Financial Statement Disclosures: A Guide for Small and Medium-Sized Businesses

GSM4/23V1

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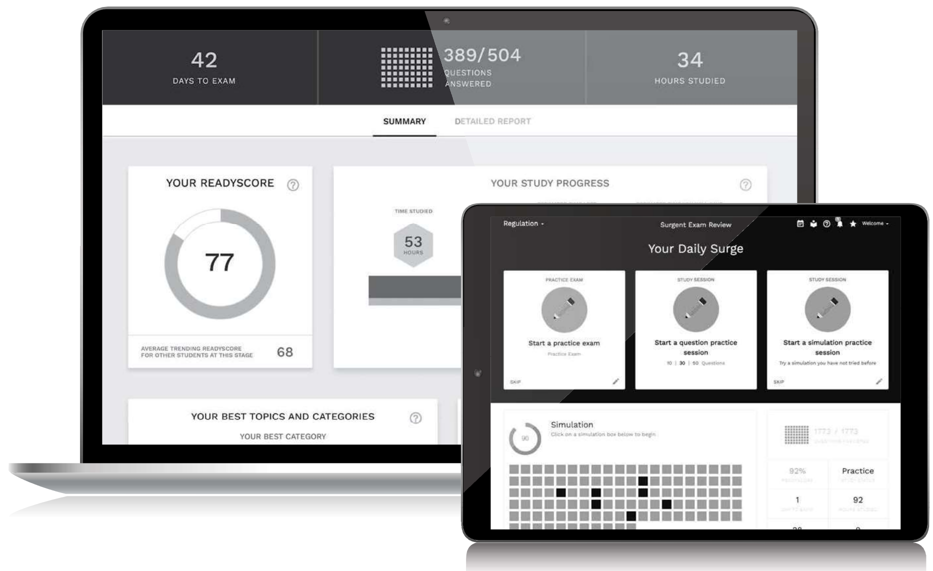

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Financial Statement Disclosures: Building a Foundation

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Financial Statement Disclosures: Building a Foundation

Learning objectives

After completing this chapter, you should be familiar with:

- The FASB Accounting Standards Codification™;
- SFAC No. 8, *Conceptual Framework for Financial Reporting*;
- The key role risk factors play in financial statement disclosures; and
- The "Summary of Significant Accounting Policies" financial statement disclosure.

I. Introduction

Financial statement disclosure matters have been around for a long time, a really long time. Some say that the first recorded financial statement footnote was written in 44 BC by journal scribes for Julius Caesar, noting which Egyptian farmers had registered their fields as fallow and thus tax-exempt (depending on flood patterns of the Nile). During the "early years," footnotes were often an afterthought, a bit of the "writing behind the numbers, old chap" if you will. However, today's financial statement disclosures have evolved, from simple and brief, to quite complex and lengthy; these are definitely NOT your daddy's Chevrolet anymore. One of the most common complaints about the current nature of U.S. Generally Accepted Accounting Standards is that the disclosure requirements are too detailed and not cost effective.

In this chapter, we will touch upon the FASB's Statement of Financial Accounting Concepts No. 8, *Conceptual Framework for Financial Reporting*, and the key role risk factors play in financial statement disclosures. Note that the FASB is proposing changes to CONS Statement No. 8 as part of its Disclosure Framework project. We will conclude the material by reviewing the "Summary of Significant Accounting Policies" financial statement disclosure.

Before we get started, a final note on disclosures. While all entities that prepare financial statements in accordance with U.S. GAAP must follow the same disclosure guidance, entities whose securities are registered with the U.S Securities and Exchange Commission (SEC) often need to comply with additional disclosures mandated by the SEC. As we go through our examples in the course, we will look at disclosures for both SEC registrants and non-SEC registrants. Irrespective of whether the entity has securities registered with the SEC, these examples will demonstrate the disclosure requirements for the particular topic. Where significant, the course will highlight any additional disclosures in the public entity examples which are required by SEC rules and regulations. Examples from SEC registrants are taken directly from their SEC filings, while private entity examples have been sanitized of client identifying data in order to maintain confidentiality.

