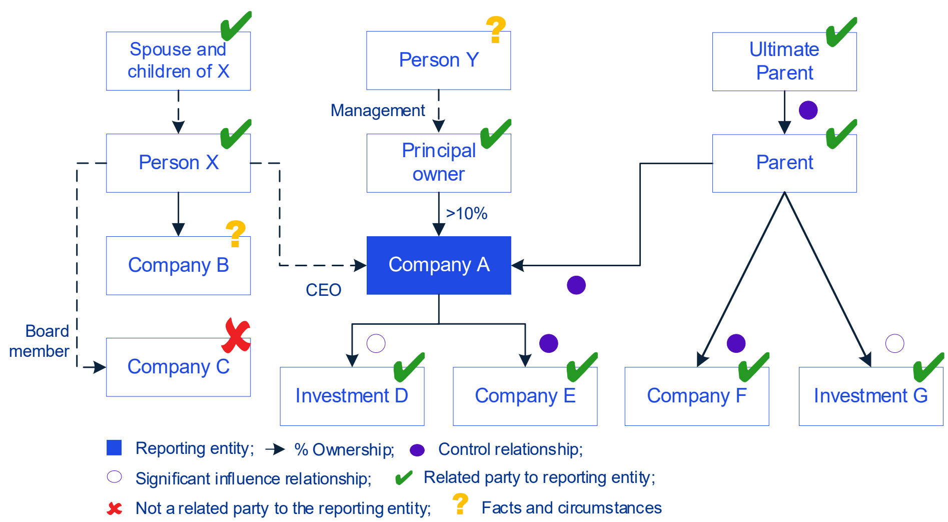
Related-party transactions often occur in the normal course of business, such as purchases and sales among companies of the same group. They are typically accounted for in accordance with their terms, under the same accounting requirements as similar transactions with unrelated parties.

However, related-party transactions cannot be presumed to occur at arm's length because the requisite conditions of a competitive market may not exist. As a result, providing specific information about related-party transactions in the financial statements is key to understanding how an entity's financial performance and financial position may be affected by these transactions.

Topic 850 does not address the accounting for related-party transactions but includes related-party presentation and disclosure requirements incremental to other applicable US GAAP. Registrants have additional related-party requirements in the financial statements and in other filings.

This chapter explains who is a related party, discusses common examples of related-party relationships and transactions, and explains how these transactions are accounted for, presented and disclosed.

The following diagram illustrates common related-party relationships.



8.2 Scope

Excerpt from ASC 850-10

05-1 The Related Party Disclosures Topic provides disclosure requirements for related party transactions and certain common **control** relationships. Accounting and reporting issues concerning certain related party transactions and relationships are addressed in other Topics.

05-2 Information about transactions with **related parties** is useful in comparing an entity's results of operations and financial position with those of prior periods and with those of other entities. It helps users of financial statements to detect and explain possible differences.

05-3 Examples of related party transactions include those between:

a. A parent entity and its subsidiaries
b. Subsidiaries of a common parent
c. An entity and trusts for the benefit of employees, such as pension and profit-sharing trusts that are managed by or under the trusteeship of the entity's **management**
d. An entity and its **principal owners**, management, or members of their **immediate families**
e. **Affiliates**.

05-4 Transactions between related parties commonly occur in the normal course of business. Examples of common transactions with related parties are:

a. Sales, purchases, and transfers of real and personal property
b. Services received or furnished, such as accounting, management, engineering, and legal services
c. Use of property and equipment by lease or otherwise
d. Borrowings, lendings, and guarantees
e. Maintenance of compensating bank balances for the benefit of a related party
f. Intra-entity billings based on allocations of common costs
g. Filings of consolidated tax returns.

05-5 Transactions between related parties are considered to be related party transactions even though they may not be given accounting recognition. For example, an entity may receive services from a related party without charge and not record receipt of the services. While not providing accounting or measurement guidance for such transactions, this Topic requires their disclosure nonetheless.

10-1 Information about transactions with **related parties** that would make a difference in decision making shall be disclosed so that users of the financial statements can evaluate their significance. Therefore, this Topic establishes requirements to disclose certain significant related party transactions and

control relationships. Relevant information is omitted if the disclosures required by this Topic are not made.

> Entities

15-2 The guidance in the Related Party Disclosures Topic applies to all entities.

> Other Considerations

15-3 The guidance in the Related Party Disclosures Topic is limited to disclosures. Accounting and reporting issues concerning certain related party transactions and relationships are addressed in other Topics.

15-4 The requirements of the Related Party Disclosures Topic are applicable to separate financial statements of each or combined groups of each of the following:

a. A parent entity
b. A subsidiary
c. A corporate joint venture
d. A 50-percent-or-less owned investee.

The term 'related party' encompasses certain common control relationships, as well as several other types of relationships between entities or individuals. The assessment of whether an entity or individual is a related party is performed from the standpoint of the reporting entity (see Question 8.3.20).

Generally, related-party transactions are accounted for and disclosed in the same way as transactions with unrelated parties. However, Topic 850 requires certain quantitative and qualitative information about related-party transactions for each related party identified. [850-10-05-3 – 05-5, 10-1]

There are additional presentation and disclosure requirements for registrants.

Question 8.2.10
When do the requirements in Topic 850 apply?

Interpretive response: Topic 850 applies to all entities that prepare separate (often referred to as stand-alone) or combined financial statements. Topic 850 also applies to consolidated financial statements when transactions are with related parties outside of the consolidated group. [850-10-15-2, 15-4]

Question 8.2.20
What are common related-party transactions?

Interpretive response: Related-party transactions include transactions between the following entities and/or individuals: [850-10-05-3]

- a parent entity and its subsidiaries;
- subsidiaries of a common parent (also known as common control relationships);
- an entity and trusts for the benefit of employees such as a pension plan trust;
- an entity and its principal owners, management or members of their immediate families; and
- affiliates.

Related-party transactions often occur in the normal course of business, although they cannot be presumed to be at arm's length. Some examples of related-party transactions are: [850-10-05-4]

- sales, purchases and transfers of real or personal property;
- services received or furnished;
- use of property or equipment;
- borrowings, lendings and guarantees;
- maintenance of compensating bank balances on behalf of a related party;
- intra-entity billings for common costs; and
- filing of consolidated tax returns.

8.3 Who is a related party?

Excerpt from ASC 850-10

20 Glossary

Affiliate

A party that, directly or indirectly through one or more intermediaries, controls, is controlled by, or is under common control with an entity. See **Control**.

Control

The possession, direct or indirect, of the power to direct or cause the direction of the management and policies of an entity through ownership, by contract, or otherwise.

Immediate Family

Family members who might control or influence a principal owner or a member of management, or who might be controlled or influenced by a principal owner or a member of management, because of the family relationship.

Management

Persons who are responsible for achieving the objectives of the entity and who have the authority to establish policies and make decisions by which those objectives are to be pursued. Management normally includes members of the board of directors, the chief executive officer, chief operating officer, vice presidents in charge of principal business functions (such as sales, administration, or finance), and other persons who perform similar policy making functions. Persons without formal titles also may be members of management.

Principal Owners

Owners of record or known beneficial owners of more than 10 percent of the voting interests of the entity.

Related Parties

Related parties include:

a. Affiliates of the entity
b. Entities for which investments in their equity securities would be required, absent the election of the fair value option under the Fair Value Option Subsection of Section 825-10-15, to be accounted for by the equity method by the investing entity
c. Trusts for the benefit of employees, such as pension and profit-sharing trusts that are managed by or under the trusteeship of management
d. Principal owners of the entity and members of their immediate families
e. Management of the entity and members of their immediate families
f. Other parties with which the entity may deal if one party controls or can significantly influence the management or operating policies of the other to an extent that one of the transacting parties might be prevented from fully pursuing its own separate interests
g. Other parties that can significantly influence the management or operating policies of the transacting parties or that have an ownership interest in one of the transacting parties and can significantly influence the other to an extent that one or more of the transacting parties might be prevented from fully pursuing its own separate interests.

Excerpt from Reg S-X Rule 1-02

Definitions of terms used in Regulation S-X.

(s) *Promoter*. The term *promoter* includes:

(1) Any person who, acting alone or in conjunction with one or more other persons, directly or indirectly takes initiative in founding and organizing the business or enterprise of an issuer;

(2) Any person who, in connection with the founding and organizing of the business or enterprise of an issuer, directly or indirectly receives in consideration of services or property, or both services and property, 10 percent or more of any class of securities of the issuer or 10 percent or more of the proceeds from the sale of any class of securities. However, a person who receives such securities or proceeds either solely as underwriting commissions or solely in consideration of property shall not be deemed a promoter within the meaning of this paragraph if such

person does not otherwise take part in founding and organizing the enterprise.

(u) *Related parties*. The term *related parties* is used as that term is defined in the FASB ASC Master Glossary.

8.3.10 Overview

Topic 850 provides the following examples of related parties: [850-10 Glossary]

- principal owners of the reporting entity (see section 8.3.20);
- management of the reporting entity (see section 8.3.30);
- immediate family members of principal owners and management of the reporting entity (see section 8.3.40);
- affiliates of the reporting entity (see section 8.3.50);
- investments under significant influence (see section 8.3.60);
- trusts for the benefit of employees (such as pensions); and
- other parties that:
  - can control or significantly influence the management or operating policies of the transacting parties; or
  - have an ownership interest in one of the transacting parties and can significantly influence the other to an extent that one or more of the transacting parties might be prevented from fully pursuing its own separate interests (see section 8.3.70).

Question 8.3.10
Is the definition of related parties different for registrants?

Interpretive response: No. For financial statement purposes, the definition of related parties under Reg S-X is consistent with how the term is applied in Topic 850. [S-X Rule 1-02]

However, for purposes of certain SEC filings, registrants may need to supplement, outside of the financial statements, the related-party disclosures included in the financial statements (see Question 8.6.20).

Question 8.3.20
From which standpoint are related parties identified?

Interpretive response: It is key to perform the assessment from the standpoint of the reporting entity. We believe a reporting entity, its subsidiaries (see section 8.3.50) and its other affiliates (as defined by Topic 850) that are not consolidated should be treated as a single entity when evaluating the reporting entity's relationships with other parties. The Topic 850 definition of affiliate may include entities outside the consolidated group (see Question 8.3.120).

While the related-party relationship is often reciprocal between the parties involved in the relationship, this cannot be assumed. See Questions 8.3.50, 8.3.110, and 8.3.160 for reciprocity considerations for specific related-party relationships. [850-10 Glossary]

Question 8.3.30
Must a reporting entity identify related-party transactions in a consolidated group?

Interpretive response: No, it is not necessary for a reporting entity to identify and disclose related-party transactions within a consolidated group for purposes of the consolidated financial statements. However, if an entity within that consolidated group issues separate financial statements, the disclosure requirements of Topic 850 apply. See section 8.6.40 for disclosure requirements in separate financial statements.

8.3.20 Principal owners

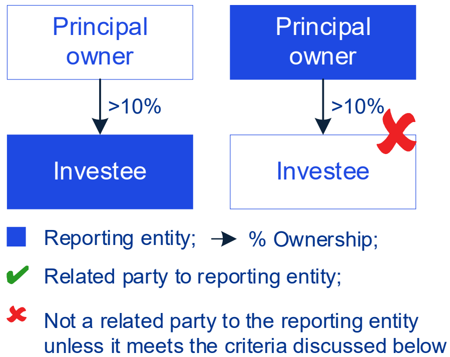
Related parties include principal owners of the reporting entity. [850-10 Glossary]

Question 8.3.40
Which individuals or parties are considered principal owners?

Interpretive response: Principal owners are owners of record or known beneficial owners of more than 10% of the voting interests of the reporting entity. These can be individuals or legal entities. [850-10 Glossary]

Question 8.3.50
Is the related-party relationship between principal owner and investee reciprocal?

Interpretive response: No. The analysis is performed from the standpoint of the reporting entity (see Question 8.3.20). If the investee is the reporting entity, its principal owners are related parties (see Question 8.3.40). However, the inverse is not necessarily true as illustrated in the following diagram.



If the principal owner is the reporting entity, the investee is not a related party unless the investee is:

- an affiliate or a subsidiary of the principal owner (see section 8.3.50);
- an entity for which the principal owner either is required to apply the equity method or would be if it did not elect to apply the fair value option instead (see section 8.3.60); or
- an entity that the principal owner can significantly influence to the extent that the investee might be prevented from fully pursuing its own separate interests or that can significantly influence the principal owner to the extent that the principal owner might be prevented from fully pursuing its own separate interests (see section 8.3.70).

8.3.30 Management

Related parties include management of the reporting entity. [850-10 Glossary]

Question 8.3.60
Which individuals are considered management?

Interpretive response: Management represents persons who are responsible for achieving the objectives of the reporting entity and who have the authority to establish policies and make decisions by which those objectives are to be pursued. [850-10 Glossary]

Management normally includes: [850-10 Glossary]

- members of the board of directors;
- the chief executive officer;
- the chief operating officer;
- vice presidents in charge of principal business functions (e.g. sales, administration, finance); and
- other persons who perform similar policy making functions.

Persons without formal titles may also be members of management. [850-10 Glossary]

While the definition includes individuals who would normally be considered management, the definition is not prescriptive. Therefore, judgment is required when determining who management is, considering factors such as the reporting structure and the involvement of principal owners.

For example, a reporting structure that includes a clear hierarchy with well-defined reporting roles and responsibilities may have fewer members of management than a reporting structure that is mostly flat, with many individuals contributing to the overall strategy and decision-making of the entity.

Question 8.3.70

Is management of principal owners of the reporting entity always considered management of the reporting entity?

Interpretive response: No. We do not believe management of the principal owners (see Question 8.3.40) of an investee entity automatically meet the definition of management of the investee. However, the investee considers the Topic 850 definition of management in its evaluation.

Management or employees of the principal owners are considered management of the investee if they are responsible for achieving the objectives of the investee and have the authority to establish policies and make decisions by which those objectives are to be pursued. This may apply to private equity funds and their portfolio companies. See Example 8.3.10. [850-10 Glossary]

Example 8.3.10

Assessing if managers of a private equity fund portfolio constitute management of the portfolio company

Opco is 51% owned by a private equity firm (the controlling owner), with the remaining shares publicly traded. In their role at the private equity firm, Person X is in charge of the Opco investment.

Opco first determines that due to the private equity firm's controlling interest in Opco, the private equity firm is a related party of Opco. See section 8.3.50.

Opco also identifies Person X as a related party because Person X constitutes a member of management to Opco by virtue of their participation in the oversight of and ability to establish policies and make decisions at Opco. As a result, transactions with Person X and members of their immediate family, as well as transactions with the private equity firm, need to be disclosed by Opco under Topic 850.

Question 8.3.80
Are promoters considered related parties?

Background: Promoters are defined in Reg S-X as individuals who start or organize a business entity, or who receive 10% or more of the entity's stock in connection with its founding or organization. [S-X Rule 1-02(s)]

Interpretive response: Generally, yes. We believe promoters can be related parties of the reporting entity they started whether or not they are principal owners of the reporting entity – e.g. they own 10% or more of the entity's stock – see section 8.3.20. Because the promoter is generally responsible for achieving the objectives of the entity, they generally would meet the definition of management of the entity. However, all relevant facts and circumstances are considered in the analysis.

8.3.40 Immediate family

Related parties include immediate family members of management and principal owners of the reporting entity. [850-10 Glossary]

Question 8.3.90
Which individuals are considered immediate family members?

Interpretive response: Immediate family members encompasses family members who because of the family relationship might: [850-10 Glossary]

- control or influence a principal owner or member of management; or
- be controlled or influenced by a principal owner or a member of management.

For nonpublic entities, because Topic 850 does not specifically list individuals who are immediate family members, this analysis may involve significant judgment when evaluating the extent of control or influence over or by another individual. However, we believe immediate family members would generally include the spouse, spousal equivalent and children, and may include parents and siblings. Whether other family members are considered immediate family members depends on the facts and circumstances.

For registrants, for financial statement purposes, the definition of related parties under Reg S-X is consistent with the FASB definition. [S-X Rule 1-02]

However, for use in specific contexts, SEC regulations provide different lists of individuals who constitute immediate family members. The following are examples.

- For bank holding companies: a person's spouse, parents, children, siblings, mothers and fathers-in-law, sons and daughters-in-law, and brothers and sisters-in-law. [S-X Rule 9-03(7)(e)(4)]
- In the context of assessing auditors' independence: a person's spouse, spousal equivalent and dependents. [S-X Rule 2-01(f)(13)]
- In the context of disclosing transactions with related persons in MD&A: a person's child, stepchild, parent, stepparent, spouse, sibling, mother-in-law, father-in-law, son-in-law, daughter-in-law, brother-in-law, or sister-in-law, or any person (other than tenant or employee) sharing a household with another individual. [S-K Item 404(a) Instr 1(a)(iii)]

Because Topic 850 establishes a principle and the SEC regulations specify individuals, we do not believe all immediate family members under the SEC's definitions would always be considered immediate family members under Topic 850. However, a registrant may leverage its process for complying with SEC regulations when identifying related parties under Topic 850.

8.3.50 Affiliates

Related parties include affiliates of the reporting entity. [850-10 Glossary]

Question 8.3.100
What are 'affiliates'?

Interpretive response: There are two types of affiliates, as explained in the following table. [850-10 Glossary]

A party that controls or is controlled by an entity	In Topic 850, control is defined as the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of an entity through ownership, by contract, or otherwise. Control can be exercised directly, or indirectly through intermediaries.
A party that is under common control with the entity	Two or more entities may be deemed to be under common control when they are subject to control by the same parent, investor or ownership group that has agreed to vote in concert.

The determination of whether to consolidate another entity under Topic 810 (consolidation) is not based on the definition of control in Topic 850. Therefore, there may be circumstances in which an entity is consolidated by its parent under Topic 810 (i.e. is a subsidiary) but does not meet the definition of an affiliate. However, we believe the concept of control in Topic 850 is intended to be inclusive of the concept of a controlling financial interest in Topic 810. Therefore, we believe a subsidiary and its parent should be treated in the same way as affiliates under Topic 850. [850-10-05-3]

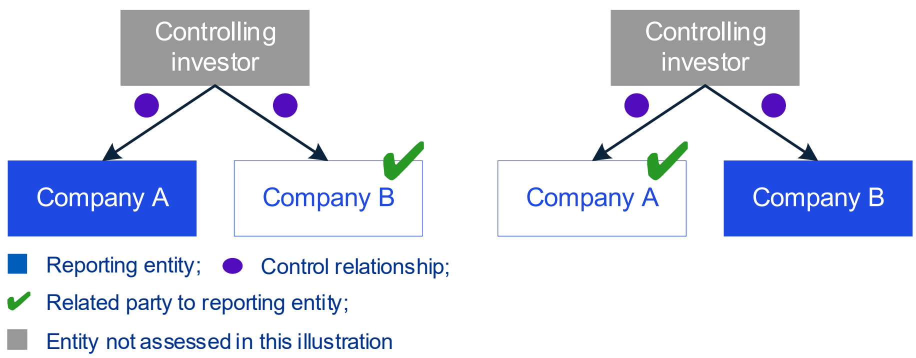
Conversely, there may be circumstances in which an affiliate is not consolidated. That is, consolidation is not necessary for an affiliate relationship to exist (see Question 8.3.120).

