1987

Report of the Task Force on Risks and Uncertainties

American Institute of Certified Public Accountants. Task Force on Risks and Uncertainties

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NOTICE TO READERS

This report has been prepared by the Accounting Standards Executive Committee's Task Force on Risks and Uncertainties, and the conclusions and recommendations presented herein are those of the task force. Issuance of the document as a task force report was approved by the Accounting Standards Executive Committee. The primary purpose of the report is to urge the Financial Accounting Standards Board1 to consider practical ways of establishing requirements for improved disclosures in financial statements of information on risks and uncertainties and to provide readers with an informed discussion of the issues involved.

1. The Financial Accounting Standards Board is the body authorized to establish accounting standards with which AICPA members must comply. While the Governmental Accounting Standards Board is authorized to establish accounting standards for state and local governmental entities, recommendations in this report relate only to financial reporting by business enterprises.
Report of the Task Force on Risks and Uncertainties

JULY 1987

American Institute of Certified Public Accountants
July 30, 1987

Mr. J.T. Ball
Assistant Director of Research
and Technical Activities
Financial Accounting Standards Board
High Ridge Park
P.O. Box 3811
Stamford, Connecticut 06905-0821

Dear Mr. Ball:

Enclosed for consideration by the Financial Accounting Standards Board is the Report of the Task Force on Risks and Uncertainties, as approved for issuance as a task force report by the Accounting Standards Executive Committee.

Representatives of the Accounting Standards Division are available to meet with members of the board or its staff at their convenience to discuss the report. We would appreciate being kept informed of the FASB's action on the report.

Yours very truly,

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Chairman
Accounting Standards
Executive Committee

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The contributions to the project of Steven Rubin, who provided staff support to the task force before leaving the Accounting Standards Division in 1986 to become assistant director of the AICPA Examinations Division, are greatly appreciated.
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CHAPTER 1

Introduction

Today's volatile business environment underscores a need for improved disclosure about the risks and uncertainties that face business enterprises. In 1985 the Task Force on Risks and Uncertainties was established to consider ways to meet that need. This report is intended to help standards-setting bodies and others identify practical methods of improving the information communicated to users to help them assess those risks and uncertainties.

This report recommends expanded disclosures of significant information by business enterprises. The central feature is selectivity. The proposed criteria serve to screen the host of risks and uncertainties that affect each business so that recommended disclosures can be limited to significant matters.

The recommendations focus primarily on significant risks and uncertainties that stem from the necessary use of estimates in the preparation of financial statements and from significant concentrations in aspects of the entity's operations. The recommended disclosures do not encompass risks that might be associated with dependence on or quality of management or the quality of the business enterprise. Nor do they encompass acts of God or other sudden catastrophes. The disclosures called for relate to risks and uncertainties that can be described in a factual, useful way. The task force believes that implementation of the recommendations for expanded disclosures would enhance the usefulness of the financial statements of business enterprises.

The recommendations in this report apply only to business enterprises. They do not extend to governmental and not-for-profit organizations.
CHAPTER 2

Why Improved Disclosures Are Needed

A primary mission of financial reporting is to provide information that is useful for investment decisions. Today's volatile economy has multiplied the risks and uncertainties endemic to business and has spurred demands by financial statement users for more responsive financial reports. That mission and those demands can be met by improved disclosures.

FASB Statement of Financial Accounting Concepts No. 1, Objectives of Financial Reporting by Business Enterprises, states that financial reporting should "provide information that is useful to present and potential investors and creditors and other users in making rational investment, credit and similar decisions" (paragraph 34). To support that decision-making process, financial reports should help such users "assess the amounts, timing, and uncertainty of prospective net cash inflows to the related enterprise" (paragraph 37) by providing "information about the economic resources of an enterprise, the claims to those resources... and the effects of transactions, events, and circumstances that change its resources or claims to those resources" (paragraph 40). Without additional disclosure in financial reports about significant risks and uncertainties, that objective may not be fully met in today's environment.

That environment is characterized by a volatility created by numerous developments—a volatility that shows no signs of diminishing. For example, since the mid-1970s, when the Organization of Petroleum Exporting Countries (OPEC) initiated controls of oil prices and supplies, sudden shifts in the international petroleum market have had pervasive worldwide economic consequences.

Other developments producing volatility include more intensive competition in domestic and international markets, wide fluctuations in interest and in foreign currency exchange rates, deregulation of a number of industries and rapid technological developments in many business sectors. Advances in microcomputers, robotics, and telecommunications—already dramatic—are viewed as certain sources of significant future change. Inevitably, sharp escalation in the risks and uncertainties facing business enterprises is a direct result of such developments.

Recognizing that a riskier business climate equates to a riskier investment climate, users increasingly are demanding that financial statements include more information to help them assess the risks and uncertainties concerning a business enterprise's future cash flows and results of operations. These demands are evident from several sources. The trend is clear, for example, in the results of A Study of the Attitudes Toward and an Assessment of the Financial Accounting Standards Board, a 1985 survey conducted for the FASB by Louis Harris.
and Associates, Inc. That study reported that 74 percent of respondents said that information about cash flows was highly important, and 61 percent said that forecasts of future earnings was highly or somewhat important.

The same trend is underscored in calls for an “early warning system” expressed in the financial press, in recent Congressional hearings, and in allegations in court cases involving issuers of financial statements and their independent accountants. These sources suggest that financial reporting should alert users to a possibility that the enterprise is in danger of failing or, short of failing, of suffering severe financial setbacks, if there is such a possibility.

No system of reporting can provide early warnings of all future detrimental events. Indeed, management may be unaware, and reasonably so, of some significant risks and uncertainties. And, clearly, financial statements should not be burdened in an attempt to describe every possible risk and uncertainty facing the reporting enterprise.

But such limitations should not prevent users from receiving improved disclosures concerning risks and uncertainties needed in the current more volatile economic environment. Their existence merely means that any new disclosure requirements must focus on what is important. They should effectively separate the significant matters that warrant reporting from the host of lesser risks and uncertainties that do not. The task force believes that the recommendations in this report meet those objectives.
CHAPTER 3

Conclusions and Recommendations

The task force has concluded that a business enterprise should make disclosures beyond those now generally made in financial reports about the risks and uncertainties facing it as of the date of the financial reports. The disclosures should include the following:

1. *Nature of Operations*
   A description of the kinds of products or services the enterprise sells, its principal markets, and the locations of those markets.