All of the disclosure guidance we will discuss is taken from the FASB's Accounting Standards Codification (ASC). The ASC is organized as follows:

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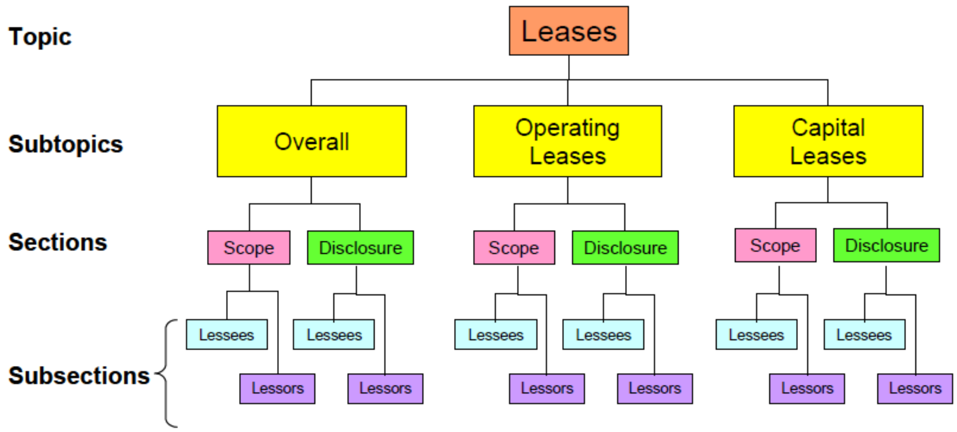
II. The Accounting Standards CodificationTM

On July 1, 2009, the FASB launched its Accounting Standards Codification™ (Codification or ASC), which supersedes the previous level (a) – (d) accounting hierarchy of generally accepted accounting principles (GAAP) and is now the single authoritative source of nongovernmental U.S. GAAP. The Codification uses the following structure to organize and present authoritative U.S. GAAP: Topics; Subtopics; Sections; and Subsections.



Note: This is for illustration purposes only and does not include all Topics, Subtopics, Sections and Subsections.

a. Topics represent a collection of related guidance and are arranged as follows:
   - **General Principles** relating to broad conceptual matters. Topics 105 – 199.
   - **Presentation** relating only to presentation matters; for example, the balance sheet, income statement, and EPS. Topics 205 – 299.
   - **Financial Statement Accounts** relating to assets, liabilities, equity, revenues, and expenses. Topics 305 – 799.
   - **Broad Transactions** relating to, for example, business combinations, fair value measurements, and leases. Topics 805 – 899.
   - **Industry** relating to accounting unique to a particular industry; for example, contractors, financial services, and not-for-profits. Topics 905 – 999.

b. Subtopics represent subsets of a Topic; for example, Internal-Use Software and Website Development Costs are two Subtopics of the "Intangibles–Goodwill and Other" Topic. Each Topic contains an Overall Subtopic to begin with and then other guidance related to the Topic.

c. Sections represent subsets of a Subtopic and every Subtopic has the same Sections as follows:
   - **00 Status** – Includes references to the ASUs that affect the Subtopic.
   - **05 Overview and Background** – General overview and background on the Subtopic.
   - **10 Objectives** – High-level objectives of the Subtopic.
   - **15 Scope and Scope Exceptions** – Outlines the items to which the guidance in the Subtopic does or does not apply.
   - **20 Glossary** – All the glossary terms used in the Subtopic.
   - **25 Recognition** – Criteria, timing, and location within the financial statements for recognizing a particular item.

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- **30 Initial Measurement** – Criteria and amounts used to measure a particular item at date of recognition.
- **35 Subsequent Measurement** – Criteria and amounts used to measure a particular asset, liability, or equity item subsequent to the date of recognition.
- **40 Derecognition** – Criteria, the method to determine the amount of basis, and the timing to be used when derecognizing a particular asset, liability, or equity item for purposes of determining any gain or loss.
- **45 Other Presentation Matters** – Includes other presentation matters related to the Subtopic.
- **50 Disclosure** – Contains specific disclosure requirements for a Subtopic.
- **55 Implementation Guidance and Illustrations** – Contains implementation guidance and illustrations integral to the standards.
- **60 Relationships** – References to other Subtopics that may contain guidance related to the Subtopic.
- **65 Transition and Open Effective Date Information** – References to paragraphs within the Subtopic that have open transition guidance.
- **70 Grandfathered Guidance** – Descriptions, references, and transition periods for content grandfathered after July 1, 2009, by an ASU.
- **75 XBRL Elements** – Contains the related XBRL Elements for the Subtopic.