Determining whether control or common control exists may require significant judgment. See KPMG Handbooks, Consolidation and Business combinations, for guidance on the concept of controlling financial interest and common control, respectively.

Question 8.3.110
Is the related-party relationship between affiliates reciprocal?

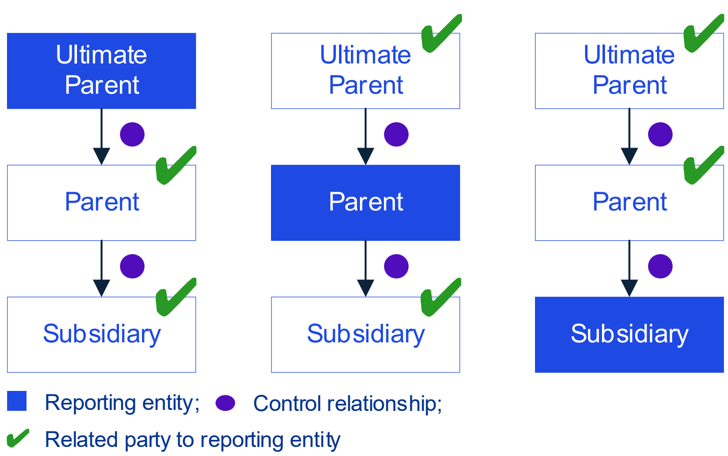
Interpretive response: Yes. The related-party relationship is reciprocal between affiliates.

Sister companies controlled by same investor



As illustrated in the diagram, Company A is a related party of Company B and vice versa, because A and B are under common control of the same investor.

Parent subsidiary relationship



As illustrated in the diagram, a parent and its direct and indirect subsidiaries are related parties of one another regardless of who the reporting entity is, because they are treated as affiliates of one another (see Question 8.3.100).

Question 8.3.120

Must an entity be consolidated by its controlling owner for a related-party relationship to exist?

Background: There are several situations in US GAAP in which a controlling owner may not consolidate its controlled investee. The following are two examples.

- A private equity firm that meets the criteria of an investment company in the scope of Topic 946 (investment companies) is generally precluded from consolidating investees that do not also meet those criteria. However, the private equity firm may nevertheless control those investees.
- Private companies have an accounting alternative to not evaluate certain entities under common control under the VIE consolidation model. The accounting alternative may result in a private company not consolidating certain entities that it might be required to consolidate under the VIE consolidation model absent the alternative. See chapter 2 of KPMG Handbook, Consolidation. [810-10-15-17AC]

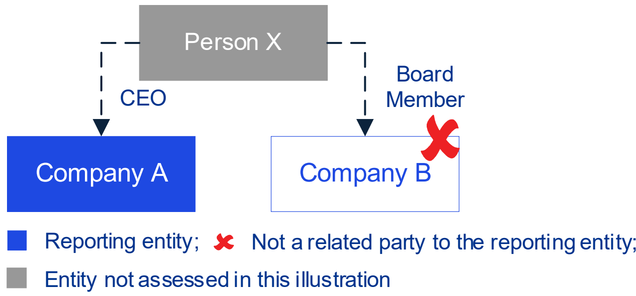
Interpretive response: No. The definition of affiliate is based on the existence of control or a common control relationship, irrespective of what accounting is followed. Even if not consolidated by their common controlling owner, controlled investees are affiliates of one another and of the controlling owner. They are therefore related parties of one another and of the controlling owner.

Question 8.3.130

Are entities with common management or directors considered related parties?

Interpretive response: Not necessarily. Two entities that share a common member of management or member of the board of directors are generally related parties only if the two entities are affiliates under common control. We generally do not believe that being a member of management or a director of an entity in and of itself equates to having control over the entity; see Question 8.3.200 for specific application to investment companies. However, the two entities still evaluate whether the other aspects of the definition of a related party are met (see section 8.3.70).

This is illustrated in the following diagram, which assumes that the boards of Companies A and B do not otherwise share common members of management or board members other than Person X, and that Person X does not control the boards of A and B.



Although Person X and Company A are related parties, Company B and Company A are not simply by virtue of Person X being on Company B's board.

8.3.60 Investments under significant influence

Related parties include investees under significant influence of the reporting entity. [850-10 Glossary]

Question 8.3.140
What are investments under significant influence?

Interpretive response: For purposes of applying Topic 850, investments under significant influence are any of the following: [850-10 Glossary]

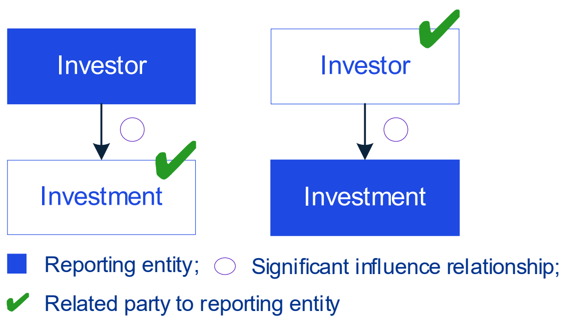
- investments accounted for under the equity method in Topic 323, such as:
  - corporate-like investees where the investor (reporting entity) can exercise significant influence over their operating and financial decisions; or
  - partnership-like investees where the investor has more than virtually no influence over the investee;
- investments for which the investor elected the fair value option in Subtopic 825-10, but that would be accounted for under the equity method by the investor otherwise.

In addition, there are several situations in US GAAP in which investments under significant influence are not accounted for under the equity method or at fair value under the option in Subtopic 825-10. These may still be related parties – see section 8.3.70.

See chapter 2 of KPMG Handbook, Equity method of accounting, for guidance on indicators of significant influence.

Question 8.3.150
Is the related-party relationship between investor and investee under significant influence reciprocal?

Interpretive response: Generally, yes. The related-party relationship is generally reciprocal between the investor and its equity method investee, as illustrated below.



If the reporting entity is the investor, the investee under significant influence is its related party. [850-10 Glossary]

If the reporting entity is the investee, the investor is generally its related party because the investor:

- is a principal owner – i.e. it holds more than 10% of the voting interest of the investee (see section 8.3.20). This would generally be the case for corporations because Topic 323 establishes a presumption that significant influence only exists when the investor holds at least a 20% voting interest in that corporation. However, all relevant facts and circumstances are considered; and/or [323-10-05-5, 15-7 – 15-8]
- can significantly influence the management or operating policies of the investee to an extent that one of the transacting parties might be prevented from fully pursuing its own separate interests. [850-10 Glossary]

8.3.70 Other related parties

Related parties also include: [850-10 Glossary]

- trusts – i.e. trusts for the benefit of employees, such as pension and profit-sharing trusts that are managed by or under the trusteeship of management; and
- other parties – i.e. parties that:
  - the entity may deal with (transacting parties) if one party controls or can significantly influence the management or operating policies of the other,
  - can significantly influence the management or operating policies of the transacting parties, or

– have an ownership interest in one of the transacting parties and can significantly influence the other

to an extent that one or more of the transacting parties might be prevented from fully pursuing its own separate interests.

Question 8.3.160
What are examples of when one transacting party controls or can significantly influence the other?

Interpretive response: Topic 850 includes in the definition of a related party transacting parties if one controls or can significantly influence the other's management or operating policies to the point that one of the transacting parties might be prevented from fully pursuing its own separate interests. [850-10 Glossary]

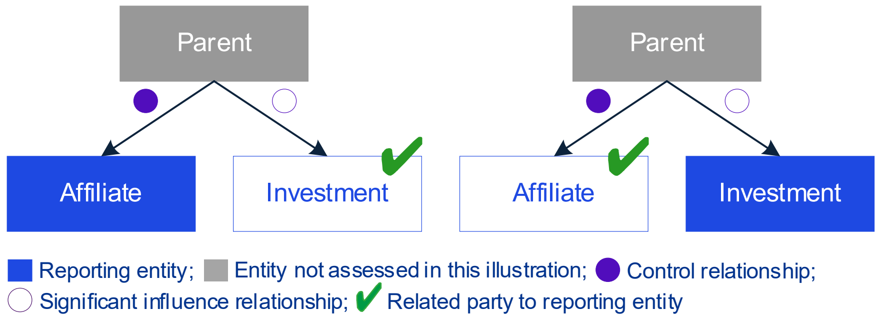
We believe the indicators of control in Topic 810 and significant influence in Topic 323 should be considered in this assessment. See sections 5.2 and 6.2 of KPMG Handbook, Consolidation, and chapter 2 of KPMG Handbook, Equity method of accounting. [323-10-15-6, 810-10-15-8, 25-1, 25-5, 25-38A]

As a result, the definition of a related party under Topic 850 captures certain control or significant influence relationships that would not otherwise be captured under the definitions of affiliate (see section 8.3.50) or investment under significant influence (see section 8.3.60). The following are examples.

- Company A has significant influence over Company B but does not apply the equity method of accounting. This may be because its interest in B is not common stock or in-substance common stock, or because it has significant influence through contract but has no equity interest.
- Company C has control over Company D but does not consolidate D because D is a VIE and the economic interest held by C is not significant to the VIE (i.e. it does not meet both of the primary beneficiary criteria).
- Investment Company E has significant influence over investee Company F. It does not apply the equity method of accounting but instead applies Topic 946 and records its investment in Company F at fair value.

Question 8.3.170
Are an affiliate and an investment under significant influence of a common owner considered related parties?

Interpretive response: Generally, yes. However, all relevant facts and circumstances are considered in the analysis. We believe an affiliate or other subsidiary (see section 8.3.50) and an investment under significant influence (see section 8.3.60) of a common owner (e.g. parent company) are generally related parties because, by virtue of this common owner, one party generally controls or can significantly influence the other's management or operating policies to the point that one of the transacting parties might be prevented from fully pursuing its own separate interests. [850-10 Glossary]



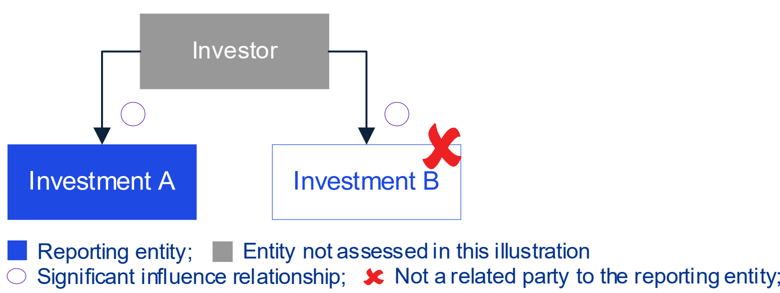
In this fact pattern, Parent is the common owner. However, Parent may not consolidate its affiliate or may not account for its investment over which it exercises significant influence under the equity method. For example, Topic 946 generally precludes an investment company from applying consolidation guidance and the equity method to its investments.

Question 8.3.180

Are investments under significant influence of a common owner considered related parties?

Interpretive response: Not necessarily. We believe the significant influence that a common owner may have over its investees generally would not, in and of itself, allow one investee to prevent the other from fully pursuing its own separate interests (see Question 8.3.170). However, all relevant facts and circumstances are considered in the analysis to conclude if a related-party relationship exists.

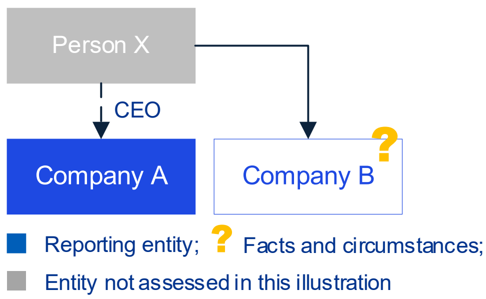
This is illustrated below, assuming no other relevant facts exist.



Question 8.3.190

Are entities owned by management of the reporting entity considered related parties of the reporting entity?

Interpretive response: It depends. An entity owned by management of the reporting entity may be a related party of the reporting entity if, by virtue of this relationship, one of the two entities controls or can significantly influence the management or operating policies of the other to an extent that at least one entity may be prevented from fully pursuing its own separate interests. All relevant facts and circumstances are considered in the analysis.



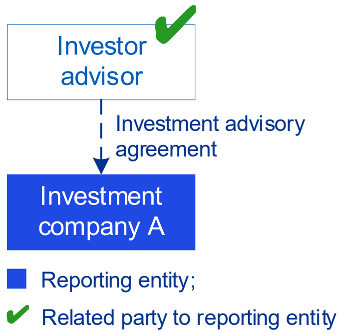
Question 8.3.200

Is the investment advisor a related party to the investment company it manages?

Background: An investment advisor or sponsor may establish an investment company complex comprising multiple investment companies that share common management, such as a common investment advisor or board of directors. The investment advisor may, for example, be a general partner or an investment manager.

Under certain circumstances described in Topic 946, an investment company may be consolidated by an investment advisor under Topic 810. See chapters 2 and 3 of KPMG Handbook, Consolidation. [946-10-55-5, 946-810-45-3]

Interpretive response: Yes. Often the investment advisor and the investment company are related parties because they are affiliates, regardless of whether the advisor consolidates the investment company (see section 8.3.50). In addition, we believe the investment advisor is responsible for achieving the objectives of the investment company and, through the investment advisory agreement, has the authority to establish policies and make decisions by which those objectives are to be pursued. Therefore, the investment advisor also meets the definition of management (see section 8.3.30). [850-10 Glossary]



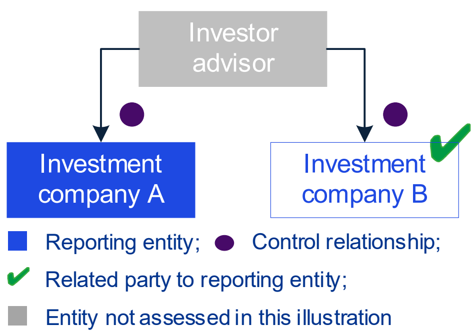
Question 8.3.210

Are investment companies with the same investment advisor considered related parties?

Interpretive response: It depends. As explained in Question 8.3.200, an investment company and its investment advisor are related parties regardless of whether they are affiliates (see section 8.3.50).

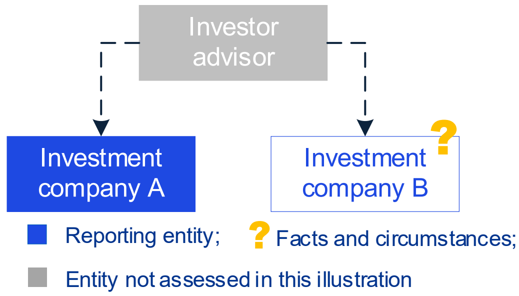
Investment companies are affiliates of the same investment advisor

Investment companies that are affiliates of the same investment advisor are entities under common control under Topic 850 and are related parties of one another.



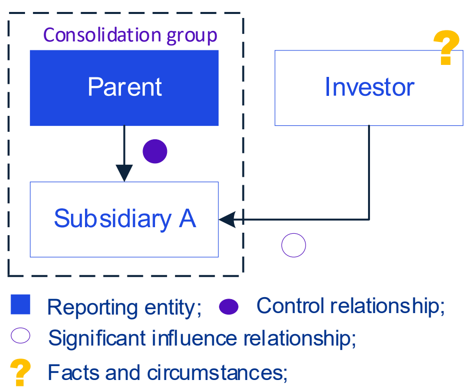
Investment companies are not affiliates of the same investment advisor

Investment companies that are managed by the same investment advisor but are not both affiliates of the advisor may still be related parties. This may happen if by virtue of their common investment advisor, at least one party controls or can significantly influence the other's management or operating policies to the extent that one of the transacting parties might be prevented from fully pursuing its own separate interests. All relevant facts and circumstances are considered in the analysis. [850-10 Glossary]



Question 8.3.220
Is an NCI holder of a subsidiary a related party of the parent company?

Interpretive response: It depends. If the NCI holder has significant influence over the subsidiary, judgment is required to assess if the parent company can fully pursue its own separate interests (see Question 8.3.170). We believe this determination is performed by treating the consolidation group – i.e. the parent company, its affiliates, and its other consolidated subsidiaries – as a single entity (see Question 8.3.20).



In the diagram, the NCI holder (Investor) may prevent Parent from fully pursuing its own separate interests if the business purpose and/or substantive activities of the consolidation group are indistinguishable from the activities of Subsidiary A – e.g. if Subsidiary A comprises a substantial majority of the consolidation group.

Regardless of the conclusion reached for the consolidation group, for purposes of Subsidiary A's financial statements, the NCI holder with significant influence is a related party of Subsidiary A (see Question 8.3.160).

Question 8.3.230
Are franchisors and franchisees considered related parties?

Interpretive response: It depends. If a franchisor controls or has significant influence over the management and operating policies of the franchisee, such that it can prevent the franchisee from fully pursuing its own separate interests (see Question 8.3.170), the franchisor and franchisee would be related parties. All relevant facts and circumstances are considered in the analysis. [850-10 Glossary]

Question 8.3.240**
Are multiemployer plans considered related parties?

Background: Multiemployer plans are retirement plans in which two or more unrelated entities participate pursuant to a collective bargaining agreement with a plan sponsor. Collective-bargaining agreements are contracts negotiated between an employer and a trade union or labor union, which generally include the terms and conditions of employment (e.g. hours of work, benefits, compensation). For additional discussion of multiemployer plans, see section 10.5 of KPMG Handbook, Employee benefits.

Interpretive response: Yes. We believe that a multiemployer plan of which a reporting entity is one of the sponsoring entities is a related party to the reporting entity even if the reporting entity does not have significant influence over the multiemployer plan.

8.4 Accounting for related-party transactions

8.4.10 General considerations

Topic 850 does not address the accounting for related-party transactions. However, other Codification Topics may be relevant.

Question 8.4.10#
Are related-party transactions accounted for based on their substance or their form?

Background: In general, to provide faithful representation of financial information, all transactions are accounted for based on their economic substance rather than their form. [CON 8.BC3.26]

Interpretive response: It is often not possible to determine and measure the economic substance of transactions with related parties. In our experience, unless US GAAP specifically says otherwise or there is a clear difference between the substance and the stated terms (i.e. their form), related-party transactions are generally accounted for, and therefore presented and disclosed:

- based on their stated terms; and
- using the accounting guidance applicable to similar transactions with unrelated parties.

Regardless of whether a transaction is recognized, the disclosure requirements discussed in section 8.6 apply. [850-10-05-5]

For all entities, US GAAP requires certain transactions, such as revenue from contracts with customers and leases, to be accounted for based on their legally enforceable terms (see Question 8.4.20).

Further, in unusual circumstances, the substance of a transaction with a related party clearly may be different from its form (e.g. the transaction attempts to achieve an accounting, tax or regulatory result that differs from its substance). In that situation, the transaction is accounted for, presented and disclosed based on its substance, including contingent liabilities that may arise, such as fines, penalties and covenant violations.