2. *Basis of Financial Statement Preparation*
   An explanation that the preparation of historical financial information requires the use of management’s estimates.

3. *Certain Significant Estimates*
   A discussion of significant, change-sensitive estimates used by management to measure assets and liabilities at the reporting date. Disclosure would be required for any significant estimate used in the determination of the carrying amount of an asset or a liability at the current reporting date that, based on facts and circumstances existing at that date, is particularly susceptible to changes that could result in material effects on near-term results of operations.

4. *Current Vulnerability Due to Concentrations*
   Information about current vulnerability to risk due to concentrations—for example, in the enterprise’s assets, customers, or suppliers—other than those generally known to be associated with the industry or trade in which the entity operates, would be required in the following circumstances: (a) concentrations existing at the report date make the enterprise vulnerable to the risk of severe impact on near-term cash flows or results of operations and (b) it is at least reasonably possible that the events that could cause the severe impact will occur.

The above four kinds of disclosure are not mutually exclusive. The information required by each may overlap.

Applying the criteria presented and discussed in this report for disclosure of significant estimates and current vulnerability due to concentrations requires considerable professional judgment. Because of the nature and complexity of the risks and uncertainties involved, the task force has not recommended quantitative criteria. The task force believes that application of professional judgment to the qualitative criteria recommended would result in meaningful disclosures that are reasonably comparable in comparable circumstances.
Furthermore, though all risks and uncertainties involve the future, as discussed above, applying the criteria recommended does not involve prediction. It involves current assessments of those possibilities, not judgment about whether those possibilities will become realities.

Possibly Controversial Aspects

The concepts associated with the first three recommended disclosures are not believed to be exceptionally controversial. Each of those kinds of disclosure is found in some financial statements, but its inclusion is voluntary. The thrust of these recommendations is to extend desirable practices to additional entities.

The fourth recommendation, disclosure of current vulnerability due to concentrations, goes beyond what is generally presented in financial statements, even on a voluntary basis. The task force expects this recommendation to generate questions about where the information should be disclosed, about additional risks to preparers and auditors flowing from such disclosure, and about the desirability of requiring nonpublic enterprises to disclose such information.

Some believe information about risks caused by concentrations should be disclosed in financial reports as supplementary information rather than in the basic financial statements. They believe direct auditor association with such information should not be required, either because they see the information as not sufficiently verifiable or because they believe the cost of auditor association would not be justified by benefits to users.

Others believe information about risks caused by concentrations should appear in the basic financial statements. They point out that (1) financial statements, as the central focus of financial reporting, are where users likely would expect to find such disclosures and (2) independent accountant association enhances confidence in the reliability of the information presented.

Still others believe that the FASB should decide where this information should be disclosed. In Statement of Financial Accounting Concepts No. 1, the Board indicated that "criteria for distinguishing information to be included in financial statements from that which should be provided by other means of financial reporting" (paragraph 2) have not been developed. Therefore, "the Board will draw boundaries, as needed, in other parts of the conceptual framework project or in financial accounting standards" (paragraph 5).

Subsequently, in Statement of Financial Accounting Concepts No. 5, Recognition and Measurement in Financial Statements of Business Enterprises, the Board tried to distinguish information that should be disclosed in notes from supplemental information. It indicated that information in notes—

Is essential to understanding the information recognized in financial statements and has long been viewed as an integral part of financial statements prepared
in accordance with generally accepted accounting principles. Supplementary information, such as disclosures of the effects of changing prices, and other means of financial reporting, such as management discussion and analysis, add information to that in the financial statements or notes, including information that may be relevant but that does not meet all recognition criteria. (paragraph 7)

The Board indicated in a footnote to that paragraph that “supplementary financial statements, complete or partial, may be useful, especially to introduce and to gain experience with new kinds of information.” Emphasis added.

Some believe the recommended disclosures on current vulnerability due to concentrations should not apply to nonpublic enterprises, as defined in FASB Statement No. 21, Suspension of the Reporting of Earnings Per Share and Segment Information by Nonpublic Enterprises, because the cost to nonpublic enterprises of providing the information would exceed the benefits to users. Others believe the cost of providing the information is not excessive and, accordingly, it should be required of all business enterprises. The task force believes that determination should be made only after due process and makes no recommendation at this time. The task force believes, however, that the disclosures required under the first three recommendations are clearly relevant to all business enterprises and that the cost of providing the information will be nominal, so they should be required in the financial statements of all of them.

Cost/Benefit

The recommendations in this report are compatible with the Financial Accounting Standards Board’s conceptual framework for financial reporting. For example, the FASB’s Statement of Financial Accounting Concepts No. 1 states that—

The role of financial reporting in the economy is to provide information that is useful in making business and economic decisions. . . . To the extent that financial reporting provides information that . . . aids in assessing relative returns and risks of investment opportunities. . . . it helps to create a favorable environment for capital formation decisions. (paragraph 33)

Action Required

Though the recommendations in this report are compatible with the FASB’s conceptual framework for financial reporting and some of the disclosures recommended by this report are now made in certain circumstances, existing standards do not require comprehensive disclosure of the kinds of information recommended. Therefore, to make the recommendations effective, the FASB would
need to reconsider its requirements for the disclosure of information about risks and uncertainties. Also, the AICPA Auditing Standards Board would need to consider the advisability of providing additional guidance to independent accountants who are associated with financial reports that include the added disclosures.

The Appendix to this report presents the basis for the task force's conclusions and recommendations.
Recommended Additional Disclosures

The kinds of disclosures recommended by this report are discussed below, followed by one or more illustrations. Each illustrative disclosure is accompanied by a scenario of the circumstances in which the disclosure would likely be made and by an explanation of how and why the illustrative disclosure complies with the conclusions in this report.

Nature of Operations

The disclosure of a description of the kinds of products or services an enterprise sells, its principal markets, and the location of those markets, is fundamental to reporting information related to risks and uncertainties.

FASB Statement No. 14, "Financial Reporting for Segments of a Business Enterprise," sets forth requirements for disclosure by publicly held business enterprises of the enterprise’s operations in different industries, its foreign operations and export sales, and its major customers. Nonpublic business enterprises are not subject to the reporting requirements of FASB Statement No. 14 and, therefore, are not required to make such disclosures. Thus, users now sometimes cannot discern the nature of the operations of nonpublic business enterprises from information presented in their financial statements.