Subsections further break down Sections and are really used to filter the data.

All disclosure guidance for a Topic is in Section 50 of the Topic or Subtopic.

III. "Back to the future"

The FASB issued Statement of Financial Accounting Concepts (SFAC) No. 1, *Objectives of Financial Reporting by Business Enterprises*, back in November 1978. Then in September 2010, it issued its most recent Concepts Statement, SFAC No. 8, *Conceptual Framework for Financial Reporting*, which supersedes SFAC No. 1 and SFAC No. 2, *Qualitative Characteristics of Accounting Information*.

In a nutshell, what the FASB is doing with its original Concepts Statements now is superseding them with individual chapters in SFAC No. 8 in a coordinated project with the International Accounting Standards Board (IASB) to improve and converge both of their conceptual frameworks for financial reporting. For example, chapter 1 of SFAC No. 8 is now the old SFAC No. 1 and chapter 3 is now the old SFAC No. 2 (chapter 2 is being reserved for the chapter on the reporting entity).

According to SFAC No. 8, the conceptual framework is intended to set the objectives and fundamental concepts that will be the basis for developing financial accounting and reporting guidance. The objectives are meant to identify the goals and purposes of financial reporting, and the fundamental concepts are those underlying financial accounting, such as:

- Concepts that guide the selection of transactions and other events and conditions to be accounted for;
- Their recognition and measurement; and
- The means of summarizing and communicating them to interested parties.

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Concepts of this type are fundamental in the sense that other concepts flow from them and repeated reference to them will be necessary in establishing, interpreting, and applying accounting and reporting guidance. Establishment of objectives and identification of fundamental concepts will not directly solve financial accounting and reporting problems. Rather, objectives give direction, and concepts are the tools to be used to solve problems.

It is very important to note here that Concepts Statements are not part of the FASB Accounting Standards Codification™ discussed above, which as we said, is now the single authoritative source of nongovernmental U.S. GAAP. Instead, Concepts Statements describe concepts that will underlie guidance on future financial accounting practices and in due course will serve as a basis for evaluating existing guidance and practices.

A. The objective of general purpose financial reporting

According to Chapter 1 of SFAC No. 8, this is *The Objective of General Purpose Financial Reporting*:

> The objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders, and other creditors in making decisions about providing resources to the entity.

Notice how the above objective does not attempt to make any differentiation in the objective of general purpose financial reporting between say, public and private entities, small and medium-sized entities and larger entities, or closely held entities versus those with widely dispersed ownership. This lack of differentiation was intentional on the FASB's part in that the Board concluded that the objective of general purpose financial reports is the same for all entities. That is, external users of financial reporting have similar objectives, irrespective of the type of entities in which they invest (although cost constraints and differences in activities among entities might sometimes lead to differences in reporting for different types of entities).

This objective also forms the foundation of the conceptual framework from which the aspects of presentation and disclosure (among others) logically flow. In this respect, it is easy to conclude that the "financial information" referred to in the objective is not simply the quantitative figures found in the financial statements but also includes the "words" if you will, typically found in the notes to the financial statements. Of course, cost, as always, is a pervasive constraint on the reporting entity's ability to provide useful financial information.

B. Qualitative characteristics of financial information

To be useful, financial statement information, both the numbers and the words, has to be relevant and "faithfully represent" what it purports to represent.

Relevance in this context simply means that the information is capable of making a difference in the decision-making process of financial statement users. Notice the word "capable" here, which means that it does not matter whether or not financial statement users choose to actually use the information, just that it is capable of making a difference to them. According to Chapter 3, *Qualitative Characteristics of Useful Financial Information*, of SFAC No. 8, financial information is capable of making a difference in decisions if it has predictive value, that is, it can be used as an input by users to predict future outcomes, confirmatory value, that is, it provides feedback about previous evaluations, or both.