For registrants, the SEC staff has provided several specific exceptions to accounting for related-party transactions based on their form (see section 8.4.20).

Question 8.4.20#

How are related-party leases accounted for?

Interpretive response: Topic 842 (leases) requires that entities determine whether related-party arrangements are or contain a lease. An entity classifies, recognizes and measures a lease with a related party on the basis of the legally enforceable terms and conditions of the lease, not based on an evaluation of its economic substance. This requirement is consistent with the requirements for lease arrangements between unrelated parties. [842-10-55-12, ASU 2016-02.BC374]

Similarly, a sale-leaseback transaction between related parties is also accounted for based on the legally enforceable terms and conditions of the transaction, meaning neither the seller-lessee nor the buyer-lessor adjusts its sale-leaseback accounting for off-market terms as is required for sale-leaseback transactions between unrelated parties. See paragraphs 9.2.110 and 9.2.120 of KPMG Handbook, Leases. [842-40-30-4, ASU 2016-02.BC362]

Practical expedient for arrangements between nonpublic entities under common control

Common control arrangements are a subset of related-party arrangements that are entered into by entities under common control. See Question 8.3.100 for discussion of common control.

Under Topic 842, nonpublic entities (i.e. entities that are not public business entities and most not-for-profit entities) may elect to use the written terms and conditions of a common control leasing arrangement (without regard to enforceability) to determine whether a lease exists and, if so, the classification of and accounting for that lease. [842-10-15-3A]

If no written terms and conditions exist between the parties, an entity cannot use the practical expedient; instead, it identifies the legally enforceable terms and conditions to determine whether a lease exists and, if so, uses those terms and conditions in applying Topic 842. [842-10-15-3B]

Arrangements to which the practical expedient applies are still subject to the disclosure requirements in Topic 850. [842-20-50-7, 842-30-50-4]

Question 8.4.30

How are related-party debt extinguishment transactions accounted for?

Interpretive response: A reporting entity evaluates the extinguishment of debt with a related party to determine whether the related gains or losses are in essence capital transactions. See chapter 4 of KPMG Handbook, Debt and equity financing. [470-50-40-2]

Question 8.4.40

How are common control transactions accounted for?

Interpretive response: When accounting for a transfer of assets or exchange of shares between entities under common control, the entity that receives the net assets or the equity interests initially measures the recognized assets and liabilities received at the historical cost of the ultimate parent at the date of transfer. See section 28 of KPMG Handbook, Business combinations. [805-50-30-5]

8.4.20 Considerations for registrants

Question 8.4.50
What are considerations for registrants when accounting for related-party transactions?

Interpretive response: The SEC staff generally believes that financial statements are more useful to investors if they reflect all costs of doing business. All costs of doing business, including costs incurred by a parent and others on behalf of a registrant, should be reflected in the financial statements of the registrant. Allocation of common expenses, such as interest or income tax, may be required. A registrant is not required to impute costs if they were not incurred by its parent or others. [SAB Topic 1.B.1, FRM 7210]

Consistent with this general principle, the SEC staff has issued guidance addressing how a registrant should reflect the following in its historical financial statements.

- Expenses incurred on its behalf by a parent when these expenses have not been charged to the registrant in the past. This guidance is written in the context of a subsidiary filing a registration statement in connection with an IPO but is often applied more broadly. [SAB Topic 1.B.1]
- Organizational and offering costs paid on its behalf by a related party of the registrant when these costs will be directly or indirectly reimbursed. [SAB Topic 5.D, FRM 7210.1]
- Expenses or liabilities paid or settled on its behalf by a parent or principal shareholder. [SAB Topic 5.T, FRM 7210.2]

The SEC staff has also addressed transfers of nonmonetary assets and receivables to or from shareholders before an IPO. [SAB Topic 5.G, FRM 7300]

See Appendix for a full reproduction of SAB Topics 1.B.1 and 5.T, which include additional guidance for assessing expenses paid by others.

8.5 Presentation of related-party transactions

Excerpt from Reg S-X Rule 4-08

> General Notes to Financial Statements

If applicable to the person for which the financial statements are filed, the following shall be set forth on the face of the appropriate statement or in appropriately captioned notes. The information shall be provided for each statement required to be filed, except that the information required by paragraphs (b), (c), (d), (e), and (f) of this section shall be provided as of the most recent audited balance sheet being filed and for paragraph (j) of this section as specified therein. When specific statements are presented separately, the pertinent notes shall accompany such statements unless cross-referencing is appropriate. …

(k) *Related party transactions that affect the financial statements*.

(1) Amounts of related party transactions should be stated on the face of the balance sheet, statement of comprehensive income, or statement of cash flows.

(2) In cases where separate financial statements are presented for the registrant, certain investees, or subsidiaries, any intercompany profits or losses resulting from transactions with related parties and the effects thereof shall be disclosed.

Question 8.5.10#

How are related-party transactions presented?

Interpretive response: SEC regulations require registrants to present related-party transactions separately on the balance sheet, in the income statement and in the statement of cash flows. [S-X Rule 4-08(k)]

More specifically, registrants that are commercial and industrial registrants state separately: [S-X Rule 5-02]

- from other accounts and notes receivable: amounts receivable from related parties; [S-X Rule 5-02.3]
- from other assets: securities of related parties; [S-X Rule 5-02.10]
- from other assets: indebtedness of related parties – noncurrent; [S-X Rule 5-02.11]
- from other amounts payable: amounts payable to related parties; [S-X Rule 5-02.19]
- from other liabilities: indebtedness to related parties – noncurrent; [S-X Rule 5-02.23]
- net sales and gross revenues; [S-X Rule 5-03.1]
- costs and expenses applicable to sales and revenues. [S-X Rule 5-03.2]

For all entities, Topic 850 also requires that notes or accounts receivable from officers, employees or affiliated entities be shown separately and not included under a general heading (such as notes receivable or accounts receivable). See Question 8.6.10. [850-10-50-2]

8.6 Disclosures of related-party transactions

8.6.10 General disclosure requirements

Excerpt from ASC 850-10

> Related Party Transactions

50-1 Financial statements shall include disclosures of material related party transactions, other than compensation arrangements, expense allowances, and other similar items in the ordinary course of business. However, disclosure of transactions that are eliminated in the preparation of consolidated or combined financial statements is not required in those statements. The disclosures shall include:

a. The nature of the relationship(s) involved
b. A description of the transactions, including transactions to which no amounts or nominal amounts were ascribed, for each of the periods for which income statements are presented, and such other information deemed necessary to an understanding of the effects of the transactions on the financial statements
c. The dollar amounts of transactions for each of the periods for which income statements are presented and the effects of any change in the method of establishing the terms from that used in the preceding period
d. Amounts due from or to **related parties** as of the date of each balance sheet presented and, if not otherwise apparent, the terms and manner of settlement
e. The information required by paragraph 740-10-50-17.

50-2 Notes or accounts receivable from officers, employees, or affiliated entities must be shown separately and not included under a general heading such as notes receivable or accounts receivable.

50-3 In some cases, aggregation of similar transactions by type of related party may be appropriate. Sometimes, the effect of the relationship between the parties may be so pervasive that disclosure of the relationship alone will be sufficient. If necessary to the understanding of the relationship, the name of the related party shall be disclosed.

> Disclosures About Arm's-Length Bases of Transactions

50-5 Transactions involving related parties cannot be presumed to be carried out on an arm's-length basis, as the requisite conditions of competitive, free-market dealings may not exist. Representations about transactions with related parties, if made, shall not imply that the related party transactions were consummated on terms equivalent to those that prevail in arm's-length transactions unless such representations can be substantiated.

Topic 850 requires information about material related-party transactions to be disclosed, unless those transactions: [850-10-50-1]

- occur in the ordinary course of business; or
- are eliminated in the preparation of the consolidated or combined financial statements.

The disclosure requirements in Topic 850 were developed to address the fact that arrangements between related parties often are not consummated at arm's length and, therefore, may not reflect their economic substance.

The disclosure requirements in Topic 850 are incremental to all other disclosure requirements for a particular transaction. For example, a revenue transaction with a related-party customer is subject to the disclosure requirements of both Topic 606 (revenue) and Topic 850.

Question 8.6.10#

What types of information does Topic 850 require to be disclosed?

Interpretive response: Topic 850 requires that both qualitative and quantitative information be disclosed about related-party transactions not in the ordinary course of business (see Question 8.6.30). [850-10-50-1]

Qualitative information	Quantitative information
• Nature of the relationship • Description of the transactions • Change in terms from the prior period presented • Terms and manner of settlement	• Dollar amount of the transaction (for each period an income statement is presented) • Amounts due from or to related parties (for each balance sheet presented)

Topic 850 also requires that notes or accounts receivable from officers, employees or affiliated entities be shown separately and not included under a general heading (such as notes receivable or accounts receivable). [850-10-50-2]

Question 8.6.20

Are there additional related-party disclosure requirements for registrants?

Interpretive response: Yes. Section 8.6.30 provides examples of additional related-party disclosures that are required in the financial statements for registrants. These include disclosures pertaining to related-party: [S-X Rule 3-10, 13-01, 4-08]

- compensation arrangements;
- guarantees;
- debt; and
- equity arrangements.

For purposes of certain SEC filings, registrants may need to supplement, outside of the financial statements, the related-party disclosures included in the financial statements. A registrant discloses the following information regarding certain transactions with related persons (as defined in Reg S-K). [S-K Item 404]

Qualitative information	Quantitative information
• Description of the transactions • The name of the related person and the basis on which the person is a related person • The related person's interest in the transaction with the registrant • Any other information regarding the transaction or the related person in the context of the transaction that is material to investors	• Dollar amount involved in the transaction • The approximate dollar value of the amount of the related person's interest in the transaction

Disclosure requirements in Topic 850 cannot be satisfied by referring to information outside the financial statements (e.g. in MD&A) (see Question 6.2.50).

Question 8.6.30

What are related-party transactions in the ordinary course of business?

Interpretive response: We believe asserting that a transaction is in the ordinary course of business may require judgment considering, for example, the nature and purpose of the transaction, its routine character, and the pricing of the transaction. These may include compensation arrangements (see Question 8.6.100), expense allowances and other similar items.

Question 8.6.40

Is disclosure required if the related-party transaction is not recognized in the financial statements?

Interpretive response: Yes. Related-party transactions are subject to the disclosure requirements in Topic 850 even if they are not recognized in the financial statements (e.g. transactions priced at zero). See Question 8.4.10 for accounting for related-party transactions based on form. [850-10-05-5]

Question 8.6.50
Is disclosure required for transactions eliminated in consolidation?

Interpretive response: No. Transactions eliminated in consolidation need not be disclosed in the consolidated or combined financial statements of the reporting entity. However, these transactions need to be disclosed in the separate financial statements of either party (see section 8.6.40). [850-10-50-1]

Question 8.6.60
Is quantitative disclosure of material related-party transactions always required?

Interpretive response: No. Aggregation of similar related-party transactions by type is permitted. In addition, in certain cases, a related-party relationship may be pervasive, such that it impacts many aspects of the financial statements. In these cases, disclosure of the relationship alone is sufficient. [850-10-50-3]

Question 8.6.70
Is disclosure of the name of the related party required?

Interpretive response: Generally, no. Topic 850 does not require the name of the related party to be disclosed unless this information is necessary to understand the relationship. [850-10-50-3]

Registrants are required to disclose the name of the related person in a related-party transaction (see Question 8.6.20). Although the requirement applies outside the financial statements, registrants may find it more practical to provide this disclosure in the financial statements, where relevant. [S-K Item 404(a)(1)]

Question 8.6.80
Is disclosure of the fact that a related-party transaction is consummated on an arm's length basis permitted?

Interpretive response: Yes. An entity may disclose that a related-party transaction is at arm's length but only if it can substantiate such a statement. Without disclosure to the contrary, there is a general presumption that related-party transactions are not consummated at arm's length because the requisite conditions of competitive, free-market dealings may not exist. [850-10-50-5]

For registrants, SEC guidance requires additional disclosures for certain related-party transactions when they are not carried out at arm's length. See Question 8.6.120 for related-party debt.

8.6.20 Control relationships

Topic 850 generally requires the nature of control relationships to be disclosed. [850-10-50-6]

Excerpt from ASC 850-10

> Control Relationships

50-6 If the reporting entity and one or more other entities are under common ownership or **management control** and the existence of that control could result in operating results or financial position of the reporting entity significantly different from those that would have been obtained if the entities were autonomous, the nature of the control relationship shall be disclosed even though there are no transactions between the entities.

Question 8.6.90

When does a reporting entity disclose information about certain control relationships and transactions with related parties?

Background: When an entity is under common control or management control with one or more entities, the relationship may affect its operating performance and financial situation. For example, two or more entities in the same line of business may be controlled by a single party that can increase or decrease the amount of business done by each.

Interpretive response: A reporting entity discloses the nature of this control relationship if its operating results or balance sheet would be significantly different absent the control relationship. This disclosure is made even if there are no transactions between the entities during the reporting period. This information helps financial statement users form predictions and analyze the extent to which those statements may have been affected by that relationship. [850-10-50-6]

Combinations of entities under common control require specific disclosures beyond those required by Topic 850. See section 28 of KPMG Handbook, Business combinations. These transactions may also result in a change in reporting entity and trigger additional disclosures. See section 3.6 of KPMG Handbook, Accounting changes and error corrections. [805-50-50-1 – 50-3]

8.6.30 Disclosure requirements for specific transactions

Question 8.6.100
How are related-party compensation arrangements disclosed?

Interpretive response: The general disclosures in Topic 850 (see section 8.6.10) apply only to related-party compensation arrangements not in the ordinary course of business (see Question 8.6.30). [850-10-50-1]

In addition, SEC guidance requires registrants to disclose the following specific information related to related-party compensation arrangements: [FRM 7220]

- significant compensation arrangements (disclosed quantitively) with related parties that resulted in below-market compensation expense;
- the salary commitment if historical statements reflect compensation that will be materially different from the compensation expense expected after an offering or in the future (pro forma data for the latest year and interim period may also be necessary); and
- other forms of compensation provided by a related party or other holder of an economic interest in the entity to an employee for services.

Question 8.6.110
How are related-party guarantees disclosed?

Interpretive response: A reporting entity (guarantor) that issues a guarantee to benefit a related party is required to provide the disclosures in Topic 460 in addition to the general disclosures in Topic 850 (see Question 8.6.10). [460-10-50-6]

In addition, for registrants, a guarantee of a registered (or to be registered) security is considered a security of the guarantor(s) – i.e. separate from the security it guarantees. The registrant in those situations may have to comply with the disclosure guidance in Reg S-X (see Question 8.6.20). [S-X Rules 3-10 and 13-01]

Question 8.6.120
How is related-party debt disclosed?

Interpretive response: A reporting entity that enters into a lending arrangement with a related party considers the disclosure requirements in Topic 470 (debt), Subtopic 405-40 (joint and several liability arrangements), and Subtopic 860-30 (secured borrowing and collateral) as applicable, in addition to the general disclosures in Topic 850 (see Question 8.6.10). See section 3.8 of KPMG Handbook, Debt and equity financing. [470-10-50, 405-40-50, 860-30-50-1A(b)]

Registrants are also required to:

- separately present long-term related-party debt on the balance sheet (see Question 8.5.10); [S-X Rule 5-02.23]
- disclose financing arrangements with the parent and terms of the loans between affiliates; [SAB Topic 1.B.1]
- include specific disclosure for loans among affiliates that are noninterest-bearing or carry an unreasonable rate of interest. [SAB Topic 1.B.1]

Question 8.6.130
How are related-party leases disclosed?

Interpretive response: A reporting entity that enters into a lease with a related party considers the disclosure requirements in Topic 842 (leases) in addition to the general disclosures in Topic 850 (see Question 8.6.10). The general disclosures in Topic 850 apply even if the lease is not recognized in the financial statements. See chapter 12 of KPMG Handbook, Leases, for additional disclosure requirements. [842-20-50-7]

In addition, if a lease arrangement creates a variable interest, Topic 810 requires specific disclosures. See section 8.3.20 of KPMG Handbook, Consolidation, for required disclosures for VIEs.

Question 8.6.140
How are related-party equity arrangements disclosed?

Interpretive response: The general disclosures in Topic 850 (see Question 8.6.10) may apply to related-party equity arrangements. Examples of such circumstances include the following.

- Agreements with shareholders that contain specific terms or preferences. For example, shareholders may have different classes of equity (common or preferred), liquidation preferences, voting rights, or dividend rights.
- Sales of common shares at an off-market price (see section 5.3.40 of KPMG Handbook, Debt and equity financing).
- Advances to, or receivables from, shareholders resulting from such arrangements.

Registrants also disclose the nature and amount of any restrictions that limit the payment of dividends and/or transfer of funds in the form of cash dividends, loans or advances. [S-X Rule 4-08(e)(3)(i)]

Question 8.6.150

How are intercompany transactions with investments under significant influence disclosed by the investor?

Interpretive response: An investor and its investee under significant influence are related parties (see section 8.3.60). Therefore, the investor applies the general disclosures in Topic 850 (see Question 8.6.10) to transactions between them. Registrants have additional disclosure considerations. See Questions 7.3.20 and 7.3.30 in KPMG Handbook, Equity method of accounting. [850-10-50-1]

Private companies have an accounting alternative to not evaluate certain entities under common control under the VIE consolidation model. If elected, this alternative does not change the definition of a related party (see Question 8.3.120). In addition to the general disclosures in Topic 850 (see Question 8.6.10), the investor also applies the disclosure requirements in Topic 323 to any entity that is accounted for under the equity method as a result of the alternative. See chapter 2 of KPMG Handbook, Consolidation.

Question 8.6.160

How are related-party transactions disclosed in a business combination?

Interpretive response: Topic 805 requires the disclosure of preexisting relationships that are settled in connection with a business combination (see section 13 of KPMG Handbook, Business combinations). In addition, if the counterparty in that preexisting relationship was a related party before the business combination, the general disclosure requirements in Topic 850 apply (see Question 8.6.10). [805-10-50-2(e)]

A business combination between entities under common control is a related-party transaction that is not accounted for as a business combination. Subtopic 805-50 provides guidance on the accounting for common control transactions and related disclosures. See section 28 of KPMG Handbook, Business combinations. [805-50-50-1 – 50-4]

Question 8.6.170
How is a related-party transaction that results in the deconsolidation of a subsidiary disclosed?

Interpretive response: Topic 810 requires a reporting entity to disclose: [810-10-50-1B]

- whether the transaction that resulted in the deconsolidation of a subsidiary (or derecognition of a group of assets) was with a related party; and
- whether the former subsidiary (or entity acquiring a group of assets) is a related party after the transaction.

See section 8.3 of KPMG Handbook, Consolidation, for additional guidance about disclosure requirements upon deconsolidation of a subsidiary.