Such information is necessary because the various kinds of industries in which business enterprises operate have diverse degrees and kinds of risks. Certain of these risks are inherent to the business in which a business enterprise is engaged. Simply by knowing the nature of an enterprise’s business and the principal markets for its products or services, a financial statement user is alerted, indirectly, about the risks common to that industry or business. If a business enterprise operates in more than one industry, the disclosure should also indicate the relative importance of its operations in each industry, based on whatever criteria—for example, assets, revenues, or earnings—the business enterprise believes to be most relevant. To comply with this recommendation, the disclosure need not be quantified; relative importance could be conveyed by use of terms such as "predominantly," "about equally," or "major and other."

Furthermore, disclosure of the locations of a business enterprise’s principal markets provides information useful in assessing risks and uncertainties related to the environments in which the business enterprise 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. Knowledge of the environments in which a business enter-
prise sells its products or services would help users of financial reports to assess certain risks based on day-to-day national and world events.

The task force considered whether disclosure of the location of an enterprise’s principal operating locations would be informative to financial statement users and should, therefore, be included in the first recommendation. The task force concluded that, although in certain circumstances such information would be relevant, generally it would not be. In addition, disclosure of an enterprise’s principal operating locations could be required under the fourth recommendation (current vulnerability due to concentrations) in circumstances where operating in that particular environment created substantive risk to the enterprise. However, knowing that an enterprise is located in, for example, Dallas, Texas, was not considered particularly relevant information. On the other hand, knowing that a residential housing construction contractor’s principal market is in the Dallas area, is considered to be highly relevant. As a result, disclosure of the location of principal markets was chosen by the task force for inclusion in the first recommendation while disclosure of the location of principal operating units was considered unnecessary.

**Illustrative Disclosure A**

**Scenario.** 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, Smith changed its name to Smith Corporation. Smith has one factory, located on Long Island, New York. The following illustrates disclosure of the nature of operations recommended by this report.

**Disclosure.** Smith Corporation is engaged principally in the design, engineering, and manufacturing of military aircraft and related peripheral equipment for sale primarily to the United States government and NATO allies. Sales of aircraft to foreign governments, which represented about 30% of sales in 1986, require the advance approval of the U.S. government.

**Discussion.** This disclosure meets the objectives of the first recommendation in that—

1. It provides information needed by users who are not familiar with the operations of the enterprise to identify and consider the broad risks and uncertainties faced by all or most enterprises operating in a specific industry or market, which in this case is the defense contracting industry. From this disclosure, users should know, based on their own knowledge, that the enterprise’s business may be heavily affected by future changes
in U.S. economic, military, and foreign policies. Such business could be
affected, for example, in times of increasing federal budget constraints or
impending changes in influential political positions.

2. It provides users with information that aids in the overall understanding of
the other financial information presented. Certain accounting procedures
may apply only to particular industries or may be relevant in comparing a
business enterprise’s financial reports with those of business enterprises in
other industries. This kind of disclosure could provide users with a means
to compare an enterprise’s financial information with that of competitors in
the industry and with applicable industry statistics.

3. This information provides financial statement users insight into the loca­tion of the company’s principal product markets. In the illustration, users
would be able to recognize and assess the company’s dependency on
sales to the U.S. government as well as the various risks associated with
conducting business with NATO countries.

Illustrative Disclosure B

Scenario. Conglomerate, Inc. is a United States-based multinational corpora­
tion operating in over 100 countries worldwide. Conglomerate’s principal lines
of business are automotive products, aerospace products and technologies,
textiles, and nonprescription health care products. The principal markets for
the company’s 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 to wholesale and retail distributors worldwide. The following illustrates
disclosure of the nature of operations recommended by this report.

Disclosure. Conglomerate, Inc. is a multinational manufacturer and en­
gineering concern operating in over 100 countries worldwide. The com­
pany’s principal lines of business are automotive products, aerospace
products and technologies, textiles, and nonprescription health care
products. The principal markets for the automotive and aerospace prod­
ucts and technologies are European- and Far-East-based industrial con­
cerns. Textiles are sold primarily to domestic clothing manufacturers, while nonprescription health care products are sold primarily to
wholesale and retail distributors worldwide.

Discussion. This disclosure meets the objectives of the first recommendation
in that—

1. It provides information necessary for users not familiar with the operations
of the company to identify and consider the broad risks associated with
the industries and markets in which the company operates and competes.
From the disclosures provided, financial statement users should be able to assess, based on their own knowledge, that the company’s product lines are subject to different and varied risks. Those financial statement users familiar with the industries recognize the general risks associated with these industries and the related markets.

2. It provides information that facilitates the overall understanding of the financial information presented in the report. This kind of disclosure could provide users with a basis for comparing an enterprise’s financial information with that of competitors or with applicable industry statistics.

3. This information provides insight into the location of the company’s principal markets, although on a broad scale. Because the company’s markets are so diverse, it would not be useful to enumerate the specific locations of the company’s markets. The operations of the company in any one country are not substantive in relation to the company’s overall operations. For this reason, the manner in which the information is disclosed in the example disclosure is sufficient to meet the broad objectives of the first recommendation.

It is important to recognize that if Conglomerate, Inc. were a public company, disclosure of certain of the information required under the first recommendation would already be required under FASB Statement No. 14.

**Basis of Financial Statement Preparation**

There is a need to communicate explicitly to users of financial reports that the inescapable use of estimates in the preparation of historical financial information results in the presentation of a considerable number of approximate rather than exact amounts. If users understand better the inherent limitations on precision in financial statements, they will be better able to make decisions.

Estimates inherent in the current financial reporting process inevitably involve assumptions about future events. For example, accruing income for the current period under a long-term contract requires an estimate of the total profit to be earned on the contract. By way of further example, recording inventories at the lower of cost and market 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 market is used, that it can be estimated. Making such estimates accurately is often difficult even in periods of economic stability; it is more so in periods of economic volatility. Though many users of financial reports are aware of that aspect of financial reporting, the many others who are not often assume an unwarranted degree of precision in financial statements. The recommended disclosure should help dispel such inappropriate assumptions.