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For information to faithfully represent what it purports to represent, it should be complete, neutral, and free from error. Of course, perfect faithful representation is seldom, if ever, achievable, but the overall objective is to maximize these qualities to the extent possible.

"Complete" as it is used in defining faithful representation is generally meant to mean that financial statements are not simply the numbers that go into them, but also a complete and thorough set of disclosures that help to explain significant facts behind those numbers. For example, the number that represents an entity's total cash and cash equivalents certainly appears on the balance sheet, but without a disclosure explaining what a "cash equivalent" is, well, that number is just a number. Likewise, depreciation expense is just a number on the income statement until you wrap it in a disclosure explaining exactly how it was calculated.

Of course, underpinning both the numbers and the words behind them is the concept of materiality, which uses the standard accounting definition – information is material if omitting or misstating it could influence decisions that users make on the basis of the financial information of a specific reporting entity. An "enhancing" (as SFAC No. 8 puts it) qualitative characteristic of financial information is understandability, which basically means classifying, characterizing, and presenting information clearly and concisely. In a presentation and disclosure sense, we all know that some accounting transactions and events are inherently complex and cannot be made easy to understand, for example, level 3 fair value measurements. Excluding information about these types of transactions and events from the financial statements might make them easier to understand but would also make them incomplete and therefore potentially misleading. At the same time, understandability does assume that financial statement users have a reasonable degree of financial knowledge and a willingness to review and analyze the information with reasonable diligence. In the end, understandability is intended to indicate that information that is difficult to understand should be presented and explained as clearly as possible.

C. What about "transparency"?

One of today's favorite accounting buzz words is "transparency," which many practitioners suggest should also be included as a qualitative characteristic of financial information. However, after considering this suggestion, the FASB decided that transparency is just another word being used to describe financial information that has the qualitative characteristics of relevance and representational faithfulness that is enhanced by understandability. Interestingly, former SEC Chief Accountant Lynn Turner said of transparent disclosures that in general, registrants should ensure disclosures provide investors with the ability to see the company through the "eyes of management" and reflect, in a timely manner, the actual economic results and trends in operations and liquidity of the business, and the industry and environment in which it is operating.

D. FASB's current Disclosure Framework Project

Framework projects do not change the FASB's Accounting Standards Codification (ASC) per se, but rather update the theoretical underpinnings of the accounting standards found in the FASB Concepts Statements. These updated concepts are then applied to accounting topics, the changes to which would update the ASC.

Per the FASB website, the FASB Concepts Statements are intended to serve the public interest by setting the objectives, qualitative characteristics, and other concepts that guide selection of economic phenomena to be recognized and measured for financial reporting and their display in financial

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statements or related means of communicating information to those who are interested. Concepts Statements guide the Board in developing sound accounting principles and provide the Board and its constituents with an understanding of the appropriate content and inherent limitations of financial reporting. A Statement of Financial Accounting Concepts does not establish generally accepted accounting standards.

The objective of this conceptual framework project is to develop an improved conceptual framework that provides a sound foundation for developing future accounting standards. Such a framework is essential to fulfilling the Board's goal of developing standards that are principles-based, internally consistent, and that lead to financial reporting that provides the information capital providers need to make decisions in their capacity as capital providers. The new FASB framework will build on the existing framework.

With the completion of the Disclosure Framework project in 2018, and its Elements and Presentation framework projects in 2021, the FASB currently has three framework projects on its technical agenda dealing with measurement, recognition and derecognition, and the reporting entity. The projects are focused on:

- Measurement - identifying appropriate types of measurements and determining which measurements to use in specific circumstances. This project is currently in the exposure draft phase..
- Recognition and Derecognition – the issue of derecognition was not specifically addressed in Concepts Statement No. 5 and FASB launched this project to address the issue of derecognition. This project is currently in the final concepts phase.
- Reporting Entity – This project is intended to develop the concept of the reporting entity as previous guidance has not sufficiently described a reporting entity. This project is currently in the final concepts phase.