8.6.40 Disclosure requirements in a set of separate financial statements

Excerpt from ASC 850-10

> Related Party Transactions

50-4 It is not necessary to duplicate disclosures in a set of separate financial statements that is presented in the financial report of another entity (the primary reporting entity) if those separate financial statements also are consolidated or combined in a complete set of financial statements and both sets of financial statements are presented in the same financial report.

Question 8.6.180
Are there specific disclosure considerations in separate financial statements?

Interpretive response: Yes. If separate financial statements are presented for the registrant and investees or subsidiaries, any intercompany profits or losses (and the related effects) resulting from related-party transactions are disclosed based on the guidance in Topic 850. [S-X Rule 4-08(k), 850-10-50-1]

Question 8.6.190

Can related-party disclosures be omitted in a set of separate financial statements?

Interpretive response: Yes, but only if the set of separate financial statements is presented in the financial report of another entity (the primary reporting entity) and those separate financial statements are consolidated or combined in a complete set of financial statements that are presented in the same financial report. [850-10-50-4]

Topic 850 or other Codification Topics do not define 'financial report'. We believe this relief would rarely apply in practice.

9. Subsequent events

Detailed contents

Item significantly updated in this edition: #

9.4 Assess whether subsequent events are recognized or nonrecognized

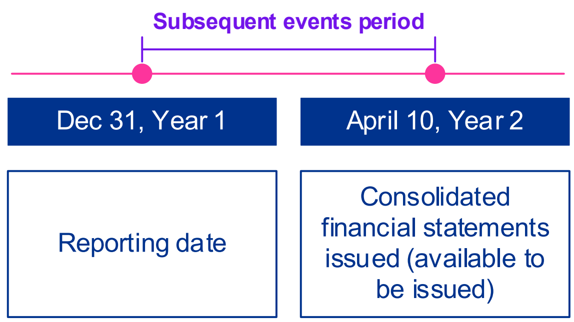
Questions

Examples

9.1 How the standard works

Subsequent events are events or transactions that occur after the reporting date (i.e. balance sheet date) but before financial statements are issued or are available to be issued.

The following timeline illustrates the subsequent events period of a calendar year-end company issuing financial statements on April 10, Year 2.



Subsequent events are categorized into two broad types.

Recognized events (Type 1)

- Events or transactions that provide additional evidence about conditions that *existed* at the reporting date.
- Require adjustment to the financial statements to reflect the impact of events or transactions, and possible specific disclosures.

Nonrecognized events (Type 2)

- Events that provide evidence about conditions that *did not exist* at the reporting date but arose subsequent to that date.
- May require disclosure in the notes but the financial statements are not adjusted.

This chapter addresses the recognition and disclosure of subsequent events in the scope of Topic 855.

If another Topic also addresses the recognition and disclosure of subsequent events, the guidance in that Topic applies instead of the guidance in Topic 855.

9.2 Overview

Excerpt from ASC 855-10

> Entities

15-2 The guidance in the Subsequent Events Topic applies to all entities.

> Transactions

15-3 The guidance in the Subsequent Events Topic shall be applied in the accounting for, and disclosure of, **subsequent events** not addressed in other Topics of the Codification.

15-4 Other Topics may address the accounting treatment of events or transactions that occur after the balance sheet date. If an event or transaction is within the scope of another Topic, then an entity shall follow the guidance in that Topic, rather than the guidance in this Topic.

15-5 The following are examples (not collectively exhaustive) of other subsequent events guidance that is not consistent with the principles in this Topic for the recognition and disclosure of events or transactions that occur after the balance sheet date.

a. Income Taxes—See paragraph 740-10-25-15 for guidance on changes in judgment after the balance sheet date that results in subsequent recognition, derecognition, or change in measurement of a tax position taken in a prior annual period.
b. Earnings per Share—See paragraph 260-10-55-12 for guidance on the effect on earnings per share of changes in the number of common shares as a result of a stock dividend or stock split that occurs after the balance sheet date but before the financial statements are issued or are available to be issued.
c. Gain Contingencies—See paragraph 450-30-25-1 for guidance on gain contingencies that are rarely recognized after the balance sheet date but before the financial statements are issued or are available to be issued.

20 Glossary

Subsequent Events

Events or transactions that occur after the balance sheet date but before **financial statements are issued** or are **available to be issued**. There are two types of subsequent events:

a. The first type consists of events or transactions that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing financial statements (that is, recognized subsequent events).
b. The second type consists of events that provide evidence about conditions that did not exist at the date of the balance sheet but arose subsequent to that date (that is, nonrecognized subsequent events).

> Recognized Subsequent Events

• > Evidence about Conditions That Existed at the Date of the Balance Sheet

25-1 An entity shall recognize in the financial statements the effects of all **subsequent events** that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing financial statements. See paragraph 855-10-55-1 for examples of recognized subsequent events.

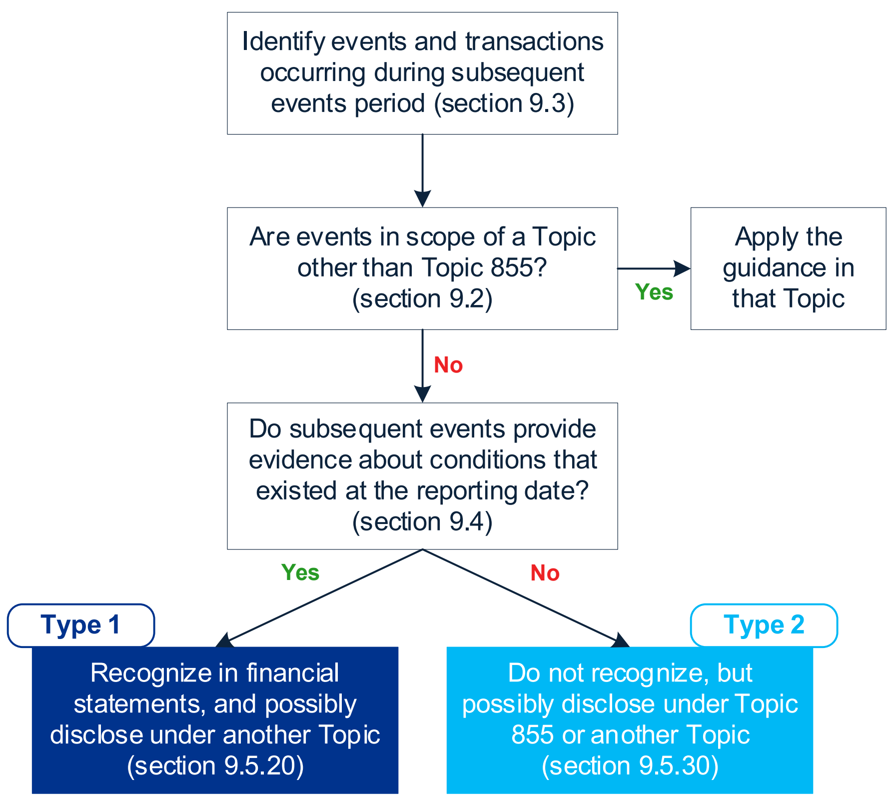
> Nonrecognized Subsequent Events

• > Evidence about Conditions That Did Not Exist at the Date of the Balance Sheet

25-3 An entity shall not recognize subsequent events that provide evidence about conditions that did not exist at the date of the balance sheet but arose after the balance sheet date but before **financial statements are issued** or are **available to be issued**. See paragraph 855-10-55-2 for examples of nonrecognized subsequent events.

A subsequent event is an event or transaction that occurs during the subsequent events period – i.e. after the reporting date but before the financial statements are issued (available to be issued). The subsequent events period is further explained in section 9.3.

There are two types of subsequent events: recognized (Type 1) and nonrecognized (Type 2) subsequent events. [855-10 Glossary]



Assessing whether subsequent events are recognized or nonrecognized is often very judgmental, and these judgments should be clearly documented.

Question 9.2.10
Does Topic 855 apply to all subsequent events?

Interpretive response: No. Certain Topics address the recognition and disclosure of subsequent events. If a subsequent event is in the scope of a Topic other than Topic 855, an entity follows the guidance in that Topic. [855-10-15-3 – 15-4]

The following are examples. [855-10-15-5]

- Topic 260 (earnings per share) addresses the effect on EPS of changes in the number of common shares as a result of a stock dividend or stock split that occurs during the subsequent events period. See section 9.2.30 of KPMG Handbook, Earnings per share.
- Topic 360 (property, plant and equipment) specifies when an entity classifies a long-lived asset as held-for-sale, as well as disclosure requirements. See section 4.4 of KPMG Handbook, Discontinued operations and held-for-sale disposal groups.
- Topic 450 (contingencies) elaborates on the guidance in Topic 855 and explains how to consider information obtained during the subsequent events period in relation to a loss or gain contingency. See section 9.4.30.
- Topic 740 (income taxes) explains how to consider information obtained during the subsequent events period. See KPMG Handbook, Accounting for income taxes.

Topic 855 applies to subsequent events not in the scope of another Topic. [855-10-15-3]

Question 9.2.20
What are recognized subsequent events?

Interpretive response: Recognized subsequent events (also referred to as Type 1) are those that provide additional evidence about conditions that existed at the reporting date, including the estimates inherent in the process of preparing financial statements. Assessing conditions at the reporting date may require judgment (see section 9.4). [855-10 Glossary]

Financial statements are prepared as if these existing conditions had been known at the reporting date (see section 9.5.10). [855-10-25-1]

Question 9.2.30
What are nonrecognized subsequent events?

Interpretive response: Nonrecognized subsequent events (also referred to as Type 2) are events that provide evidence about conditions that did not exist at the reporting date but arose subsequent to that date (e.g. natural disaster, business combination). [855-10 Glossary]

Because Type 2 events relate to conditions that did not exist at the reporting date, they are not recognized in the financial statements but might have to be disclosed (see section 9.5.20). [855-10-25-3]

9.3 Determine the subsequent events period

9.3.10 Financial statements are issued or available to be issued

Excerpt from ASC 855-10

20 Glossary

Financial Statements Are Available to Be Issued

Financial statements are considered available to be issued when they are complete in a form and format that complies with GAAP and all approvals necessary for issuance have been obtained, for example, from management, the board of directors, and/or significant shareholders. The process involved in creating and distributing the financial statements will vary depending on an entity's management and corporate governance structure as well as statutory and regulatory requirements.

Financial Statements Are Issued

Financial statements are considered issued when they are widely distributed to shareholders and other financial statement users for general use and reliance in a form and format that complies with GAAP. (U.S. Securities and Exchange Commission [SEC] registrants also are required to consider the guidance in paragraph 855-10-S99-2.)

Securities and Exchange Commission (SEC) Filer

An entity that is required to file or furnish its financial statements with either of the following:

a. The Securities and Exchange Commission (SEC)
b. With respect to an entity subject to Section 12(i) of the Securities Exchange Act of 1934, as amended, the appropriate agency under that Section.

Financial statements for other entities that are not otherwise SEC filers whose financial statements are included in a submission by another SEC filer are not included within this definition.

> Recognized Subsequent Events

• > Evidence about Conditions That Existed at the Date of the Balance Sheet

25-1A An entity that meets either of the following criteria shall evaluate subsequent events through the date the financial statements are issued:

a. It is an **SEC filer**.
b. It is a conduit bond obligor for **conduit debt securities** that are traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local or regional markets).

25-2 An entity that meets neither criteria in the preceding paragraph shall evaluate subsequent events through the date that the financial statements are available to be issued.

> SEC Staff Guidance

• > Announcements Made by SEC Staff at Emerging Issues Task Force (EITF) Meetings

• • > SEC Staff Announcement: Issuance of Financial Statements

S99-2 The following is the text of SEC Staff Announcement: **Issuance of Financial Statements**.

In considering when financial statements have been issued, the SEC staff observed that Rules 10b-5 and 12b-20 under the Securities Exchange Act of 1934 and General Instruction C(3) to Form 10-K specify that financial statements must not be misleading as of the date they are filed with the Commission. For example, assume that a registrant widely distributes its financial statements but, before filing them with the Commission, the registrant or its auditor becomes aware of an event or transaction that existed at the date of the financial statements that causes those financial statements to be materially misleading. If a registrant does not amend those financial statements so that they are free of material misstatement or omissions when they are filed with the Commission, the registrant will be knowingly filing a false and misleading document. In addition, registrants are reminded of their responsibility to, at a minimum, disclose subsequent events, [FN1] while independent auditors are reminded of their responsibility to assess subsequent events [FN2] and evaluate the impact of the events or transactions on their audit report. [FN3]

[FN1] See AU Section 560, Subsequent Events, paragraphs 5 and 8 and Section 855-10-50.

[FN2] See AU 560 and AU Section 561, Subsequent Discovery of Facts Existing at Date of the Auditor's Report.

[FN3] See AU Section 530, Dating of the Independent Auditor's Report, and AU 560, paragraph 9.

A registrant and its independent auditor have responsibilities with regard to post-balance-sheet-date subsequent events, as well as the application of authoritative literature applicable to such events. See Topic 855 and AU 560, Subsequent Events, paragraph 3.

Generally, the staff believes that financial statements are "issued" as of the date they are distributed for general use and reliance in a form and format that complies with generally accepted accounting principles (GAAP) and, in the case of annual financial statements, that contain an audit report that indicates that the auditors have complied with generally accepted auditing standards (GAAS) in completing their audit. Issuance of financial statements then would generally be the earlier of when the annual or quarterly financial statements are widely distributed to all shareholders and other financial statement users [FN4] or filed with the Commission. Furthermore, the issuance of an earnings release does not constitute issuance of financial statements because the earnings release would not be in a form and format that complies with GAAP and GAAS.

[FN4] Posting financial statements to a registrant's web site would be considered wide distribution to all shareholders and other financial statement users if the registrant uses its web site to disclose information to the public in a manner consistent with the requirements of Regulation FD. See the Commission's interpretive guidance in Exchange Act Release No. 58288 (Aug. 7, 2008).

Subsequent events are assessed through the end of the subsequent events period, which is the date the financial statements are issued or available to be issued, depending on the type of entity. [855-10-25-1A – 25-2]

Question 9.3.10
When does the subsequent events period end?

Interpretive response: The end of the subsequent events period varies by type of entity. [855-10-25-1A – 25-2]

Type of entity	Subsequent events period ends when the financial statements are:
SEC filer, including voluntary filer (see Question 9.3.20), or conduit bond obligor	Issued
Non-SEC filer, including a non-SEC filer whose financial statements are included in an SEC filing of another entity (see Question 9.3.30)	Available to be issued

An SEC filer is an entity that is required to file or furnish financial statements with either the SEC or, for an entity subject to Section 12(i) of the Securities Exchange Act of 1934 (as amended), the appropriate agency under that Section. [855-10 Glossary]

Question 9.3.20
When does the subsequent events period end for an entity during the IPO process?

Interpretive response: The SEC staff believes that a registrant does not become an SEC filer until its initial registration statement goes effective because that is the point at which it becomes required by regulation to file or furnish financial statements with the SEC. Therefore, registrants that have filed their IPO registration statement are not considered SEC filers. An entity whose financial statements were available to be issued before the filing of its financial statements with the SEC does not have to 're-open' its subsequent events recognition period through the date of filing. Because the entity is not yet an SEC filer, the date through which subsequent events have been evaluated is disclosed (see Question 9.5.60). [CAQ 04/2010]

In addition, subsequent events occurring after the date the financial statements have been made available for issuance but before the financial statements are filed (reissued) may need to be disclosed to prevent the financial statements from being misleading. To provide additional context, we believe that disclosing the date through which subsequent events were evaluated for disclosure (i.e. the date of filing) is a best practice. [S-X Rule 4-01, 855-10-25-4]

Example 9.3.10
Non-SEC filer financial statements included in IPO registration statement

ABC Corp is a calendar year-end company. As part of an IPO, ABC files an initial Form S-1 on February 28, Year 2, which includes its Year 1 financial statements. The financial statements disclose that subsequent events were evaluated through February 28, Year 2, the date the financial statements were available to be issued. ABC is not considered an SEC filer until its Form S-1 is declared effective.

On April 15, Year 2, ABC settles material litigation from a Year 1 incident. The related loss contingency was appropriately accrued in its Year 1 financial statements, based on the information available on February 28, Year 2. However, the litigation is settled for more than the accrual.

On May 1, Year 2, ABC files an amended Form S-1 to respond to SEC comments. ABC continues to disclose February 28, Year 2 as the date through which subsequent events were evaluated for recognition in the financial statements and does not recognize the litigation settlement. However, ABC discloses the litigation settlement in an unaudited note to the financial statements. To provide additional context to the litigation settlement disclosure, ABC discloses that subsequent events were evaluated for disclosure through May 1, Year 2.

Question 9.3.30
Is a voluntary filer an SEC filer?

Background: A voluntary filer is an entity that is not required to file reports under Sections 13 or 15(d) of the Exchange Act but does so voluntarily. For example, an entity may have a provision in a debt agreement that requires it to file financial statements with the SEC as long as the debt is outstanding. [CAQ 04/2010]

Interpretive response: Yes. While a voluntary filer is not required by regulation to file reports with the SEC, the SEC staff believes voluntary filers should apply Topic 855 as if they were registrants. This is because the staff generally expects a voluntary filer to comply with all public company reporting requirements.

Question 9.3.40
If a nonpublic entity's financial statements are included in the filing of a registrant, is the nonpublic entity an SEC filer?

Interpretive response: No. The financial statements of a nonpublic entity are often required to be included in a report filed by a registrant with the SEC – e.g. S-X Rule 3-05 financial statements for an acquired company or equity investee. Topic 855 specifically excludes these entities from the definition of an SEC filer. [855-10 Glossary]

Question 9.3.50
What is the difference between financial statements being 'issued' and 'available to be issued'?

Interpretive response: Financial statements are considered 'issued' when they are widely distributed to shareholders and other financial statement users for general use and reliance in a form and format that complies with US GAAP. The issuance of an earnings release does not constitute issuance of financial statements. [855-10 Glossary, 855-10-S99-2]

Financial statements are considered 'available to be issued' when they are complete in a form and format that complies with US GAAP and all approvals necessary for issuance have been obtained – e.g. from management, the board of directors or significant shareholders. [855-10 Glossary]

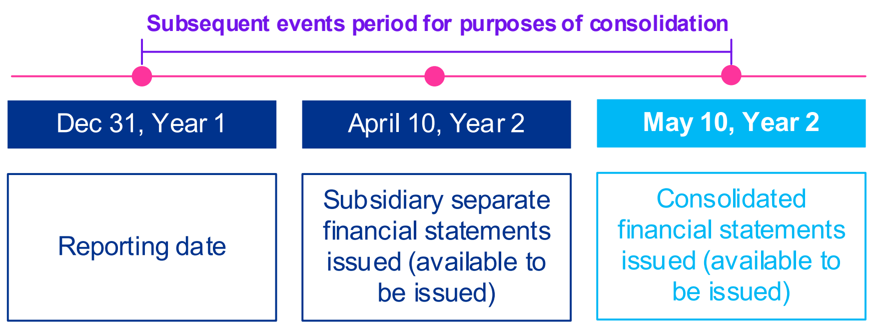
The FASB used the term 'available to be issued' because some nonpublic entities do not widely distribute their financial statements to shareholders or other financial statement users and may provide them to different users at different times. This accommodation is meant to be representative of issuance, and therefore we do not expect a significant difference between the date the financial statements are available to be issued and the date they are initially distributed. [FAS 165.A11]

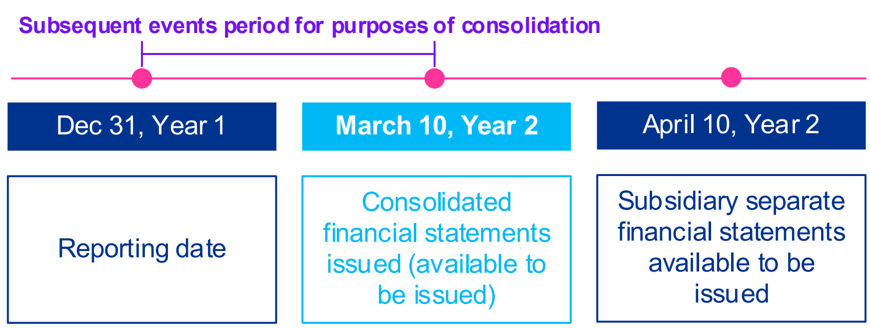
Question 9.3.60

What is the date through which a subsidiary evaluates subsequent events for the consolidated financial statements of its parent?