A number of publicly held business enterprises now issue management reports in their annual reports to stockholders. Many such reports state that
estimates and assumptions are required to prepare financial statements in con­formity with generally accepted accounting principles. The task force acknowledges that development, but it believes the disclosure should be mandated and included in the notes to financial statements, though that could be accomplished by cross-reference from the notes to the management reports.

The Auditing Standards Board has released an exposure draft, *The Auditor’s Standard Report*, that, if adopted, would require the auditor to refer to “the significant estimates made by management” in preparing the financial statements. The task force has concluded that this reference does not meet all of its objectives and that the disclosure should be made by the reporting entity in addition to, or in lieu of, the independent auditor.

**Illustrative Disclosure**

Scenario. The following illustrates disclosure of the pervasiveness of estimates in the financial reports of all business enterprises.

**Disclosure.** The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the reporting date and revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term are described elsewhere in this report.

**Discussion.** This disclosure is intended to inform users of the inherent uncertainties in preparing financial information and that results achieved could differ from results anticipated. Such disclosure alerts users to the fact that uncertainties are present in the financial statements of all business enterprises.

The last sentence of the suggested note would be deleted when such disclosures are not required to be made.

**Certain Significant Estimates**

A business enterprise should provide a discussion of certain significant changesensitive estimates used by management to measure assets and liabilities at the reporting date. A significant estimate requiring disclosure is one used to determine the carrying amount of an asset or a liability that, based on facts and circumstances existing at the balance sheet date, is particularly susceptible to changes that could result in a material adjustment to results of operations in the near term. Materiality should be determined in relation to the results of operations taken as a whole rather than the recorded amounts of assets or liabilities to which the estimates relate.
Simply because an estimate results in the recognition of a small financial statement amount, or no amount, does not mean that it does not have to be disclosed. The criteria for significance do not depend on the amount that has been reported in the financial statements, but rather are based on the significance of the estimate and the degree of its variability.

The estimates disclosed would be similar to those that would be discussed with an enterprise's audit committee under the proposed Statement on Auditing Standards (SAS), Communication With Audit Committees or Others With Equivalent Authority and Responsibility. The proposed SAS describes such estimates as follows:

Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ markedly from management's current judgments.
(paragraph 8)

For disclosure to be required, the potential impact should appear at the reporting date to be near term, though its effects may be both near term and long term. Disclosing information related to estimates that could have effects only in the long term is not recommended because (1) such estimates become decreasingly relevant to a business enterprise's current financial condition the farther the possible outcomes are from the reporting date, (2) the information is less reliable because of the changes that can affect the estimates over time, and (3) disclosure of such information detracts from the significance of other, perhaps more relevant and more reliable, information provided. In this context, near term is defined as up to approximately one year from the reporting date.

The disclosures should be tailored in each reporting period to the particular estimates used in that reporting period. Furthermore, if practicable, business enterprises should disclose quantitative information concerning significant estimates.

Some believe that the disclosure called for by this recommendation is already required by FASB Statement No. 5, Accounting for Contingencies, paragraph 10. However, practice has not interpreted the statement that way and few such disclosures are currently made.

The FASB staff is considering a request from the AICPA that the FASB address the accounting for the inability to recover fully the carrying amounts of long-lived assets, which was the subject of an AICPA issues paper. In the event the FASB decides to undertake a project addressing this issue, authoritative guidance may ultimately be promulgated focusing on recognition, measure-

1. Paragraph 10 of FASB Statement No. 5 says, in part: "If no accrual is made for a loss contingency because one or both of the conditions in paragraph 8 are not met, or if an exposure to loss exists in excess of the amount accrued pursuant to the provisions of paragraph 8, disclosure of the contingency shall be made when there is at least a reasonable possibility that a loss or an additional loss may have been incurred."
ment, and disclosure requirements for long-lived assets whose carrying value is judged to be impaired.

The task force believes that the guidance provided in this report is applicable to long-lived assets whose value may become impaired in the near term, such as assets that are idled or that are operating at a loss. Until the FASB issues authoritative recognition, measurement, and disclosure guidance on this topic, the task force believes that financial statement preparers should disclose significant estimates used by management to measure long-lived assets at the balance sheet date when the criteria of recommendation 3 are met. In the absence of authoritative measurement guidance, the task force further believes that, if disclosure under the recommendation is made, the specific measurement technique used by management in assessing the carrying value of its long-lived assets, such as estimated gross or discounted future cash flows, would also be informative disclosure.

Illustrative Disclosure A

Scenario. XYZ Corporation manufactures high technology stereo equipment. In June 1987, one of XYZ's competitors introduced a new model stereo system with the same features as XYZ's Model A. The competitor's version sells for 20 percent less than XYZ's suggested retail price for Model A. At December 31, 1987, XYZ has accumulated excess inventory quantities of its Model A system, which represent approximately one-third of XYZ's inventory at that date. The remaining two-thirds of XYZ's inventory consists of products experiencing only normal competitive pressures. XYZ has established obsolescence reserves for this latter group of products in the normal course of business.

Management has developed a program to provide substantial customer rebates on purchases of the Model A for a specified period, which it expects will result in the sale of the excess inventory. Because of the relatively high profit margin on its stereo systems, XYZ would continue to earn a marginal profit on such sales of the Model A. However, if XYZ's competitor acted to further reduce the price of its competing model, XYZ would be unable to match such reduction without sustaining significant losses on the sale of its remaining Model A inventories. The following illustrates the disclosure of this significant estimate.

Disclosure. At December 31, 1987, because new competition has caused unanticipated reductions in demand for one of its products, XYZ has inventories in excess of its current requirements that are reported at $6 million in the accompanying balance sheet. Management has developed a program to reduce the quantities to desired levels and believes no loss is probable on their disposition. XYZ's ability to recover the cost of the inventories depends, however, on the success of its program, which may be affected by competitive and other factors beyond its control.
Discussion. This situation meets the criteria for disclosure under the significant estimate recommendation because at the balance sheet date management’s plan to liquidate its $6 million of excess inventory without a loss is particularly susceptible to changed conditions that would have a material impact on the enterprise’s results of operations in the near term. In this situation, the background information indicates that even though management has developed a plan to dispose of the inventory without a loss, any further action by the enterprise’s competitor could jeopardize its success.

In this illustration, XYZ discloses the existence and the amount of potentially excess quantities of inventory at the reporting date. The disclosure is intended to provide users with insight into management’s assessment of the recoverability of cost of inventories existing at that date.