Most pertinent to our discussion is the FASB's completed Disclosure Framework project, which was completed in 2018. The overall objective of this project was to improve the effectiveness of disclosures in the notes to the financial statements by clearly communicating the information that is most important to users of each entity's financial statements. In essence, the FASB looked to improve its own procedures for establishing disclosure requirements and to provide a way for reporting organizations to exercise judgment about which disclosures are relevant to them. The ultimate goal was to enhance users' abilities to analyze the information in the notes to the financial statements while minimizing the burden on reporting organizations. Achievement of the objective of improving effectiveness required the development of a framework that promotes consistent decisions about disclosure requirements by the Board and the appropriate exercise of discretion by reporting entities.

In 2018, the FASB issued in final, *Conceptual Framework for Financial Reporting: Chapter 8 Notes to Financial Statements*. The Board will use the concepts developed as a result of this project as a basis for establishing disclosure requirements in the future as well as in evaluating existing disclosure requirements.

Related to the Entity's decision process, in 2018, the Board issued *Conceptual Framework for Financial Reporting: Chapter 3 Qualitative Characteristics of Useful Financial Information*. This updated CONS chapter addresses the use of materiality in helping organizations employ discretion when determining what disclosures in notes to financial statements should be considered "material" in their particular

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circumstances, and helping the Board understand the reporting environment in which it sets financial accounting and reporting standards.

Specifically, these amendments to FASB Concepts Statement No. 8, *Conceptual Framework for Financial Reporting*, clarify the concept of materiality, defining it as a legal concept. These amendments were made to Chapter 3, *Qualitative Characteristics of Useful Financial Information*.

The FASB Board also proposed a series of Disclosure Review projects in light of the proposed changes to the Disclosure Framework. Currently, disclosures in two areas are being evaluated as part of the Disclosure Framework project:

- Disclosure Improvements in Response to the SEC's Release on Disclosure Update and Simplification;
- Income Taxes.

The review of disclosure improvements is in the final ASU phase while the review of disclosures related to income taxes is in the exposure draft phase..

IV. Risk – A key element in financial statement disclosures

Discussing risk is a key element in financial statement disclosures. In general, the following principles are the "backbone" of integrating risk factors into financial statement disclosures:

- **Consistency** – Disclosures should be consistent with management's approach to risk management.
- **Focus** – Disclosures should focus on how risk within an entity changes over time.
- **Responsiveness** – Disclosures should be responsive to changes in internal practices.
- **Balanced** – Disclosures should be balanced between quantitative and qualitative information.

A. Risk management

There should be as strong a link as possible between the framework relied upon by senior management to evaluate the risks and returns of the business and the information that is disclosed. Such a linkage provides insight into management practice, financial performance, risk discipline, and also helps ensure that the information disclosed will be meaningful. At the same time, the information that is disclosed needs to be easily understood, nonproprietary, and based on a "mature" framework. As such, the information may not be as detailed as the information that senior management uses to evaluate risk.

The FASB has identified this lack of congruency between an entity's risk management approach and the relevant accounting guidance as a reason for its proposed changes to certain elements of hedge accounting as it relates to certain cash flow risks.

B. Changing risk over time

While comparable data across firms is conceptually appealing, it is difficult to achieve. Because risk information is based on inherently imprecise estimations, having frequent information to relate the earnings volatility of a business over time to the estimates will be the best way for a user to assess the quality of those estimates.

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C. Responses to changes in internal practices

Maintaining continuous and comparable prior period data is less important than having the best currently available view of an entity's risk profile. It can be expected that the pace of innovation and modifications to risk management and measurement practices will be rapid and such changes should be reflected as quickly as possible in financial statement disclosures. A discussion of material changes in risk measurement and how those changes might affect the trend in disclosed information should accompany significant changes.

D. Balancing quantitative and qualitative information

Best practice disclosures incorporate clear and concise informative discussions about an entity's risk management processes. Such disclosures would include defining the various risk factors, discussing the framework for management of each risk factor (for example, responsible individuals, groups, or committees), and describing the main elements of risk assessment, including key metrics. These qualitative disclosures combined with quantitative information around each risk factor and the performance of risk estimates are aimed at providing a well-balanced view of the entity's overall risk profile.