Question 9.3.80 addresses the date used by the subsidiary to evaluate subsequent events in its separate (often described as 'stand-alone') financial statements.

Interpretive response: For purposes of the consolidated financial statements of its parent, we believe a subsidiary should evaluate subsequent events through the end of the subsequent events period applicable to the consolidated financial statements. This is regardless of whether the consolidated financial statements of the parent are issued before or after the separate financial statements of the subsidiary as illustrated below.





We believe this also applies to a combined entity in combined financial statements.

Example 9.3.20
Combined financial statements issued after the financial statements of the combined entities

As part of an IPO, ABC Corp files a Form S-1 in May, Year 2, which includes the combined financial statements of Company A and Company B. Company A and Company B have each prepared separate financial statements for the year ended December 31, Year 1, and these were available to be issued before the IPO process. For their separate financial statements, Company A and Company B evaluated subsequent events through March 8 and 10, Year 2, respectively. ABC is not considered an SEC filer until its Form S-1 is declared effective.

Although Company A and Company B evaluated subsequent events through March 8 and 10, Year 2, respectively, in their separate financial statements, ABC continues to evaluate the events at Company A and at Company B for the effect on its combined financial statements through the date those financial statements are available to be issued in connection with the filing of the Form S-1 in May, Year 2.

9.3.20 Financial statements are reissued

Excerpt from ASC 855-10

20 Glossary

Revised Financial Statements

Financial statements revised only for either of the following conditions:

a. Correction of an error
b. Retrospective application of U.S. GAAP.

• > Reissuance of Financial Statements

25-4 An entity may need to reissue financial statements, for example, in reports filed with the SEC or other regulatory agencies. After the original issuance of the financial statements, events or transactions may have occurred that require disclosure in the reissued financial statements to keep them from being misleading. An entity shall not recognize events occurring between the time the financial statements were issued or were available to be issued and the time the financial statements were reissued unless the adjustment is required by GAAP or regulatory requirements. Similarly, an entity shall not recognize events or transactions occurring after the financial statements were issued or were available to be issued in financial statements that are later reissued in comparative form along with financial statements of subsequent periods unless the adjustment meets the criteria stated in this paragraph.

> Revised Financial Statements

50-4 Unless the entity is an SEC filer, an entity shall disclose in the **revised financial statements** the dates through which subsequent events have been evaluated in both of the following:

a. The issued or available-to-be-issued financial statements
b. The revised financial statements.

50-5 Revised financial statements are considered reissued financial statements. For guidance on the recognition of subsequent events in reissued financial statements, see paragraph 855-10-25-4.

Entities may need to revise and reissue their financial statements for a variety of reasons, such as correction of an error or retrospective application of US GAAP. See KPMG Handbook, Accounting changes and error corrections.

When an entity reissues its financial statements, Topic 855 prohibits the entity from recognizing events occurring between the time the financial statements were issued (available to be issued) and the time the financial statements were reissued unless the adjustment is required by US GAAP or regulatory requirements. However, events or transactions may have occurred that require disclosure in the reissued financial statements to keep them from being misleading. [855-10-25-4]

Question 9.3.70
Does the reissuance of financial statements affect the date through which subsequent events are evaluated?

Interpretive response: Generally, no. In some cases, entities will reissue financial statements to reflect retrospective application for certain changes in presentation. For example, when there are discontinued operations or changes in segments, US GAAP requires that the comparative financial statements retrospectively reflect these events.

These retrospective changes to previously issued financial statements do not affect the date through which subsequent events were evaluated – i.e. the financial statements issuance (available-for-issuance) date for that comparative period does not change as a result of the reissuance. As a result, the reissued financial statements cannot be adjusted for events that have occurred between the original issuance (available-for-issuance) date and the date of reissuance, unless the adjustment is specifically required by US GAAP or regulatory requirements. [855-10-25-4]

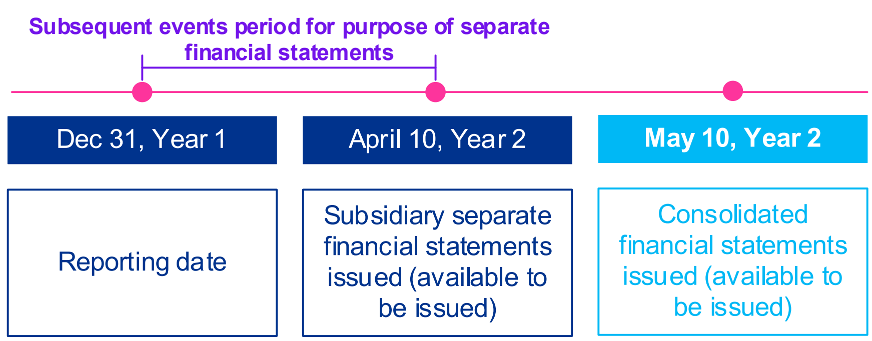
Question 9.3.80
What is the date through which a subsidiary evaluates subsequent events for its separate financial statements?

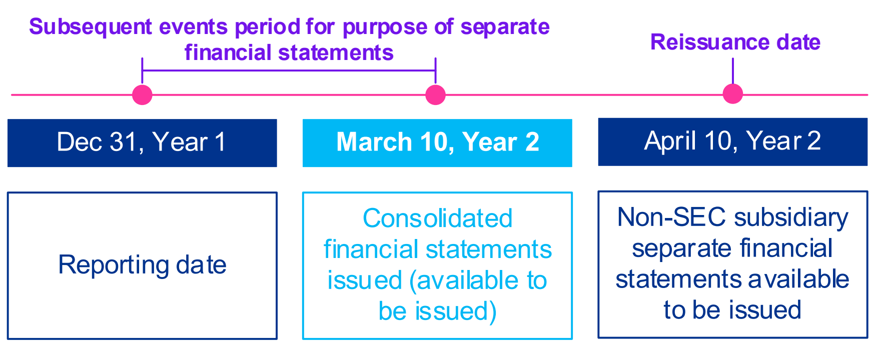
Question 9.3.60 addresses how a subsidiary evaluates subsequent events for the consolidated financial statements of its parent.

Interpretive response: For its separate financial statements, a subsidiary evaluates subsequent events through the date its financial statements are issued (available to be issued). [855-10-25-1A]

This date is generally straightforward, except when the subsidiary is a non-SEC filer and its separate financial statements are available to be issued after the parent's consolidated financial statements are issued (available to be issued). In this case, we believe that including the subsidiary's financial results in the parent's consolidated financial statements generally constitutes the end of the subsidiary's subsequent events period for its separate financial statements. This means the subsidiary's financial statements have been issued at that date and are considered subsequently reissued.

Therefore, the subsidiary may retain and disclose the date at which the consolidated financial statements of the parent are issued (available to be issued), to determine the end of the subsequent events period for recognition purposes in its separate financial statements (see Question 9.3.60), as illustrated below.





The subsidiary should still assess events or transactions that may occur after that date but before the date of so-called reissuance, for disclosure purposes only. In this scenario, any such events that require disclosure (see section

9.5.20) to keep the financial statements from being misleading are not recognized at the reporting date. To provide context, we believe that disclosing the date through which subsequent events were evaluated for disclosure purposes only is a best practice. [855-10-25-4]

We believe this position also applies to combined and carve-out financial statements when the components are non-SEC filers.

However, in our experience, some entities evaluate subsequent events through the date their separate financial statements are issued (available to be issued), without consideration of the parents' consolidated financial statements subsequent events period. [855-10-25-1A]

Example 9.3.30
Subsequent events in the financial statements of a subsidiary

ABC Corp is a non-SEC filer consolidated subsidiary of Parent. Historically, only consolidated financial statements of Parent were issued. Both Parent and ABC have a December 31 year-end.

In Year 3, ABC received a claim of damages related to services provided by a subcontractor under its direction. Management estimated the range of possible unfavorable outcomes of the loss contingency at between $2 million and $5 million, with no amount within the range a better estimate than any other amount.

The following additional facts are relevant.

- February 25, Year 4: Parent issues its Year 3 consolidated financial statements. Under Topic 450 (contingencies), the Year 3 consolidated financial statements include a liability for the minimum amount in the range ($2 million), with appropriate disclosure.
- December 1, Year 4: More information becomes available, and ABC management's best estimate of the loss claim becomes $5 million.
- February 25, Year 5: Parent issues its Year 4 consolidated financial statements. The Year 4 consolidated financial statements reflect the contingent liability of $5 million, adjusted from Year 4 as a change in estimate with appropriate disclosure.
- April 1, Year 5: ABC settles the contingent liability for $7 million.
- June 30, Year 5: ABC management prepares separate financial statements of ABC, for the first time, for the years ended December 31, Year 3 and Year 4.

For its Year 4 separate financial statements, ABC evaluates subsequent events for recognition through the date Parent's consolidated financial statements were issued (i.e. February 25, Year 5). This is because ABC is consolidated by Parent and is not an SEC-filer.

The settlement of the contingent liability on April 1, Year 5 therefore occurs after the end of the subsequent events period. Therefore, ABC determines that its separate financial statements must reflect the contingent liability of $2 million and $5 million as of December 31, Year 3 and Year 4, respectively – i.e. in the same amounts and periods as Parent's previously issued consolidated financial statements. ABC also determines that the settlement on April 1, Year 5 must be disclosed in its separate financial statements to keep them from being misleading.

ABC discloses the date through which subsequent events have been evaluated (i.e. February 25, Year 5) (see section 9.5.30), and the settlement of the contingent liability as a nonrecognized subsequent event.

9.4 Assess whether subsequent events are recognized or nonrecognized

Excerpt from ASC 855-10

> Implementation Guidance

• > Recognized Subsequent Events

55-1 The following are examples of recognized **subsequent events** addressed in paragraph 855-10-25-1:

a. If the events that gave rise to litigation had taken place before the balance sheet date and that litigation is settled after the balance sheet date but before the **financial statements are issued** or are **available to be issued**, for an amount different from the liability recorded in the accounts, then the settlement amount should be considered in estimating the amount of liability recognized in the financial statements at the balance sheet date.
b. Subsequent events affecting the realization of assets, such as receivables and inventories or the settlement of estimated liabilities, should be recognized in the financial statements when those events represent the culmination of conditions that existed over a relatively long period of time. For example, a loss on an uncollectible trade account receivable as a result of a customer's deteriorating financial condition leading to bankruptcy after the balance sheet date but before the financial statements are issued or are available to be issued ordinarily will be indicative of conditions existing at the balance sheet date. Thus, the effects of the customer's bankruptcy filing shall be considered in determining the amount of uncollectible trade accounts receivable recognized in the financial statements at balance sheet date.

• > Nonrecognized Subsequent Events

55-2 The following are examples of nonrecognized subsequent events addressed in paragraph 855-10-25-3:

a. Sale of a bond or capital stock issued after the balance sheet date but before financial statements are issued or are available to be issued
b. A business combination that occurs after the balance sheet date but before financial statements are issued or are available to be issued (Topic 805 requires specific disclosures in such cases.)
c. Settlement of litigation when the event giving rise to the claim took place after the balance sheet date but before financial statements are issued or are available to be issued
d. Loss of plant or inventories as a result of fire or natural disaster that occurred after the balance sheet date but before financial statements are issued or are available to be issued
e. Losses on receivables resulting from conditions (such as a customer's major casualty) arising after the balance sheet date but before financial statements are issued or are available to be issued
f. Changes in the fair value of assets or liabilities (financial or nonfinancial) or foreign exchange rates after the balance sheet date but before financial statements are issued or are available to be issued
g. Entering into significant commitments or contingent liabilities, for example, by issuing significant guarantees after the balance sheet date but before financial statements are issued or are available to be issued.

Pending Content

Transition Date: (P) December 16, 2019; (N) December 16, 2022 ¦ **Transition Guidance**: 326-10-65-1

e. Changes in estimated credit losses on receivables arising after the balance sheet date but before financial statements are issued or are available to be issued

As discussed in section 9.2, subsequent events fall into two broad types.

Recognized events (Type 1)	Nonrecognized events (Type 2)
Events or transactions that provide additional evidence about conditions that *existed* at the reporting date.	Events that provide evidence about conditions that *did not exist* at the reporting date but arose subsequent to that date.

Assessing whether subsequent events are recognized or nonrecognized requires an entity to understand what conditions existed at the reporting date and how those might be affected by the subsequent events. Although Topic 855 provides examples of recognized and nonrecognized subsequent events, this determination by its nature can be very judgmental, particularly when estimates or contingencies are involved.

9.4.10 General considerations

Question 9.4.10
How can subsequent events provide additional evidence about conditions that existed at the reporting date?

Interpretive response: Subsequent events are recognized when they provide additional evidence about conditions that existed at the reporting date. We believe this can happen in two ways. Subsequent events can provide additional evidence relevant to:

- an accounting judgment, such as confirmation that a liability has been incurred or an asset has been impaired at the reporting date. Question 9.4.80 illustrates this concept in the context of a litigation claim. By contrast, subsequent events that confirm that a liability has been incurred or an asset has been impaired after the reporting date are nonrecognized subsequent events (see Example 9.4.10);
- the measurement of an estimate at the reporting date (see Question 9.4.50). By contrast, changes in market conditions after the reporting date do not provide evidence of conditions that existed at the reporting date and are nonrecognized subsequent events (see Question 9.4.60).

Because it is difficult to separate the benefit of hindsight when assessing conditions existing at an earlier date, it is important that judgments about those conditions and their implications on accounting judgments and measurement of estimates be documented together with supporting evidence on a timely basis.

Example 9.4.10
Hurricane as a nonrecognized subsequent event

After year-end and before the Year 1 financial statements are issued, a hurricane damages one of ABC Corp's major shipping terminals.

ABC determines that the hurricane is a nonrecognized subsequent event because it does not provide evidence about conditions that existed at year-end. Therefore, it is not appropriate for the loss to be accrued or the corresponding long-lived assets to be impaired at year-end.

ABC further assesses whether it should disclose the nature and effect of the subsequent event (see section 9.5.20).

Question 9.4.20
Are similar subsequent events always characterized similarly?

Interpretive response: No. To assess if subsequent events are recognized or nonrecognized, we believe an entity should carefully consider their nature and timing as well as the context in which they are evaluated. Conclusions may vary based on the applicable guidance besides Topic 855 (see Question 9.2.10), and an entity should refrain from making analogies between Codification Topics. Conclusions may also vary under Topic 855 in the context of an accounting judgment or an estimate (see Question 9.4.10).

Question 9.4.30
How are large scale or global events considered?

Interpretive response: For large scale or global events, we believe entities may need to separately assess a series of unfolding subsequent events, instead of focus on a single subsequent event, before concluding that they are recognized or nonrecognized subsequent events.

For example, in the case of COVID-19, in our experience entities separately assessed the effects of each outbreak in each relevant geography, local containment measures or government aid package announcements.

In the case of the Russia-Ukraine war, there are many potential consequences for entities, such as termination of operations in Ukraine or Russia; effects of economic sanctions on Russia; stranded, idle or lost assets; or decisions to exit specific markets. Entities need to assess whether these and other consequences of the war are:

- subsequent events to be separately assessed; or
- consequences of the war that could be expected at the reporting date and should be recognized if the reporting date is after the beginning of the military invasion of Ukraine on February 24, 2022.

Each entity may be affected differently by large scale events and must make its own determination.

Question 9.4.40
How are subsequent events considered in the going concern assessment?

Interpretive response: As discussed in section 2.3 of KPMG Handbook, Going concern, the going concern assessment is based on relevant conditions and events that are known and reasonably knowable as of the date the financial statements are issued (available to be issued). Therefore, all events and transactions in the subsequent events period are relevant to the going concern assessment and disclosures, regardless of whether they are recognized or nonrecognized under Topic 855.

9.4.20 Estimates

Question 9.4.50
Are all subsequent events affecting estimates recognized subsequent events?

Interpretive response: No. We believe the entity needs to consider the nature and timing of the event or transaction providing new information about the estimate (see Question 9.4.10) and how the estimate is derived – e.g. methodology and assumptions used.

Information relates to conditions that existed at the reporting date

If the information relates to conditions that existed at the reporting date, the new information represents a recognized subsequent event. For example, an external valuation report as of the reporting date is received in the subsequent events period. In addition, Topic 855 requires that: [855-10-55-1]

- subsequent events affecting the realization of assets, such as receivables and inventories, or the settlement of estimated liabilities be recognized when those events represent the culmination of conditions that existed over a relatively long period of time – e.g. a customer bankruptcy; and
- settlement of a litigation existing at the reporting date, for an amount different than that accrued, be considered in the estimate of the liability.

Information relates to conditions that changed after the reporting date

If the information relates to conditions that changed after the reporting date, including changes in market conditions (see Question 9.4.60), the new information represents a nonrecognized subsequent event. For example, after the reporting date, a competitor launched a new product that decreases the net realizable value of inventory.

However, such changes may require the entity to reevaluate whether all conditions existing at the reporting date were adequately considered. For example, sales volumes and prices in the subsequent events period may provide insights about the reliability of forecasts used to measure inventory net realizable value at the reporting date.

Example 9.4.20
Change in loss contingency estimate assumptions after reporting date – recognized event

A week before year-end, ABC Corp suffers a significant loss resulting from hurricane damage to one of its major shipping terminals. At year-end, ABC estimates the loss assuming that two of its five slips remain operational. A month later, before the financial statements are issued, ABC obtains an engineering report concluding that, due to the hurricane damage, none of the slips are operational.

ABC determines that the engineering report represents a recognized subsequent event because the additional information provides evidence about conditions that existed at year-end. Therefore, ABC revises its loss estimate at year-end to reflect information in the report.