Disclosure of routine estimates would not normally be required because they would not meet the criteria in this report. Examples of these routine estimates include those associated with determinations of potentially uncollectible accounts receivable, normal warranty costs, inventory obsolescence or slow moving inventories, and accrued liabilities. For this reason, disclosure of XYZ’s obsolescence reserve for the remaining two-thirds of its inventory is not required.

Illustrative Disclosure B

Scenario. Axel Industries, a manufacturer of automotive components and heavy trucks, currently has facilities in Michigan, Tennessee, and Ontario, Canada. As a result of weak demand in the automobile industry, Axel’s management has decided to discontinue Axel’s automotive components business. Axel has charged current operations with the estimated loss on discontinuing the business based, in part, on valuations by its investment banker and its independent appraiser. After year end, Axel entered into negotiations to sell its Michigan facility to a Japanese automobile manufacturer. The following illustrates disclosure of significant estimates and would appear as part of the footnote on the restructuring.

Disclosure. The provision for restructuring reflects management’s estimates of the amounts that can be realized on the disposition of certain facilities. The estimates are based on an analysis of the facilities, including valuations by independent appraisers and investment bankers. The amounts the company will ultimately realize, however, depend on the outcome of negotiations with prospective buyers and, accordingly, they could differ materially from the amounts assumed in arriving at the provision for restructuring.

Discussion. The existence of facilities held for disposition by Axel at the reporting date represents an uncertainty to the business enterprise. The task force
believes it is important for users to be able to understand the basis for the financial information prepared by management related to the facilities. Determining a provision for the restructuring activities required the use of assumptions and estimates. In this case, the disclosure is required because, at the balance sheet date, the estimates obtained from investment bankers and appraisers and used as a basis for recognizing the charge to income associated with management's disposal plan were considered to be particularly susceptible to changes in an amount that would be material to the enterprise's financial statements in the near term.

**Illustrative Disclosure C**

**Scenario.** Offshore Industries is a manufacturer of offshore drilling rigs and platforms. The company's manufacturing process requires significant specialized equipment, which it presently owns or leases under long-term non-cancelable leases. As a result of the decline in the price of oil, the demand for its products and services has fallen dramatically in the past two years, resulting in a significant underutilization of its manufacturing capacity.

The company depreciates its investments in specialized equipment based upon its original estimate of the remaining useful lives of the equipment on the straight line basis. The company reevaluates these estimates in light of current conditions in accordance with generally accepted accounting principles. The company also monitors the policies of its major competitors and is aware that several have reported large writedowns of similar assets. Nevertheless, while the company believes it is possible that its estimate that it will recover the carrying value of those assets from future operations will change during the next year, it believes it is more likely that conditions in the industry will improve and that the necessity for a writedown for permanent impairment will not be necessary.

**Disclosure.** Offshore's policy is to depreciate specialized manufacturing equipment (with a net book value of $25 million at December 31, 1987) over its remaining useful life on the straight line basis and to evaluate those lives in light of current conditions. Given the present conditions in the industry, it is possible that the company's estimate that it will recover the carrying value from future operations will change, but the company currently believes it is more likely that conditions in the industry will improve and that writedowns for permanent impairment will not be necessary.

**Discussion.** In this illustration, the company acknowledges that the carrying amount of the specialized assets is subject to significant uncertainty. The uncertainty relates to the measurement of the specialized assets at the current reporting date and the company's disclosure makes clear that the carrying amount is particularly susceptible to changes that would be material to its results of operations in the near term.
Current Vulnerability Due to Concentrations

Information about vulnerability to risk due to concentrations—for example, in the enterprise's assets, customers, or suppliers—other than those generally known to be associated with the industry or trade in which the entity operates should be disclosed in the following circumstances: (1) concentrations existing at the report date make the enterprise vulnerable to the risk of severe impact on near-term cash flows or results of operations and (2) it is at least reasonably possible that the events that could cause the severe impact will occur.

The FASB has already determined, for public enterprises, as defined, that "if 10 percent or more of the revenue of an enterprise is derived from sales to any single customer, that fact and the amount of revenue from each such customer shall be disclosed" in the financial statements (FASB Statement No. 14, paragraph 39). The task force is not recommending a change to that requirement; however, if recommendation 4 is applied to nonpublic enterprises, that requirement should be extended to such enterprises as well.

If the risk or uncertainty is evident from the description of the concentration, no further explanation is necessary. The disclosure made should be adequate, however, to inform users of the ramifications of the risk.

Disclosures about concentrations may overlap disclosures about the nature of the reporting entity's operations. Therefore, concentrations that are known to be common to enterprises in a particular industry or trade are specifically excluded from the fourth recommendation. Disclosure of such vulnerabilities is inherent in the information covered by the first kind of disclosure recommended by this report.

Concentrations that meet all of the following five criteria should be disclosed, and discussed to the extent necessary:

1. The specific concentration that makes the enterprise vulnerable to risk at the reporting date relates to its current operations.
2. The potential impact of the risk to which the enterprise is vulnerable appears at the reporting date to be near term.
3. The risk to which the enterprise is vulnerable could result in a severe impact to the business enterprise's near-term cash flows or results of operations.
4. It is at least reasonably possible that the changes or events that would cause the impact will occur in the near term.
5. The concentration that makes the enterprise vulnerable to this kind of risk is other than one generally known to be associated with the industry or trade in which the entity operates.

Criterion 1. The concentration that makes the enterprise vulnerable to risk relates to its current operations. It can relate to assets or liabilities, commitments not requiring recognition under current generally accepted account-
ing principles, or the nature of a business enterprise’s operations or operating needs, such as customers, investments, or sources of supply.

**Criterion 2.** The potential impact of the risk to which the enterprise is vulnerable appears at the reporting date to be near term, within approximately one year from the reporting date.

**Criterion 3.** The risk to which the enterprise is vulnerable could result in a severe impact to the business enterprise’s near-term cash flows or results of operations. The potential effects associated with the concentration could result from one or more events. The events are limited to those that could have a severe impact, that is, an impact that could disrupt the business enterprise. Such an event would not necessarily threaten the business enterprise’s continued existence, but it may.