E. Risks and uncertainties in the financial statements

ASC 275, *Risks and Uncertainties*, provides the accounting guidance and disclosure requirements relating to risk and uncertainties in the financial statements. According to ASC 275, financial statements provide information about certain current conditions and trends that help users in predicting a reporting entity's 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 the entity's operations and of the information about those operations that financial reporting provides.

The disclosures required by ASC 275 focus primarily on risks and uncertainties that could significantly affect the amounts reported in the financial statements in the "near term," which is defined as a period of time not to exceed one year from the date of the financial statements. These risks and uncertainties generally stem from:

- The nature of the entity's operations;
- The use of estimates in the preparation of the entity's financial statements; and
- Significant concentrations in certain aspects of the entity's operations.

1. Nature of operations

ASC 275 notes that information about the nature of operations is helpful to users 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, for example, hauling nuclear waste. 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.

Disclosure of the locations of a business entity'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

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products or provides services helps users of financial statements to assess certain risks based on day-to-day national and world events.

2. Use of estimates in the preparation of financial statements

It is critically important to explicitly communicate to financial statement users that the use of estimates in preparing the statements results in the reporting of values that are approximations rather than exact amounts. If users better understand the inherent limitations on precision in financial statements, theoretically, they should be able to make better decisions.

According to ASC 275, 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. Making reliable estimates for such matters is often difficult even in periods of economic stability, much less in the current economic volatility of hope and change. 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 (often referred to as financial statement "fiat").

3. Current vulnerability due to certain concentrations

ASC 275 also provides guidance on disclosure of current vulnerability due to certain concentrations but stops short of requiring disclosure of all concentrations.

4. Other disclosures about risk

In addition to the risk disclosures made in the financial statements, companies with publicly traded debt or equity also disclose risks about their operations in their annual reports on Form 10-K, or others, as applicable. These disclosures often discuss in great detail the nature of the risks facing the business. However, as these disclosures are not part of the audited financial statements, they are not covered by the auditor's opinion.

F. Disclosure example – Buildco Inc.

Obviously, the nature of an entity's disclosure will vary based on the complexity of its operations. However, irrespective of the nature of an entity's operations, it should discuss the nature of its operations as well as other disclosures required by ASC Topic 275. The following are some representative disclosures for Buildco, a non-SEC registrant builder of residential houses in suburban Philadelphia.

Nature of Operations

Buildco, Inc. ("Company," "we," "our") is a business whose principal operations include the design, construction, marketing, and sales of residential real estate in the greater Philadelphia metropolitan area. The Company acquires either vacant parcels of land or those with existing structures, prepares the site for the construction of the new residence, and builds generally single family but also twin and townhouse residential property, based on prevailing trends in the local market.

Our business is subject to many risks, including risks associated with obtaining the necessary approvals on a property and completing the land improvements on it. We attempt, where possible, to reduce certain risks by controlling land for future development through options (also referred to herein as "land purchase contracts" or "option and purchase agreements"). These options enable us to obtain the necessary governmental approvals before we acquire title to the land.

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We also reduce certain risks by generally commencing construction of a detached home only after executing an agreement of sale and receiving a substantial down payment from the buyer and by using subcontractors to perform home construction and land development work on a fixed-price basis.

Concentration Risk

Potential exposure to concentration risk may impact revenue and raw materials used in the construction of our new products.

Customer concentration risk may impact revenue. In an average year, the company will construct 8 to 10 residences. Accordingly, revenue is concentrated among those customers.

We source our raw materials, primarily lumber, through a limited number of suppliers which furnish building materials which meet our high-quality standards. Lack of availability of such high-quality materials, including engineered lumber and certain energy efficient building components, could delay construction efforts.

Use of Estimates

Our financial statements have been prepared in accordance with GAAP. The preparation of these financial statements requires our management to make estimates and judgments that affect the reported amounts of assets and liabilities and the disclosures of contingent liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from our estimates.