Example 9.4.30
Change in goodwill impairment estimate assumptions after reporting date – nonrecognized event

After year-end and before the Year 1 financial statements are issued, ABC Corp loses a significant contract with a customer. The loss of this customer may indicate that it is more likely than not that the fair value of goodwill is below its carrying amount.

As part of ABC's Year 1 qualitative impairment test (Step 0), there were no indications that the contract with the customer would not be renewed – the customer was financially stable and had made no statement about nonrenewal – and therefore ABC determined that there were no signs of impairment necessitating a quantitative test.

Based on the information available about the customer and the outcome of the impairment test at year-end, ABC determines that the nonrenewal was not known or assumed and was not a result of conditions that existed at the reporting date. Therefore, the event is a nonrecognized subsequent event. The information will be considered in the impairment analysis during the Q2 of Year 2.

ABC further assesses whether to disclose the nature and effect of the subsequent event (see section 9.5.20).

Question 9.4.60
Is the change in market conditions a recognized subsequent event?

Interpretive response: No. A change in market conditions is a nonrecognized subsequent event – e.g. a change in market prices or foreign exchange rates that affects the fair value of an asset or liability. An entity recognizes only the effects of subsequent events that provide additional evidence about conditions that existed at the reporting date, not conditions that changed after the reporting date. [TQA 9070.06, 855-10-55-2(f)]

For example, volatile market conditions can cause credit spreads to widen and market prices of many loans and debt securities to decline. While these types of market price declines that occur during the subsequent events period are nonrecognized subsequent events, entities may have to disclose their nature and effect (see section 9.5.20).

Example 9.4.40
Effect on fair value measurement of Federal Open Market Committee Statement

On January 25, Year 2, the Federal Open Market Committee (FOMC) announces that it plans to hold the federal funds rate at current levels until mid-Year 4. Before this statement, market participants had assumed that the FOMC would hold rates at current levels through mid-Year 3.

ABC Corp's fair value measurement of its asset management reporting unit specifically incorporates the FOMC outlook on short-term rates as a significant assumption used to forecast cash flows. ABC believes this assumption is relevant because of the correlation between current short-term rates and certain money market fee waiver practices.

ABC determines that it cannot consider the FOMC statement on short-term rates in the fair value measurement of its asset management reporting unit as of December 31, Year 1. The FOMC statement represents a change in market participants' assumptions. Specifically, it is a change in monetary policy relative to what was expected by market participants at December 31, Year 1.

Therefore, this change in policy is a nonrecognized subsequent event, and ABC reflects the change in the fair value measurement of its asset management reporting unit in the reporting period that includes the change – i.e. the period including January 25, Year 2. This is true even though the FOMC's statement may have been based on its views of existing market forces. Because the FOMC's statements shape market forces going forward, the statement itself represents the change in assumption, not the underlying market forces that may have led to the FOMC's statement.

ABC further assesses whether to disclose the nature and effect of the subsequent event (see section 9.5.20).

Question 9.4.70
How are subsequent events assessed in the context of receivables impairment?

Interpretive response: It depends on whether the entity has adopted ASU 2016-13 on credit losses.

After ASU 2016-13 adoption

ASU 2016-13 amended Topic 855 to provide that changes in estimated credit losses on receivables arising after the reporting date but before the financial statements are issued (available to be issued) are not reflected in the allowance for credit losses at the reporting date. [855-10-55-2(e)]

Under the expected loss model, lifetime expected credit losses are estimated immediately when a financial asset is originated or purchased (i.e. projection of future conditions). Therefore, conditions related to forecasting assumptions that existed at the reporting date do not require adjustment within the expected loss model. Adjustment to the allowance for credit losses may be required if the subsequent event information is asset-specific and relates to conditions that existed as of the reporting date (e.g. appraisal reports).

See chapter 21 of KPMG Handbook, Credit impairment, for further guidance.

Before ASU 2016-13 adoption

Under the incurred loss impairment model, losses are recognized when a probable threshold is met. Therefore, the entity determines whether subsequent events affect the realization of assets and need to be reflected in the impairment allowance at the reporting date – i.e. whether the events provide evidence about conditions that existed (e.g. a customer bankruptcy – see Question 9.4.50) or did not exist (e.g. a customer's subsequent major casualty) at the reporting date.

9.4.30 Contingencies

Question 9.4.80
How are subsequent events assessed in the context of loss contingencies?

Background: A loss contingency is recognized when information available before the financial statements are issued (available to be issued) indicates that it is probable that a liability has been incurred (i.e. it is probable that a present obligation exists) at the reporting date and the amount of loss can be reasonably estimated. Probable means likely to occur. [450-20-25-2, CON 8.E38]

Interpretive response: Subtopic 450-20 (loss contingencies) requires that information obtained during the subsequent events period be considered in the recognition assessment for loss contingencies. Topic 855 specifically addresses the effect of litigation settlements on the measurement of the loss estimate. [450-20-25-2, 25-6, 855-10-55-1(a)]

We believe the nature of the subsequent events should be assessed to determine if they fall in any of the following categories.

Category	Type	Example
Creates a new obligation after the reporting date [855-10-55-2(c)]	2	An employee's work-related injury during the subsequent events period creates a new obligation for the employer. Such subsequent events may need to be disclosed (see section 9.5.20).
Confirms that the existence of a present obligation was probable at the reporting date [450-20-25-6]	1	A claim received from an employee during the subsequent events period for a work-related injury that occurred before the reporting date confirms that a present obligation existed at the reporting date.
Provides additional evidence relevant to the measurement of the loss estimate (see Question 9.4.50) [855-10-55-1(a)]	1	The settlement of litigation existing at the reporting date, for an amount different from that accrued, is considered in the estimate of the liability; see also Examples 9.4.20 and 9.4.50.

Example 9.4.50
Merger agreement terminated after the reporting date

ABC Corp is in the process of merging with XYZ Corp. The following facts are relevant.

- April 1, Year 1: ABC enters into a merger agreement with XYZ. The merger agreement requires ABC to pay a termination fee if the merger is determined to violate anti-trust provisions.
- September 1, Year 1: the US Department of Justice files a civil complaint claiming violation of anti-trust provisions and seeking to prevent the merger.
- February 1, Year 2: a US District Court rules the merger violates anti-trust provisions. The ruling is not subject to appeal.
- March 15, Year 2: December 31, Year 1 financial statements are issued.

ABC recognizes the termination fee in Year 1 because the present obligation results from the signing of the merger agreement that is ultimately determined to be a violation of law. The District Court's Year 2 determination that the merger violated law is information obtained in the subsequent events period that confirms a matter that existed at the reporting date.

Example 9.4.60
Change in expected settlement relating to unpaid sales and use taxes

ABC Corp owes between $5 million and $10 million in unpaid state sales and use taxes. The following facts are relevant.

- April 1, Year 1: ABC files a voluntary disclosure petition with the state's taxing authority to take advantage of potential statute of limitations and penalty waiver benefits in hopes of reducing its tax liability.
- December 31, Year 1: ABC has not heard from the state's taxing authority about its petition; its best estimate of sales and use tax due under Topic 450 (contingencies) is $8 million.
- February 1, Year 2: the taxing authority informs ABC that it accepts the voluntary disclosure petition, against payment of $6 million in full satisfaction of back amounts owed.
- March 15, Year 2: December 31, Year 1 financial statements are issued.

In its Year 1 financial statements as of December 31, Year 1, ABC records a $6 million liability. The taxing authority's decision to accept settlement of $6 million represents additional information about the disposition of the petition filed before year-end and ABC's uncertain sales tax obligations existing as of year-end. The facts and circumstances did not change after year-end; instead, the taxing authority's response provided additional evidence to confirm conditions (i.e. the liability) that existed at the reporting date.

Question 9.4.90
How are subsequent events assessed in the context of gain contingencies?

Background: Under Subtopic 450-30 (gain contingencies), contingencies that may result in a gain are recognized when the gain is realized or realizable. This typically only occurs when the claim is settled and proceeds are received and not subject to refund. [450-30-25-1]

Interpretive response: If a gain contingency was probable at the reporting date and is settled during the subsequent events period, the settlement is a nonrecognized subsequent event. The gain contingency is recognized in the period the gain is realized or becomes realizable. The entity also needs to assess whether to disclose the nature and effect of the subsequent event (see section 9.5.20). [450-30-25-1, 50-1]

Question 9.4.100
How are subsequent events assessed in the context of loss recoveries?

Background: The accounting for loss recoveries is not directly addressed in the Codification. Analogies are often made to the following guidance regarding:

- involuntary conversions (Subtopic 610-30);
- how to account for the impact of the September 11, 2001 terrorist attacks (superseded EITF Issue 01-10); and
- environmental obligations (Subtopic 410-30).

A loss recovery (e.g. from insurance) is recognized when recovery is probable and reasonably estimable and is directly linked to the insured event. It is limited to the amount of the loss or costs incurred. Probable means likely to occur. This probability-based approach may allow entities to recognize a loss recovery in the same reporting period that the loss or costs are incurred. [410-30-35-8, 450-20-25-1]

Interpretive response: We believe a loss recovery does not need to be settled before the end of the subsequent events period to be recognized at the reporting date; however, settlement can provide evidence about the conditions that existed at the reporting date if it is directly linked to a loss or costs incurred before the reporting date. For example, an insurance settlement confirms that the loss or costs incurred in the prior period were covered under the insurance policy and therefore may indicate that the recovery was probable at the reporting date. We believe the settlement amount should be considered in the estimate.

However, amounts recovered in excess of a loss or costs incurred are gain contingencies and nonrecognized subsequent events. See Question 9.4.90.

Example 9.4.70
Natural disaster and related insurance recovery

This example is adapted from the example in AICPA TQA 5100.35.

ABC Corp suffers equipment damage due to a natural disaster. The following facts are relevant.

- September 1, Year 1: ABC's equipment is destroyed by a hurricane. The equipment has a net book value of $1,000 and an estimated replacement cost of $1,500. ABC places a claim with its insurance shortly thereafter.
- December 31, Year 1: discussions with the insurer are ongoing.
- February 1, Year 2: ABC reaches a settlement with the insurer for $1,300 (net of deductible).
- March 15, Year 2: December 31, Year 1 financial statements are issued.

In its Year 1 financial statements, ABC writes off the net book value of the destroyed equipment of $1,000 and recognizes an asset of $1,000 for the probable recovery of its loss. ABC applies the loss recovery model to the portion of the expected insurance proceeds up to the amount of the recognized loss. The settlement during the subsequent events period confirms that the hurricane is an insured event and that the probable threshold was reached at the reporting date.

ABC recognizes the remaining recovery of $300 in the following period when the settlement is reached – i.e. the insurance proceeds in excess of the loss represent a gain contingency recognized when realized (or realizable). This is because settlement of the claim is a nonrecognized subsequent event when it relates to a gain contingency. ABC further assesses whether to disclose the nature and effect of the subsequent event (see section 9.5.20).

9.4.40 Change in law or regulation

Question 9.4.110#
How does an entity recognize the effects of law or regulation changes after the reporting date?

Background: The enactment date for a change in law or regulation is the date that the legislation becomes law, not the date the law is applicable or the periods for which it is applicable. For example:

- The President of the United States signs a law on December 22, 20X7 with provisions stating that it is effective January 1, 20X8. The enactment date is December 22, 20X7, not January 1, 20X8.
- Congress approves a bill on December 22, 20X7 with provisions stating that it is retroactively effective as of January 1, 20X7. It is signed into law by the President on January 1, 20X8. The enactment date is January 1, 20X8.

Interpretive response: We believe that changes in law or regulations should not be anticipated, even when probable at the reporting date. Instead, the effects of these changes should only be recognized in the period of enactment. If the enactment date is during the subsequent events period, the entity also needs to assess whether to disclose the nature and effect of the subsequent event (see section 9.5.20).

This approach is consistent with Topic 740, which requires that the effects of changes in income tax law be recognized in the period that includes the law's enactment date, even when there are retroactive provisions; see section 5 of KPMG Handbook, Accounting for income taxes. While Topic 740 addresses only changes in income tax law, we believe the recognition principle of Topic 740 is consistent with Topic 855 – i.e. the conditions (the tax law change) – did not exist at the reporting date. [740-10-25-45 – 25-46]

Example 9.4.80
Change in non-income tax law

The American Taxpayer Relief Act of 2012 (the Act), signed on January 2, 2013, contained provisions that were retroactively applied to periods beginning on January 1, 2012, for non-income-based tax items that were excluded from the scope of Topic 740 – e.g. alternative fuel excise tax credits and outlay payments for various alternative fuels.

Because the Act was signed into law on January 2, 2013, the effects of the new law were recognized for financial reporting purposes as of January 2, 2013. The January 2, 2013, effects included the catch-up adjustment, if any, to capture the retroactive changes that applied to the 2012 tax year.

9.5 Recognition and disclosure

9.5.10 Recognized subsequent events

The financial statements at the reporting date are adjusted for recognized subsequent events. [855-10-25-1]

Question 9.5.10
What are the effects of recognized subsequent events on financial statements?

Interpretive response: Recognized subsequent events may affect accounting judgments or the measurement of an estimate (see Question 9.4.10).

Topic 855 does not require an entity to disclose recognized subsequent events. However, their effects are disclosed when required under the Topic applicable to that transaction. [855-10-15-4]

9.5.20 Nonrecognized subsequent events

Excerpt from ASC 855-10

> Nonrecognized Subsequent Events

50-2 Some nonrecognized subsequent events may be of such a nature that they must be disclosed to keep the financial statements from being misleading. For such events, an entity shall disclose the following:

a. The nature of the event
b. An estimate of its financial effect, or a statement that such an estimate cannot be made.

50-3 An entity also shall consider supplementing the historical financial statements with pro forma financial data. Occasionally, a nonrecognized subsequent event may be so significant that disclosure can best be made by means of pro forma financial data. Such data shall give effect to the event as if it had occurred on the balance sheet date. In some situations, an entity also shall consider presenting pro forma statements, usually a balance sheet only, in columnar form on the face of the historical statements.

Topic 855 does not exhaustively describe which subsequent events to disclose. Instead, it requires that nonrecognized subsequent events be disclosed if their disclosure is necessary to prevent the financial statements from being misleading. SEC regulations contain a similar provision. [855-10-50-2, SEC Rules 10b-5, 12b-20]

Question 9.5.20
When is a nonrecognized subsequent event disclosed?

Interpretive response: Determining whether disclosure is necessary requires judgment based on the nature of the event and facts and circumstances. In general, a nonrecognized subsequent event in the scope of Topic 855 is disclosed if the event is expected to have a material effect on the financial statements when recognized, or not disclosing it would otherwise be misleading. [SEC Rules 10b-5, 12b-20]

Examples of nonrecognized subsequent events that we would generally expect to be disclosed are debt extinguishments, capital transactions, investments or changes in ownership in subsidiaries, and quantitatively large changes in the fair value of assets. Subsequent events in the scope of a different Topic may have other specific disclosure requirements (see Question 9.2.10).

Question 9.5.30
Do subsequent events disclosures need to be in a single note?

Interpretive response: No. We believe disclosures related to subsequent events do not need to be located in a single note to the financial statements. However, they should be balanced and complete. For example, in the case of subsequent events related to COVID-19, it would not be appropriate for an entity to disclose the potential upside effect of a government aid package without mentioning the potential downside effects of COVID-19 on debt covenants. The expected impact on the going concern assessment under Subtopic 205-40 (see KPMG Handbook, Going concern) and disclosures of risks and uncertainties under Topic 275 (see chapter 7) may also need to be considered.

Question 9.5.40
Is quantitative disclosure of the estimated effect of nonrecognized subsequent events required?

Interpretive response: It depends. Quantitative disclosure of the estimated financial effect of a subsequent event is required, if such an estimate can be made. This estimate is based on facts available at the date the financial statements are issued (available to be issued). Monitoring through that date all available facts (e.g. market prices) and their effect on management's estimates may present operational challenges and require judgment in complex estimate models. [855-10-50-2]

We believe general forward-looking statements are not appropriate. For example, it would not be appropriate to disclose that "We expect the fair value of our investment to recover in the near future." But an entity could say "The fair value of our investment as of this date has declined by xx% since [reporting date]."

9.5.30 Disclosing the date through which subsequent events have been evaluated

Excerpt from ASC 855-10

> Date Through Which Subsequent Events Have Been Evaluated

50-1 If an entity is not an **SEC filer**, then the entity shall disclose both of the following:

a. The date through which **subsequent events** have been evaluated
b. Whether that date is either of the following:

   1. The date the **financial statements were issued**
   2. The date the **financial statements were available to be issued**.

Question 9.5.50
Is the date through which subsequent events have been evaluated disclosed?

Interpretive response: It depends. A non-SEC filer is required under Topic 855 to disclose the following items in the notes to financial statements: [855-10-50-1]

- the date through which subsequent events have been evaluated; and
- whether that date is either of the following:
  - the date the financial statements were issued; or
  - the date the financial statements were available to be issued.

An SEC filer is not required to disclose that a subsequent events evaluation has been performed, or the date through which it has been performed, but is not prohibited from doing so.

Question 9.5.60

Does an SEC filer disclose the date through which subsequent events have been evaluated in historical financial statements issued before becoming an SEC filer?

Interpretive response: An entity does not meet the definition of an SEC filer until the effective date of its initial SEC registration statement (see Question 9.3.20). The determination of whether a registrant is an SEC filer is made at the time the financial statements are first issued for purposes of determining the subsequent events period. Therefore, an entity that becomes an SEC filer continues disclosing the date through which subsequent events were evaluated in its historical financial statements that are reissued or revised – e.g. to report a discontinued operation (see section 9.3.20). [CAQ 04/2010]

For example, if a calendar year-end entity's initial registration statement is declared effective in November Year 3 and includes Year 1 and Year 2 financial statements, those financial statements (and any interim financial statements) must include the date through which subsequent events were evaluated. The entity becomes an SEC filer for its financial statements for the year ended December 31, Year 3, and is no longer be required to disclose the date through which subsequent events were evaluated.

Question 9.5.70#

Does an entity preparing special purpose financial statements disclose the date through which subsequent events have been evaluated?

Interpretive response: Yes. When special purpose financial statements (e.g. regulatory basis) contain items that are the same as, or similar to, those in financial statements prepared under US GAAP, informative disclosures similar to those required by US GAAP are necessary to achieve fair presentation. Therefore, the date through which subsequent events have been evaluated and the basis for that date are disclosed. [TQA 1500.07]

In addition, some nonrecognized subsequent events may require disclosure to keep the financial statements from being misleading. See Question 9.5.20. [TQA 1500.07]

Appendix

Excerpt from SAB Topic 1.B

Allocation Of Expenses And Related Disclosure In Financial Statements Of Subsidiaries, Divisions Or Lesser Business Components Of Another Entity

Facts: A company (the registrant) operates as a subsidiary of another company (parent). Certain expenses incurred by the parent on behalf of the subsidiary have not been charged to the subsidiary in the past. The subsidiary files a registration statement under the Securities Act of 1933 in connection with an initial public offering

1. Costs reflected in historical financial statements

Question 1: Should the subsidiary's historical income statements reflect all of the expenses that the parent incurred on its behalf?