The concept of severe impact is different from the concept of materiality. Matters that are important enough to influence a user’s decision are deemed to be material, yet they may not be so significant as to disrupt a business enterprise. For example, some events, such as a modest decline in net income, are material to an investor because they might affect the price of a business enterprise’s stock but they would not necessarily have a severe impact on (disrupt) the enterprise itself. Without this distinction, disclosures might be made in boilerplate fashion about a broad array of risks and uncertainties, which would detract from the usefulness of more relevant information.

**Criterion 4.** The changes or events that would cause the severe impact associated with the specific concentration is considered at the reporting date to be at least reasonably possible. In this context, *at least reasonably possible* means that the chance of occurrence is more than remote. Though this criterion has a low probability threshold, it must be viewed along with the other criteria.

A conclusion that changes or events that could cause such a severe impact are at least reasonably possible is to be formed on the basis of an evaluation of current conditions related to current concentrations. Such a conclusion is not a prediction with a specified probability that there will be such an impact. The disclosure is based on an assessment of present conditions, not a prediction of the future.

On that basis, the assessment should not be found to be in error simply by future events. That is, reporting a concentration not followed by a severe impact does not imply that the disclosure was inappropriate, because something that is only reasonably possible 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 have been a violation of this recommendation if an appropriate judgment had been made that a severe impact was not reasonably possible at the reporting date.

**Criterion 5.** The concentration that makes the enterprise vulnerable to risk is other than one that is generally known to be associated with the industry or trade in which the entity operates. Simply operating in a particular industry or trade involves certain kinds of concentrations that bring certain risks and
uncertainties with them. Disclosure of the nature of the operations of an enterprise is called for by the task force's first recommendation and industry-related risks and uncertainties should be understood by reasonably informed users of financial statements. More detailed disclosures related to such risks and uncertainties would entail costs not justified by the incremental benefits to users. Statement of Financial Accounting Concepts No. 1 states that “the information [in financial reports] should be comprehensible to those who have a reasonable understanding of business and economic activities and are willing to study the information with reasonable diligence” (paragraph 34). The concentrations that should be disclosed are those that distinguish the reporting enterprise from others within the particular industry.

For example, savings and loan associations that primarily have variable rate loan portfolios might not be significantly affected by increases in interest rates, but one that has a concentration of fixed rate loans could be because such loans are typically funded by deposits whose interest rates vary over time. Since not all savings and loan associations are subject to significant interest rate risk from fixed rate loans, the task force believes that an association that is vulnerable to risk from a concentration of such loans should disclose it in its financial reports if it meets the criteria in this report.

The task force considered whether it would be useful to establish quantitative criteria for disclosure of concentrations, other than customers, either in place of or in addition to the qualitative criteria provided. The task force believes that a quantitative approach might not provide meaningful information about an enterprise (for example, a critical supplier is not necessarily a major supplier). Any potential simplification in implementing the disclosure requirements that might result from a quantitative approach would be outweighed by deterioration in the quality of information provided.

Examples of Information Related to Concentrations

The following are examples of areas in which current concentrations might make an enterprise vulnerable to a risk that would be disclosed (unless already disclosed pursuant to recommendation 1) if they meet the five criteria discussed above:

- Products
- Suppliers
- Customers
- Investments, interest rates, or foreign exchange rates exposure
- Dependence on patent protection
- Recoverability or expropriation of assets due to changes in the political climate.

The list is not all-inclusive but simply indicative of the areas in which a condition at the reporting date related to concentrations should be considered for
disclosure by all business enterprises. Enterprises in specialized industries should also consider areas affecting certain companies in their industries. Industry-oriented committees of the AICPA should help identify those areas for their industries.

**Illustrative Disclosure A**

**Scenario.** Phoenix Company manufactures various products in which copper is an important raw material. It currently buys 80% of its copper from one supplier, but alternate sources of supply are readily available on comparable terms.

**Disclosure.** *(No disclosure is required.)*

**Discussion.** Phoenix's concentration of suppliers exists at the reporting date, but it does not make Phoenix currently vulnerable because alternative suppliers are available.

**Illustrative Disclosure B**

**Scenario.** Lone Star Bank is a state-chartered bank located in Houston, Texas. Lone Star has for many years provided financing to independent oil and gas ventures, in addition to its typical lending activities associated with credit cards, auto loans, and commercial loans to businesses outside the oil and gas industry. Lone Star’s lending activities are transacted predominantly with customers located in the state of Texas. Lone Star has generated higher profits than those of its principal competitors as well as of the industry as a whole owing to its significant portfolio of high yield-high risk oil and gas venture loans. Lone Star’s oil and gas loan portfolio represents 12 percent of its overall investment portfolio, in comparison to 7 percent for its competitors and 3 percent for the industry as a whole.

**Disclosure.** At December 31, 1987, approximately 12 percent of the bank's loan portfolio comprises loans to independent oil and gas ventures. Including oil and gas venture loans, approximately 85% of the bank's loan portfolio is with customers located in the state of Texas.

**Discussion.** This disclosure informs the financial statement user of the risks, as well as the potential benefits, inherent in the bank's portfolio due to a concentration of oil and gas loans higher than that associated with competitor banks and the banking industry as a whole. Furthermore, the disclosure informs financial statement users of the general risks associated with lending activities in the state of Texas owing, in part, to that state's relative economic dependence on the oil and gas industry. Financial statement users are able to draw their
own conclusions as to the changes in economic conditions that might take place and the ultimate impact such changes might have on the bank. Although the principal focus of this disclosure is recommendation 4, the disclosure also provides information associated with recommendation 1. In this example, disclosure of the bank’s loan concentrations, both by type of borrower and location of borrower, informs financial statement users about the nature of Lone Star’s business and the risks inherent in that business. Knowing that the bank’s lending activities are concentrated primarily within the state of Texas informs financial statement users that economic conditions which broadly affect the economy in that state could adversely impact the bank more significantly than, perhaps, its competitors or the banking industry as a whole.

The recommended disclosure is also required under recommendation 4 because the concentration meets the five criteria for disclosure as follows. Criterion 1 is met because the concentration exists at the reporting date and relates to the bank’s current operations. Criteria 2 and 3 are met because rapid changes in oil and gas prices in the last fifteen years, which directly impact the potential collectibility of the loans, indicate that such changes could result in a severe, near-term impact on the bank’s results of operations or cash flows, or both. Criterion 4 is met because it is considered at least reasonably possible that such severe impact could occur, based on facts available at the reporting date. Criterion 5 is met because the bank has a higher concentration of oil and gas loans than is common in the industry.