Interpretive Response: In general, the staff believes that the historical income statements of a registrant should reflect all of its costs of doing business. Therefore, in specific situations, the staff has required the subsidiary to revise its financial statements to include certain expenses incurred by the parent on its behalf. Examples of such expenses may include, but are not necessarily limited to, the following (income taxes and interest are discussed separately below):

1. Officer and employee salaries,

2. Rent or depreciation,

3. Advertising,

4. Accounting and legal services, and

5. Other selling, general and administrative expenses.

When the subsidiary's financial statements have been previously reported on by independent accountants and have been used other than for internal purposes, the staff has accepted a presentation that shows income before tax as previously reported, followed by adjustments for expenses not previously allocated, income taxes, and adjusted net income.

Question 2: How should the amount of expenses incurred on the subsidiary's behalf by its parent be determined, and what disclosure is required in the financial statements?

Interpretive Response: The staff expects any expenses clearly applicable to the subsidiary to be reflected in its income statements. However, the staff understands that in some situations a reasonable method of allocating common expenses to the subsidiary (e.g., incremental or proportional cost allocation) must be chosen because specific identification of expenses is not practicable. In these situations, the staff has required an explanation of the allocation method used in the notes to the financial statements along with management's assertion that the method used is reasonable.

In addition, since agreements with related parties are by definition not at arms length and may be changed at any time, the staff has required footnote disclosure, when practicable, of management's estimate of what the expenses (other than income taxes and interest discussed separately below) would have been on a stand alone basis, that is, the cost that would have been incurred if the subsidiary had operated as an unaffiliated entity. The disclosure has been presented for each year for which an income statement was required when such basis produced materially different results.

Question 3: What are the staff's views with respect to the accounting for and disclosure of the subsidiary's income tax expense?

Interpretive Response: Recently, a number of parent companies have sold interests in subsidiaries, but have retained sufficient ownership interests to permit continued inclusion of the subsidiaries in their consolidated tax returns. The staff believes that it is material to investors to know what the effect on income would have been if the registrant had not been eligible to be included in a consolidated income tax return with its parent. Some of these subsidiaries have calculated their tax provision on the separate return basis, which the staff believes is the preferable method. Others, however, have used different allocation methods. When the historical income statements in the filing do not reflect the tax provision on the separate return basis, the staff has required a pro forma income statement for the most recent year and interim period reflecting a tax provision calculated on the separate return basis.1

Question 4: Should the historical income statements reflect a charge for interest on intercompany debt if no such charge had been previously provided?

Interpretive Response: The staff generally believes that financial statements are more useful to investors if they reflect all costs of doing business, including interest costs. Because of the inherent difficulty in distinguishing the elements of a subsidiary's capital structure, the staff has not insisted that the historical income statements include an interest charge on intercompany debt if such a charge was not provided in the past, except when debt specifically related to the operations of the subsidiary and previously carried on the parent's books will henceforth be recorded in the subsidiary's books. In any case, financing arrangements with the parent must be discussed in a note to the financial statements. In this connection, the staff has taken the position that, where an interest charge on intercompany debt has not been provided, appropriate disclosure would include an analysis of the intercompany accounts as well as the average balance due to or from related parties for each period for which an income statement is required. The analysis of the intercompany accounts has taken the form of a listing of transactions (e.g., the allocation of costs to the subsidiary, intercompany purchases, and cash transfers between entities) for each period for which an income statement was required, reconciled to the intercompany accounts reflected in the balance sheets.

Excerpt from SAB Topic 5.T

Accounting for Expenses or Liabilities Paid by Principal Stockholder(s)

Facts: Company X was a defendant in litigation for which the company had not recorded a liability in accordance with FASB ASC Topic 450, Contingencies. A principal stockholder[34] of the company transfers a portion of his shares to the plaintiff to settle such litigation. If the company had settled the litigation directly, the company would have recorded the settlement as an expense.

Question: Must the settlement be reflected as an expense in the company's financial statements, and if so, how?

Interpretive Response: Yes. The value of the shares transferred should be reflected as an expense in the company's financial statements with a corresponding credit to contributed (paid-in) capital.

The staff believes that such a transaction is similar to those described in FASB ASC paragraph 718-10-15-4 (Compensation – Stock Compensation Topic), which states that "share-based payments awarded to a grantee by a related party or other holder of an economic interest[35] in the entity as compensation for goods or services provided to the reporting entity are share-based payment transactions to be accounted for under this Topic unless the transfer is clearly for a purpose other than compensation for goods or services to the reporting entity." As explained in this paragraph, the substance of such a transaction is that the economic interest holder makes a capital contribution to the reporting entity, and the reporting entity makes a share-based payment to its grantee in exchange for goods or services provided to the reporting entity.

The staff believes that the problem of separating the benefit to the principal stockholder from the benefit to the company cited in FASB ASC Topic 718 is not limited to transactions involving stock compensation. Therefore, similar accounting is required in this and other[36] transactions where a principal stockholder pays an expense for the company, unless the stockholder's action is caused by a relationship or obligation completely unrelated to his position as a stockholder or such action clearly does not benefit the company.

Some registrants and their accountants have taken the position that since FASB ASC Topic 850, Related Party Disclosures, applies to these transactions and requires only the disclosure of material related party transactions, the staff should not analogize to the accounting called for by FASB ASC paragraph 718-10-15-4 for transactions other than those specifically covered by it. The staff notes, however, that FASB ASC Topic 850 does not address the measurement of related party transactions and that, as a result, such transactions are generally recorded at the amounts indicated by their terms.[37] However, the staff believes that transactions of the type described above differ from the typical related party transactions.

The transactions for which FASB ASC Topic 850 requires disclosure generally are those in which a company receives goods or services directly from, or provides goods or services directly to, a related party, and the form and terms of such transactions may be structured to produce either a direct or indirect benefit to the related party. The participation of a related party in such a transaction negates the presumption that transactions reflected in the financial statements have been consummated at arm's length. Disclosure is therefore required to compensate for the fact that, due to the related party's involvement, the terms of the transaction may produce an accounting measurement for which a more faithful measurement may not be determinable.

However, transactions of the type discussed in the facts given do not have such problems of measurement and appear to be transacted to provide a benefit to the stockholder through the enhancement or maintenance of the value of the stockholder's investment. The staff believes that the substance of such transactions is the payment of an expense of the company through contributions by the stockholder. Therefore, the staff believes it would be inappropriate to account for such transactions according to the form of the transaction.

Footnotes

[34] The FASB ASC Master Glossary defines principal owners as "owners of record or known beneficial owners of more than 10 percent of the voting interests of the enterprise."

[35] The FASB ASC Master Glossary defines an economic interest in an entity as "any type or form of pecuniary interest or arrangement that an entity could issue or be a party to, including equity securities; financial instruments with characteristics of equity, liabilities or both; long-term debt and other debt-financing arrangements; leases; and contractual arrangements such as management contracts, service contracts, or intellectual property licenses." Accordingly, a principal stockholder would be considered a holder of an economic interest in an entity.

[36] For example, SAB Topic 1.B indicates that the separate financial statements of a subsidiary should reflect any costs of its operations which are incurred by the parent on its behalf. Additionally, the staff notes that AICPA Technical Practice Aids §4160 also indicates that the payment by principal stockholders of a company’s debt should be accounted for as a capital contribution.

[37] However, in some circumstances it is necessary to reflect, either in the historical financial statements or a pro forma presentation (depending on the circumstances), related party transactions at amounts other than those indicated by their terms. Two such circumstances are addressed in Staff Accounting Bulletin Topic 1.B.1, Questions 3 and 4. Another example is where the terms of a material contract with a related party are expected to change upon the completion of an offering (i.e., the principal shareholder requires payment for services which had previously been contributed by the shareholder to the company).

Excerpt from Reg S-X Rule 4-08

General notes to financial statements.

If applicable to the person for which the financial statements are filed, the following shall be set forth on the face of the appropriate statement or in appropriately captioned notes. The information shall be provided for each statement required to be filed, except that the information required by paragraphs (b), (c), (d), (e), and (f) of this section shall be provided as of the most recent audited balance sheet being filed and for paragraph (j) of this section as specified therein. When specific statements are presented separately, the pertinent notes shall accompany such statements unless cross-referencing is appropriate.

(a) [Reserved]

(b) *Assets subject to lien*. Assets mortgaged, pledged, or otherwise subject to lien, and the approximate amounts thereof, shall be designated and the obligations collateralized briefly identified.

(c) *Defaults*. The facts and amounts concerning any default in principal, interest, sinking fund, or redemption provisions with respect to any issue of securities or credit agreements, or any breach of covenant of a related indenture or agreement, which default or breach existed at the date of the most recent balance sheet being filed and which has not been subsequently cured, shall be stated in the notes to the financial statements. If a default or breach exists but acceleration of the obligation has been waived for a stated period of time beyond the date of the most recent balance sheet being filed, state the amount of the obligation and the period of the waiver.

(d) Aggregate preferences on involuntary liquidation, if other than par or stated value, shall be shown parenthetically in the equity section of the balance sheet.

(e) *Restrictions which limit the payment of dividends by the registrant.*

  (1) Describe the most significant restrictions on the payment of dividends by the registrant, indicating their sources, their pertinent provisions, and the amount of retained earnings or net income restricted or free of restrictions.

  (2) Disclose the amount of consolidated retained earnings which represents undistributed earnings of 50 percent or less owned persons accounted for by the equity method.

  (3) The disclosures in paragraphs (e)(3)(i) and (ii) of this section shall be provided when material.

    (i) Describe the nature of any restrictions on the ability of consolidated subsidiaries and unconsolidated subsidiaries to transfer funds to the registrant in the form of cash dividends, loans or advances (i.e., borrowing arrangements, regulatory restraints, foreign government, etc.).

(ii) Disclose separately the amounts of such restricted net assets for unconsolidated subsidiaries and consolidated subsidiaries as of the end of the most recently completed fiscal year.

(f) *Significant changes in bonds, mortgages and similar debt*. Any significant changes in the authorized amounts of bonds, mortgages and similar debt since the date of the latest balance sheet being filed for a particular person or group shall be stated.

(g) *Summarized financial information of subsidiaries not consolidated and 50 percent or less owned persons.*

(1) The summarized information as to assets, liabilities and results of operations as detailed in § 210.1-02(bb) shall be presented in notes to the financial statements on an individual or group basis for:

(i) Subsidiaries not consolidated; or

(ii) For 50 percent or less owned persons accounted for by the equity method by the registrant or by a subsidiary of the registrant, if the criteria in § 210.1-02(w) for a significant subsidiary are met:

(A) Individually by any subsidiary not consolidated or any 50% or less owned person; or

(B) On an aggregated basis by any combination of such subsidiaries and persons.

(2) Summarized financial information shall be presented insofar as is practicable as of the same dates and for the same periods as the audited consolidated financial statements provided and shall include the disclosures prescribed by § 210.1-02(bb). Summarized information of subsidiaries not consolidated shall not be combined for disclosure purposes with the summarized information of 50 percent or less owned persons.

(h) *Income tax expense*.

(1) Disclosure shall be made in the statement of comprehensive income or a note thereto, of the components of income (loss) before income tax expense (benefit) as either domestic or foreign.(i) the components of income (loss) before income tax expense (benefit) as either domestic or foreign; (ii) the components of income tax expense, including (A) taxes currently payable and (B) the net tax effects, as applicable, of timing differences (indicate separately the amount of the estimated tax effect of each of the various types of timing differences, such as depreciation, warranty costs, etc., where the amount of each such tax effect exceeds five percent of the amount computed by multiplying the income before tax by the applicable statutory Federal income tax rate; other differences may be combined.)

Note 1 to paragraph (h)(1): Amounts applicable to United States Federal income taxes, to foreign income taxes and the other income taxes shall be stated separately for each major component. Amounts applicable to foreign income (loss) and amounts applicable to foreign or other income taxes which are less than five percent of the total of income before taxes or the component of tax expense, respectively, need not be separately disclosed. For purposes of this rule, foreign income (loss) is defined as income (loss) generated from a registrant's foreign operations, i.e., operations that are located outside of the registrant's home country.

(2) In the reconciliation between the amount of reported total income tax expense (benefit) and the amount computed by multiplying the income (loss) before tax by the applicable statutory Federal income tax rate, if no individual reconciling item amounts to more than five percent of the amount computed by multiplying the income before tax by the applicable statutory Federal income tax rate, and the total difference to be reconciled is less than five percent of such computed amount, no reconciliation need be provided unless it would be significant in appraising the trend of earnings. Reconciling items that are individually less than five percent of the computed amount may be aggregated in the reconciliation. Where the reporting person is a foreign entity, the income tax rate in that person's country of domicile should normally be used in making the above computation, but different rates should not be used for subsidiaries or other segments of a reporting entity. When the rate used by a reporting person is other than the United States Federal corporate income tax rate, the rate used and the basis for using such rate shall be disclosed.

(4) Price at which warrant or right is exercisable.

(i)-(j) [Reserved]

(k) *Related party transactions that affect the financial statements*.

(1) Amounts of related party transactions should be stated on the face of the balance sheet, statement of comprehensive income, or statement of cash flows.

(2) In cases where separate financial statements are presented for the registrant, certain investees, or subsidiaries, any intercompany profits or losses resulting from transactions with related parties and the effects thereof shall be disclosed.

(l) [Reserved]

(m) *Repurchase and reverse repurchase agreements*—

(1) *Repurchase agreements (assets sold under agreements to repurchase).*

(i) If, as of the most recent balance sheet date, the carrying amount (or market value, if higher than the carrying amount or if there is no carrying amount) of the securities or other assets sold under agreements to repurchase (repurchase agreements) exceeds 10% of total assets, disclose separately in the balance sheet the aggregate amount of liabilities incurred pursuant to repurchase agreements including accrued interest payable thereon.

(ii)

(A) If, as of the most recent balance sheet date, the carrying amount (or market value, if higher than the carrying amount) of securities or other assets sold under repurchase agreements, other than securities or assets specified in paragraph (m)(1)(ii)(B) of this section, exceeds 10% of total assets, disclose in an appropriately captioned footnote containing a tabular presentation, segregated as to type of such securities or assets sold under agreements to repurchase (e.g., U.S. Treasury obligations, U.S. Government agency obligations and loans), the following information as of the balance sheet date for each such agreement or group of agreements (other than agreements involving securities or assets specified in paragraph (m)(1)(ii)(B) of this section) maturing (1) overnight; (2) term up to 30 days; (3) term of 30 to 90 days; (4) term over 90 days and (5) demand:

(i) The carrying amount and market value of the assets sold under agreement to repurchase, including accrued interest plus any cash or other assets on deposit under the repurchase agreements; and

(ii) The repurchase liability associated with such transaction or group of transactions and the interest rate(s) thereon.

(B) For purposes of paragraph (m)(1)(ii)(A) of this section only, do not include securities or other assets for which unrealized changes in market value are reported in current income or which have been obtained under reverse repurchase agreements.

(iii) If, as of the most recent balance sheet date, the amount at risk under repurchase agreements with any individual counterparty or group of related counterparties exceeds 10% of stockholders' equity (or in the case of investment companies, net asset value), disclose the name of each such counterparty or group of related counterparties, the amount at risk with each, and the weighted average maturity of the repurchase agreements with each. The amount at risk under repurchase agreements is defined as the excess of carrying amount (or market value, if higher than the carrying amount or if there is no carrying amount) of the securities or other assets sold under agreement to repurchase, including accrued interest plus any cash or other assets on deposit to secure the repurchase obligation, over the amount of the repurchase liability (adjusted for accrued interest). (Cash deposits in connection with repurchase agreements shall not be reported as unrestricted cash pursuant to rule 5-02.1.)

(2) *Reverse repurchase agreements (assets purchased under agreements to resell).*

(i) If, as of the most recent balance sheet date, the aggregate carrying amount of "reverse repurchase agreements" (securities or other assets purchased under agreements to resell) exceeds 10% of total assets:

(A) Disclose separately such amount in the balance sheet; and

(B) Disclose in an appropriately captioned footnote:

(1) The registrant's policy with regard to taking possession of securities or other assets purchased under agreements to resell; and

(2) Whether or not there are any provisions to ensure that the market value of the underlying assets remains sufficient to protect the registrant in the event of default by the counterparty and if so, the nature of those provisions.

(ii) If, as of the most recent balance sheet date, the amount at risk under reverse repurchase agreements with any individual counterparty or group of related counterparties exceeds 10% of stockholders' equity (or in the case of investment companies, net asset value), disclose the name of each such counterparty or group of related counterparties, the amount at risk with each, and the weighted average maturity of the reverse repurchase agreements with each. The amount at risk under reverse repurchase agreements is defined as the excess of the carrying amount of the reverse repurchase agreements over the market value of assets delivered pursuant to the agreements by the counterparty to the registrant (or to a third party agent that has affirmatively agreed to act on behalf of the registrant) and not returned to the counterparty, except in exchange for their approximate market value in a separate transaction.

(n) *Accounting policies for certain derivative instruments.* Disclosures regarding accounting policies shall include, to the extent material, where in the statement of cash flows derivative financial instruments, and their related gains and losses, as defined by U.S. generally accepted accounting principles, are reported.

Instructions to paragraph (n):

1. For purposes of this paragraph (n), derivative financial instruments and derivative commodity instruments (collectively referred to as "derivatives") are defined as follows:

(i) *Derivative financial instruments* have the same meaning as defined by generally accepted accounting principles (see, e.g., FASB ASC Master Glossary, and include futures, forwards, swaps, options, and other financial instruments with similar characteristics.

(ii) *Derivative commodity instruments* include, to the extent such instruments are not derivative financial instruments, commodity futures, commodity forwards, commodity swaps, commodity options, and other commodity instruments with similar characteristics that are permitted by contract or business custom to be settled in cash or with another financial instrument. For purposes of this paragraph, settlement in cash includes settlement in cash of the net change in value of the derivative commodity instrument (e.g., net cash settlement based on changes in the price of the underlying commodity).

2. For purposes of paragraphs (n)(2), (n)(3), (n)(4), and (n)(7), the required disclosures should address separately derivatives entered into for trading purposes and derivatives entered into for purposes other than trading. For purposes of this paragraph, *trading purposes* means dealing and other trading activities measured at fair value with gains and losses recognized in earnings.

3. For purposes of paragraph (n)(6), *anticipated transactions* means transactions (other than transactions involving existing assets or liabilities or transactions necessitated by existing firm commitments) an enterprise expects, but is not obligated, to carry out in the normal course of business.

4. Registrants should provide disclosures required under paragraph (n) in filings with the Commission that include financial statements of fiscal periods ending after June 15, 1997.

[45 FR 63669, Sep. 25, 1980, as amended at 46 FR 56179, Nov. 16, 1981; 50 FR 25215, June 18, 1985; 50 FR 49532, Dec. 3, 1985; 51 FR 3770, Jan. 30, 1986; 57 FR 45293, Oct. 1, 1992; 59 FR 65636, Dec. 20, 1994; 62 FR 6063, Feb. 10, 1997; 74 FR 18615, Apr. 23, 2009; 76 FR 50119, Aug. 12, 2011; 83 FR 50200, Oct. 4, 2018]

Excerpt from Reg S-X Rule 5-02

Balance sheets.