Illustrative Disclosure C

Scenario. Jones Savings and Loan Association is federally chartered, with headquarters in Tucson, Arizona. Jones’ loan portfolio consists primarily of residential and commercial mortgages with fixed interest rates on properties located throughout the southwest. The original terms of the mortgages vary from fifteen to thirty years. Lending activities are funded principally from short-term savings account deposits bearing interest at rates that vary with the market over time.

Disclosure. Jones Savings and Loan Association is a federally chartered savings and loan institution based in Tucson, Arizona, engaged principally in providing first mortgage financing to persons and commercial enterprises. At December 31, 1987, the association’s loan portfolio consists primarily of fixed interest rate first mortgages with original terms varying from fifteen to thirty years, on properties located predominantly in the southwest United States. Lending activities are funded primarily with short-term deposits that have interest rates that vary with market rates over time.

Discussion. This disclosure focuses on the nature and location of the principal markets of the business (recommendation 1) and on the concentration
of the enterprise’s investments in fixed interest rate first mortgages, which leaves the enterprise currently vulnerable to interest rate fluctuations because those investments are funded by essentially variable rate deposits. Disclosure under recommendation 1 regarding the nature of the business does not cover the interest rate risk inherent in the concentration in fixed rate loans when they are funded by variable rate debt. Though some associations in the industry also invest primarily in fixed rate mortgages, many have chosen to reduce risk by investing primarily in variable rate mortgages or by hedging their interest rate risk. As a result, more detailed disclosure than that provided under recommendation 1 would be required to enable the financial statement user to understand the risks present. The disclosure does not describe the risks involved, because description of the concentration should alert users to them.

Criterion 1 is met because the concentration exists at the reporting date. Criteria 2 and 3 are met because the concentration could result in a severe impact to the enterprise’s cash flows or results of operations, or both in the near term, owing to the potential volatility in interest rates. Criterion 4 is met because it is considered at least reasonably possible that interest rates could change in the near term to an extent that could cause a severe impact. Criterion 5 is met because, as indicated, many associations have different operating policies and thereby avoid or hedge this risk.

If the disclosure is evident from the financial statements (for example, there is disclosure of the amount of fixed rate mortgage loans carried as investments, and that deposits are variable rate or short term), no additional disclosure would be necessary.

**Illustrative Disclosure D**

**Scenario.** Felt Pharmaceutical Company is a national pharmaceutical manufacturer headquartered in Atlanta, Georgia. The company markets a full line of pharmaceutical products. One of its better known name brand products, a significant source of profits and cash flow, is an antibiotic whose patent will expire in six months. Competitors are preparing to enter the market with generic alternatives when Felt’s patent expires. Though the company plans to try to differentiate its product to save as much of its market share as possible, the concentration nevertheless has the potential to impact severely on Felt’s profits and cash flow.

**Disclosure.** 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 35 percent of the company’s revenues and a higher percentage of its gross profit.

**Discussion.** The disclosure focuses on the nature of the business and its current vulnerability due to a concentration of its patented products. The concen-
tration exists at the reporting date and thus meets criterion 1. Criterion 2 is met because the company is vulnerable to competitors entering the market within one year, when the patent expires. Criteria 3 and 4 are met because it is reasonably possible that the impact on the company’s cash flows and profitability of the expiration of the patent could be severe. Criterion 5 is met because the risk is related solely to the enterprise.
Appendix: Basis for Conclusions and Recommendations

In reaching the conclusions and the recommendations in this report, the task force considered and evaluated users' reliance on financial information, sources of financial information, current accounting requirements, current Securities and Exchange Commission (SEC) requirements, and users' perceptions of the kinds of information that should be presented in financial statements.

Users' Reliance on Financial Information

Information in financial statements, largely shaped by GAAP and, for registrants, by the regulatory requirements of the SEC, is considered important to users in making investment and lending decisions. They provide information about certain current conditions and trends that help users in predicting business enterprises' 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 business enterprises' operations and of the information about those operations that financial reporting provides.

Financial reporting largely reflects the effects of past transactions and other events that have already affected a business enterprise. Such information can help users in assessing the future. But that does not mean the future can be predicted merely by extrapolating past trends or relationships. Indeed, volatility in the economic environment almost always means that extrapolating past trends and relationships will lead to inaccurate predictions. Users need to assess all currently available information to form their own expectations about the future and its relation to the past. Forming expectations—making predictions—is a vital part of the decision process. But it is a function of financial analysis, not of financial reporting.

Furthermore, financial reporting is only one source of financial information. Overviews of the sources of financial information and of the purposes and limitations of financial reporting provide a useful perspective.

Sources of Financial Information

Financial reporting encompasses the financial statements and notes, required information supplementary to the financial statements, and other means of financial reporting, such as information included in management's discussion and analysis (MD&A), which the SEC requires publicly held business enterprises to provide in their annual reports, and in other material included in financial reports. Other sources of information include investment advisory services, analysts' reports, the financial press, general economic statistics, and general news reports.

The major sources of financial information and their relationships are illustrated in the following diagram, taken from Statement of Financial Accounting Concepts No. 5, Recognition and Measurement in Financial Statements of Business Enterprises.
All Information Useful for Investment, Credit, and Similar Decisions
(Concepts Statement 1, paragraph 22; partly quoted in footnote 6)

Financial Reporting
(Concepts Statement 1, paragraphs 5–8)

Area Directly Affected by Existing FASB Standards

Basic Financial Statements
(in AICPA Auditing Standards Literature)

Scope of Recognition
and Measurement
Concepts Statement

Financial Statements

Examples:
• Accounting Policies
• Contingencies
• Inventory Methods
• Number of Shares of Stock Outstanding
• Alternative Measures (market values of items carried at historical cost)

Notes to Financial Statements
(& parenthetical disclosures)

Examples:
• Management Discussion and Analysis
• Letters to Stockholders

Supplementary Information

Examples:
• Discussion of Competition and Order Backlog in SEC Form 10-K (under SEC Reg. S-K)
• Analysts’ Reports
• Economic Statistics
• News Articles about Company

Source: FASB Statement of Financial Accounting Concepts No. 5
Current Accounting Requirements

Disclosing information to help users assess major risks and uncertainties is consistent with the established objectives of financial reporting, and some such information is already presented in financial statements. Such information includes, for example, related party disclosures and information about receivables, leases, pensions, postretirement benefits, and major commitments and contingencies. In addition, publicly held business enterprises are required to disclose segment information in their financial statements, which, among other things, helps users to assess risks and uncertainties.

However, the criteria provided in this report are intended to extend disclosures beyond those currently required. The various aspects of the recommended disclosures are discussed below to facilitate understanding the distinctions between disclosure requirements under current GAAP and the additional ones recommended by this report.

Current GAAP (FASB Statement No. 14) requires a publicly held business enterprise to disclose the nature of its business as part of segment information in its financial statements, even if the business enterprise operates in only one industry. But non-public business enterprises are not required to disclose such information. In addition, the recommended disclosures include the business enterprise's principal markets and their locations. Current segment information disclosure requirements, in contrast, focus on the locations of operations and identifiable assets.

The following table compares and contrasts the information called for by FASB Statement No. 14 with recommendation 1:

### Comparison of the Disclosure Requirements
**FAS 14 (Segment Reporting) Versus the First Recommendation of the Report**

<table>
<thead>
<tr>
<th>Disclosure</th>
<th>FAS 14</th>
<th>First Recommendation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Description of the types of products or services sold</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Revenue, profitability, identifiable assets, and other related disclosures for each reportable segment</td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>Revenue, profitability, identifiable assets for foreign operations, by geographic area</td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>Export sales by domestic operations, by geographic area</td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>Significant sales to single customer, foreign government, or domestic government agency</td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>Identification of principal markets</td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>Description of location of principal markets</td>
<td></td>
<td>X</td>
</tr>
</tbody>
</table>
The recommended explanation that the preparation of historical financial information requires the use of estimates and assumptions is not required under current GAAP. Including that explanation in financial reports is intended to inform users of the nature and limitations of financial statements themselves in contrast to providing information about the subject business enterprise. It would, nevertheless, help users make sounder use of such statements.

Information on specific estimates used by management to measure assets and liabilities at the reporting date is presented infrequently in current day financial reports, though some believe FASB Statement No. 5 requires it. Regardless of FASB Statement No. 5 requirements, the task force believes that making explicit the requirement to provide that kind of information in financial reports would enhance their usefulness in assessing risks and uncertainties.

**Current SEC Requirements**

The SEC requirement for information to be included in MD&A expands the information that financial reporting otherwise provides to include certain specific kinds of information related to solvency, capital resources, and results of operations. It further expands the information to include management analysis of trends and other factors. Thus, management's subjective analysis is a significant part of the information users obtain from financial reporting of publicly held business enterprises as the data for their decisions.

The FASB's concepts statements present the view that such analysis is helpful to users. In Statement of Financial Accounting Concepts No. 1, for example, the FASB observes that financial reporting should include explanations and interpretations, and cites as an example management's explanation of the information as a significant aid to users.

Under SEC requirements relating to MD&A, publicly held business enterprises are required to describe, among other things, "any known trends or uncertainties that have had or that the registrant reasonably expects will have a material favorable or unfavorable impact on net sales or revenues or income from continuing operations" (Regulation S-K, Item 303(a)(3)(ii)). Such business enterprises are encouraged but not required to include forward-looking information relevant to a full understanding of past and anticipated operations of the business enterprise.

The fourth kind of disclosure recommended by this report differs from the MD&A requirement in three important respects. First, the MD&A rules apply broadly to "any known trends or uncertainties" whereas the recommendations included in this report apply only to known "concentrations," as the term is used herein. Concentrations would represent only a subset of those trends or uncertainties addressed in MD&A.

Second, the MD&A rules relate to matters the business enterprise "reasonably expects," whereas this report calls for disclosure of matters that are "reasonably possible." The task force believes that the fact that a business enterprise is susceptible to severe impact from an event whose occurrence in the near term is reasonably possible should be made known to users, even if management does not expect the event to occur. It would allow users to distinguish that business enterprise from others not so exposed to such identified risks or rewards and to make their own assessment as
to whether it should affect their lending or investing decisions. Furthermore, the task force believes that the criterion of what the business enterprise reasonably expects is useful, but not for the purpose of disclosing events outside management’s control, though its inclusion in MD&A may have value to users.

Third, this report would require disclosure only if the effect would be a severe impact, which is intended to be a higher threshold than material. The task force believes a higher threshold is needed for disclosure of vulnerability due to concentrations and that the threshold selected will still meet the objective of providing an early warning of the potential for a disruptive set of events occurring in the near term.

The SEC also requires registrants, “where appropriate,” to include in prospectuses offering securities to the public “a discussion of the principal factors that make the offering speculative or one of high risk.” Among the factors cited are “the financial position of the registrant” and “the nature of the business in which the registrant is engaged or proposes to engage” (Regulation S-K, Item 503(c)).

This information required by the SEC is not now required by GAAP. However, expanding the scope of financial statements to include some of such information is compatible with the objectives of financial reporting. The recommendations in this report would include some of the information now reported in MD&A or as risk factors but would also require disclosure of certain information not currently included in either place.

**Limitations of Vulnerability Due to Concentrations as a Criterion**

The fourth recommendation in this report focuses on current vulnerability due to concentrations. It does not require disclosure of all specific risks and uncertainties currently affecting business enterprises. Specific risks and uncertainties not included are, for example, those caused by noninsurance, proposed changes in government regulations, and weaknesses in internal accounting controls.

**Role of Users’ Perceptions**

According to the FASB, the first objective of financial reporting, which includes financial statements, is to provide information to present and potential investors and others useful in making rational investment decisions. Thus, users’ perceptions of their needs should be considered in determining what information financial statements can or should provide. Users’ perceptions of their needs, however, are not always reliable guides to the information that financial statements can or should provide. For example, users may make decisions in diverse ways and may see their information needs inconsistently. Providing all users with all the information they may think they need is not a realistic aim of financial statements specifically or of financial reporting generally.

Business enterprises and those who have economic interests in them are affected by many factors that interact in complex ways. Those who use financial information for business and economic decisions need to combine information provided by financial reports with pertinent information from other sources, including additional information provided by issuers, financial analysts’ reports, business and trade publications, and reports of macroeconomic and other events.