The purpose of this rule is to indicate the various line items and certain additional disclosures which, if applicable, and except as otherwise permitted by the Commission, should appear on the face of the balance sheets or related notes filed for the persons to whom this article pertains (see § 210.4-01(a)).

Assets and Other Debits

Current Assets, when appropriate

1. *Cash and cash items*. Separate disclosure shall be made of the cash and cash items which are restricted as to withdrawal or usage. The provisions of any restrictions shall be described in a note to the financial statements. Restrictions may include legally restricted deposits held as compensating

balances against short-term borrowing arrangements, contracts entered into with others, or company statements of intention with regard to particular deposits; however, time deposits and short-term certificates of deposit are not generally included in legally restricted deposits. In cases where compensating balance arrangements exist but are not agreements which legally restrict the use of cash amounts shown on the balance sheet, describe in the notes to the financial statements these arrangements and the amount involved, if determinable, for the most recent audited balance sheet required and for any subsequent unaudited balance sheet required in the notes to the financial statements. Compensating balances that are maintained under an agreement to assure future credit availability shall be disclosed in the notes to the financial statements along with the amount and terms of such agreement.

2. *Marketable securities*. The accounting and disclosure requirements for current marketable equity securities are specified by generally accepted accounting principles. With respect to all other current marketable securities, state, parenthetically or otherwise, the basis of determining the aggregate amount shown in the balance sheet, along with the alternatives of the aggregate cost or the aggregate market value at the balance sheet date.

3. *Accounts and notes receivable*.

   (a) State separately amounts receivable from (1) customers (trade); (2) related parties (see § 210.4-08(k)); (3) underwriters, promoters, and employees (other than related parties) which arose in other than the ordinary course of business; and (4) others.
   (b) If the aggregate amount of notes receivable exceeds 10 percent of the aggregate amount of receivables, the above information shall be set forth separately, in the balance sheet or in a note thereto, for accounts receivable and notes receivable.
   (c) If receivables include amounts due under long-term contracts (see § 210.5-02.6(d)), state separately in the balance sheet or in a note to the financial statements the following amounts:

      (1) Balances billed but not paid by customers under retainage provisions in contracts.

      (2) Amounts representing the recognized sales value of performance and such amounts that had not been billed and were not billable to customers at the date of the balance sheet. Include a general description of the prerequisites for billing.

      (3) Billed or unbilled amounts representing claims or other similar items subject to uncertainty concerning their determination or ultimate realization. Include a description of the nature and status of the principal items comprising such amount.

      (4) With respect to (1) through (3) above, also state the amounts included in each item which are expected to be collected after one year. Also state, by year, if practicable, when the amounts of retainage (see (1) above) are expected to be collected.

4. *Allowances for doubtful accounts and notes receivable*. The amount is to be set forth separately in the balance sheet or in a note thereto.

5. *Unearned income.*

6. *Inventories*.

   (a) State separately in the balance sheet or in a note thereto, if practicable, the amounts of major classes of inventory such as: (1) Finished goods; (2) inventoried costs relating to long-term contracts or programs (see paragraph (d) of this section); (3) work in process; (4) raw materials; and (5) supplies. If the method of calculating a LIFO inventory does not allow for the practical determination of amounts assigned to major classes of inventory, the amounts of those classes may be stated under cost flow assumptions other that LIFO with the excess of such total amount over the aggregate LIFO amount shown as a deduction to arrive at the amount of the LIFO inventory.

   (b) The basis of determining the amounts shall be stated.

   If *cost* is used to determine any portion of the inventory amounts, the description of this method shall include the nature of the cost elements included in inventory. Elements of cost include, among other items, retained costs representing the excess of manufacturing or production costs over the amounts charged to cost of sales or delivered or in-process units, initial tooling or other deferred startup costs, or general and administrative costs.

   The method by which amounts are removed from inventory (e.g., average cost, first-in, first-out, last-in, first-out, estimated average cost per unit) shall be described. If the estimated average cost per unit is used as a basis to determine amounts removed from inventory under a total program or similar basis of accounting, the principal assumptions (including, where meaningful, the aggregate number of units expected to be delivered under the program, the number of units delivered to date and the number of units on order) shall be disclosed.

   If any general and administrative costs are charged to inventory, state in a note to the financial statements the aggregate amount of the general and administrative costs incurred in each period and the actual or estimated amount remaining in inventory at the date of each balance sheet.

   (c) If the LIFO inventory method is used, the excess of replacement or current cost over stated LIFO value shall, if material, be stated parenthetically or in a note to the financial statements.

   (d) For purposes of §§ 210.5-02.3 and 210.5-02.6, long-term contracts or programs include (1) all contracts or programs for which gross profits are recognized on a percentage-of-completion method of accounting or any variant thereof (e.g., delivered unit, cost to cost, physical completion), and (2) any contracts or programs accounted for on a completed contract basis of accounting where, in either case, the contracts or programs have associated with them material amounts of inventories or unbilled receivables and where such contracts or programs have been or are expected to be performed over a period of more than twelve months. Contracts or programs of shorter duration may also be included, if deemed appropriate.

For all long-term contracts or programs, the following information, if applicable, shall be stated in a note to the financial statements:

(i) The aggregate amount of manufacturing or production costs and any related deferred costs (e.g., initial tooling costs) which exceeds the aggregate estimated cost of all in-process and delivered units on the basis of the estimated average cost of all units expected to be produced under long-term contracts and programs not yet complete, as well as that portion of such amount which would not be absorbed in cost of sales based on existing firm orders at the latest balance sheet date. In addition, if practicable, disclose the amount of deferred costs by type of cost (e.g., initial tooling, deferred production, etc.).

(ii) The aggregate amount representing claims or other similar items subject to uncertainty concerning their determination or ultimate realization, and include a description of the nature and status of the principal items comprising such aggregate amount.

(iii) The amount of progress payments netted against inventory at the date of the balance sheet.

7. *Prepaid expenses*.

8. *Other current assets*. State separately, in the balance sheet or in a note thereto, any amounts in excess of five percent of total current assets.

9. *Total current assets, when appropriate*.

10. *Securities of related parties.* (See § 210.4-08(k).)

11. *Indebtedness of related parties—not current.* (See § 210.4-08(k).)

12. *Other investments*. The accounting and disclosure requirements for non-current marketable equity securities are specified by generally accepted accounting principles. With respect to other security investments and any other investment, state, parenthetically or otherwise, the basis of determining the aggregate amounts shown in the balance sheet, along with the alternate of the aggregate cost or aggregate market value at the balance sheet date.

13. *Property, plant and equipment*.

(a) State the basis of determining the amounts.
(b) Tangible and intangible utility plant of a public utility company shall be segregated so as to show separately the original cost, plant acquisition adjustments, and plant adjustments, as required by the system of accounts prescribed by the applicable regulatory authorities. This rule shall not be applicable in respect to companies which are not required to make such a classification.

14. *Accumulated depreciation, depletion, and amortization of property, plant and equipment*. The amount is to be set forth separately in the balance sheet or in a note thereto.

15. *Intangible assets*. State separately each class of such assets which is in excess of five percent of the total assets, along with the basis of determining the respective amounts. Any significant addition or deletion shall be explained in a note.

16. *Accumulated depreciation and amortization of intangible assets.* The amount is to be set forth separately in the balance sheet or in a note thereto.

17. *Other assets*. State separately, in the balance sheet or in a note thereto, any other item not properly classed in one of the preceding asset captions which is in excess of five percent to total assets. Any significant addition or deletion should be explained in a note. With respect to any significant deferred charge, state the policy for deferral and amortization.

18. *Total assets.*

Liabilities and Stockholders' Equity

Current Liabilities, When Appropriate

19. *Accounts and notes payable.*

    (a) State separately amounts payable to (1) banks for borrowings; (2) factors or other financial institutions for borrowings; (3) holders of commercial paper; (4) trade creditors; (5) related parties (see § 210.4-08(k)); (6) underwriters, promoters, and employees (other than related parties); and (7) others. Amounts applicable to (1), (2) and (3) may be stated separately in the balance sheet or in a note thereto.
    (b) The amount and terms (including commitment fees and the conditions under which lines may be withdrawn) of unused lines of credit for short-term financing shall be disclosed, if significant, in the notes to the financial statements. The weighted average interest rate on short term borrowings outstanding as of the date of each balance sheet presented shall be furnished in a note. The amount of these lines of credit which support a commercial paper borrowing arrangement or similar arrangements shall be separately identified.

20. *Other current liabilities*. State separately, in the balance sheet or in a note thereto, any item in excess of 5 percent of total current liabilities. Such items may include, but are not limited to, accrued payrolls, accrued interest, taxes, indicating the current portion of deferred income taxes, and the current portion of long-term debt. Remaining items may be shown in one amount.

21. *Total current liabilities, when appropriate.*

Long-Term Debt

22. Bonds, mortgages and other long-term debt, including capitalized leases.

(a) State separately, in the balance sheet or in a note thereto, each issue or type of obligation and such information as will indicate:

(1) The general character of each type of debt including the rate of interest;
(2) the date of maturity, or, if maturing serially, a brief indication of the serial maturities, such as "maturing serially from 1980 to 1990"; (3) if the payment of principal or interest is contingent, an appropriate indication of such contingency; (4) a brief indication of priority; and (5) if convertible, the basis. For amounts owed to related parties, see § 210.4-08(k).

(b) The amount and terms (including commitment fees and the conditions under which commitments may be withdrawn) of unused commitments for long-term financing arrangements that would be disclosed under this rule if used shall be disclosed in the notes to the financial statements if significant.

23. *Indebtedness to related parties—noncurrent*. Include under this caption indebtedness to related parties as required under § 210.4-08(k).

24. *Other liabilities*. State separately, in the balance sheet or in a note thereto, any item not properly classified in one of the preceding liability captions which is in excess of 5 percent of total liabilities.

25. *Commitments and contingent liabilities*.

26. *Deferred credits*. State separately in the balance sheet amounts for (a) deferred income taxes, (b) deferred tax credits, and (c) material items of deferred income.

Redeemable Preferred Stocks

27. *Preferred stocks subject to mandatory redemption requirements or whose redemption is outside the control of the issuer.*

(a) Include under this caption amounts applicable to any class of stock which has any of the following characteristics: (1) it is redeemable at a fixed or determinable price on a fixed or determinable date or dates, whether by operation of a sinking fund or otherwise; (2) it is redeemable at the option of the holder; or (3) it has conditions for redemption which are not solely within the control of the issuer, such as stocks which must be redeemed out of future earnings. Amounts attributable to preferred stock which is not redeemable or is redeemable solely at the option of the issuer shall be included under § 210.5-02.28 unless it meets one or more of the above criteria.
(b) State on the face of the balance sheet the title of each issue, the carrying amount, and redemption amount. (If there is more than one issue, these amounts may be aggregated on the face of the balance sheet and details concerning each issue may be presented in the note required by paragraph (c) below.) Show also the dollar amount of any shares subscribed but unissued, and show the deduction of subscriptions receivable therefrom. If the carrying value is different from the redemption amount, describe the accounting treatment for such

difference in the note required by paragraph (c) below. Also state in this note or on the face of the balance sheet, for each issue, the number of shares authorized and the number of shares issued or outstanding, as appropriate (See § 210.4-07).

(c) State in a separate note captioned "Redeemable Preferred Stocks" (1) a general description of each issue, including its redemption features (e.g. sinking fund, at option of holders, out of future earnings) and the rights, if any, of holders in the event of default, including the effect, if any, on junior securities in the event a required dividend, sinking fund, or other redemption payment(s) is not made; (2) the combined aggregate amount of redemption requirements for all issues each year for the five years following the date of the latest balance sheet; and (3) the changes in each issue for each period for which a statement of comprehensive income is required to be filed. (See also § 210.4-08(d).)

(d) Securities reported under this caption are not to be included under a general heading "stockholders' equity" or combined in a total with items described in captions 29, 30 or 31 which follow.

Non-Redeemable Preferred Stocks

28. *Preferred stocks which are not redeemable or are redeemable solely at the option of the issuer*. State on the face of the balance sheet, or if more than one issue is outstanding state in a note, the title of each issue and the dollar amount thereof. Show also the dollar amount of any shares subscribed but unissued, and show the deduction of subscriptions receivable therefrom. State on the face of the balance sheet or in a note, for each issue, the number of shares authorized and the number of shares issued or outstanding, as appropriate (see § 210.4-07). Show in a note or separate statement the changes in each class of preferred shares reported under this caption for each period for which a statement of comprehensive income is required to be filed. (See also § 210.4-08(d).)

Common Stocks

29. *Common stocks*. For each class of common shares state, on the face of the balance sheet, the number of shares issued or outstanding, as appropriate (see § 210.4-07), and the dollar amount thereof. If convertible, this fact should be indicated on the face of the balance sheet. For each class of common shares state, on the face of the balance sheet or in a note, the title of the issue, the number of shares authorized, and, if convertible, the basis of conversion (see also § 210.4-08(d)). Show also the dollar amount of any common shares subscribed but unissued, and show the deduction of subscriptions receivable therefrom. Show in a note or statement the changes in each class of common shares for each period for which a statement of comprehensive income is required to be filed.

Other Stockholders' Equity

30. *Other stockholders' equity.*

(a) Separate captions shall be shown for (1) additional paid-in capital, (2) other additional capital, (3) retained earnings, (i) appropriated and (ii) unappropriated (See § 210.4-08(e)), and (4) accumulated other comprehensive income.

Note 1 to paragraph 30.(a). Additional paid-in capital and other additional capital may be combined with the stock caption to which it applies, if appropriate.

(b) For a period of at least 10 years subsequent to the effective date of a quasi-reorganization, any description of retained earnings shall indicate the point in time from which the new retained earnings dates and for a period of at least three years shall indicate, on the face of the balance sheet, the total amount of the deficit eliminated.

Noncontrolling Interests

31. *Noncontrolling interests in consolidated subsidiaries*. State separately in a note the amounts represented by preferred stock and the applicable dividend requirements if the preferred stock is material in relation to the consolidated equity.

32. *Total liabilities and equity*.

[45 FR 63671, Sept. 25, 1980, as amended at 46 FR 43412, Aug. 28, 1981; 47 FR 29837, July 9, 1982; 50 FR 25215, June 18, 1985; 50 FR 49533, Dec. 3, 1985; 59 FR 65636, Dec. 20, 1994; 74 FR 18615, Apr. 23, 2009; 83 FR 50201, Oct. 4, 2018]

Excerpt from Reg S-X Rule 5-03

Statements of comprehensive income.

(a) The purpose of this rule is to indicate the various line items which, if applicable, and except as otherwise permitted by the Commission, should appear on the face of the statements of comprehensive income filed for the persons to whom this article pertains (see § 210.4-01(a)).

(b) If income is derived from more than one of the subcaptions described under § 210.5-03.1, each class which is not more than 10 percent of the sum of the items may be combined with another class. If these items are combined, related costs and expenses as described under § 210.5-03.2 shall be combined in the same manner.

1. *Net sales and gross revenues.* State separately:

   (a) Net sales of tangible products (gross sales less discounts, returns and allowances), (b) operating revenues of public utilities or others; (c) income from rentals; (d) revenues from services; and (e) other revenues. Amounts earned from transactions with related parties shall be disclosed as required under § 210.4-08(k). A public utility company using a uniform system of accounts or a form for annual report prescribed by federal or state authorities, or a similar system or report, shall follow the general segregation of operating revenues and operating expenses reported under § 210.5-03.2 prescribed by such system or report. If the total of sales and revenues reported under this caption includes excise taxes in an amount equal to 1 percent or more of such total, the amount of such excise taxes shall be shown on the face of the statement parenthetically or otherwise.

2. *Costs and expenses applicable to sales and revenues.*

   State separately the amount of (a) cost of tangible goods sold, (b) operating expenses of public utilities or others, (c) expenses applicable to rental income, (d) cost of services, and (e) expenses applicable to other revenues. Merchandising organizations, both wholesale and retail, may include occupancy and buying costs under caption 2(a). Amounts of costs and expenses incurred from transactions with related parties shall be disclosed as required under § 210.4-08(k).

3. *Other operating costs and expenses.* State separately any material amounts not included under caption 2 above.

4. *Selling, general and administrative expenses.*

5. *Provision for doubtful accounts and notes.*

6. *Other general expenses.* Include items not normally included in caption 4 above. State separately any material item.

7. *Non-operating income.* State separately in the statement of comprehensive income or in a note thereto amounts earned from (a) dividends, (b) interest on securities, (c) profits on securities (net of losses), and (d) miscellaneous other income. Amounts earned from transactions in securities of related parties shall be disclosed as required under § 210.4-08(k). Material amounts included under miscellaneous other income shall be separately stated in the statement of comprehensive income or in a note thereto, indicating clearly the nature of the transactions out of which the items arose.

8. *Interest and amortization of debt discount and expense.*

9. *Non-operating expenses.* State separately in the statement of comprehensive income or in a note thereto amounts of (a) losses on securities (net of profits) and (b) miscellaneous income deductions. Material amounts included under miscellaneous income deductions shall be separately stated in the statement of comprehensive income or in a note thereto, indicating clearly the nature of the transactions out of which the items arose.

10. *Income or loss before income tax expense and appropriate items below.*

11. *Income tax expense.* Include under this caption only taxes based on income (see § 210.4-08(h)).

12. *Equity in earnings of unconsolidated subsidiaries and 50 percent or less owned persons.* State, parenthetically or in a note, the amount of dividends received from such persons. If justified by the circumstances, this item may

be presented in a different position and a different manner (see § 210.4-01(a)).

13. *Income or loss from continuing operations.*

14. *Discontinued operations.*

15.-17. [Reserved]

18. *Net income or loss.*

19. *Net income attributable to the noncontrolling interest.*

20. *Net income attributable to the controlling interest.*

21. *Other comprehensive income*. State separately the components of and the total for other comprehensive income. Present the components either net of related tax effects or before related tax effects with one amount shown for the aggregate *income* tax expense or benefit. State the amount of income tax expense or benefit allocated to each component, including reclassification adjustments, in the statement of comprehensive income or in a note.

22. *Comprehensive income.*

23. *Comprehensive income attributable to the noncontrolling interest.*

24. *Comprehensive income attributable to the controlling interest*.

25. *Earnings per share data*.

[45 FR 63671, Sept. 25, 1980, as amended at 45 FR 76977, Nov. 21, 1980; 50 FR 25215, June 18, 1985; 74 FR 18615, Apr. 23, 2009; 83 FR 50202, Oct. 6, 2018]

Index of changes

This index lists the significant additions and changes made in this edition to assist you in locating recently added or updated content. New Questions and Examples added in this edition are identified throughout the Handbook with ** and items that have been significantly updated or revised are identified with #.

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