V. Summary of significant accounting policies

Financial statement disclosures (notes to the financial statements) are an integral part of an entity's financial reporting process. Indeed, the phrase: *The accompanying notes are an integral part of these consolidated financial statements* or *See notes to the financial statements* appears on all financial statements and is intended as an "alert" to users about the importance of such disclosures.

According to the authoritative accounting literature, a complete set of financial statements includes "notes, comprising a summary of significant accounting policies and other explanatory information." In this material, we will focus our attention on the "Summary of Significant Accounting Policies Disclosure." To illustrate this critical financial statement disclosure, we will use example excerpts from a technology company, Techno, Inc., and a residential home builder, Buildco, Inc. for your review. Disclosures for both companies were derived from published financial statements from companies in these respective industries. Of course, since there are literally thousands of such examples available, the examples included here are only meant as a sample of the many possible alternatives typically seen in practice today.

A. ASC 235, *Notes to Financial Statements*

ASC 235, *Notes to Financial Statements*, applies to all entities and addresses the content and usefulness of disclosures by an entity of the accounting policies judged by management to be most appropriate to fairly present the entity's financial statements.

ASC 235 specifically notes:

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> 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 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.

With that said however, to the extent possible, the disclosure of accounting policies should not duplicate details presented elsewhere as part of the financial statements, for example, the makeup of plant assets. Likewise, in some cases, the disclosure of accounting policies should refer to related details presented elsewhere as part of the financial statements, for example, changes in accounting policies during the period should be described with cross-reference to the disclosures required by ASC 250, *Accounting Changes and Error Corrections*.

ASC 235 also recognizes the need for flexibility in the formatting, including the location, of an entity's disclosure of its accounting policies provided that the entity identifies and describes its significant accounting policies as an integral part of its financial statements. In this respect, disclosure is preferred in a separate "Summary of Significant Accounting Policies" or similar title, before the other notes to the financial statements, or as the initial note to the financial statements.

Lastly, note that certain accounting policies are more significant to certain companies' financial statements than others. While it is reasonable to expect similar accounting policy footnotes for companies in the same industry, it is common for this note to vary significantly for companies that operate in different industries. In reviewing these examples, pay particular attention to the revenue recognition policies of each company. Also, as we know, the FASB has issued Updates which could significantly impact the financial statements of companies upon adoption. Both Techco and Buildco have discussed new Updates which could potentially impact their companies most significantly, based both in industry and company specific factors.

B. Disclosure example – Techco Inc.

NOTE 1 – ACCOUNTING POLICIES

- Accounting Principles.
- Principles of Consolidation.
- Estimates and Assumptions.
- Foreign Currencies.
- Revenue Recognition.
- Cost of Revenue.
- Product Warranty.
- Research and Development.
- Sales and Marketing.
- Income Taxes.
- Fair Value Measurements.
- Financial Instruments.
- Allowance for Doubtful Accounts.

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- Inventories.
- Property and Equipment.
- Recent Accounting Guidance.

NOTE 1 – ACCOUNTING POLICIES

Accounting Principles
The consolidated financial statements and accompanying notes are prepared in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP").

We have recast certain prior-period amounts to conform to the current-period presentation, with no impact on consolidated net income or cash flows.

Principles of Consolidation
The consolidated financial statements include the accounts of Techco, Holding Company, Inc. and its operating subsidiary, Techco, Inc. Intercompany transactions and balances have been eliminated.

Estimates and Assumptions
Preparing financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, and expenses. Examples of estimates include loss contingencies; product warranties; product life cycles; useful lives of our tangible and intangible assets; allowances for doubtful accounts; allowances for product returns; and the market value of our inventory. Examples of assumptions include: the elements comprising a software arrangement, including the distinction between upgrades or enhancements and new products; when technological feasibility is achieved for our products; the potential outcome of future tax consequences of events that have been recognized in our consolidated financial statements or tax returns; and determining when investment impairments are other-than-temporary. Actual results and outcomes may differ from management's estimates and assumptions.

Foreign Currencies
Assets and liabilities recorded in foreign currencies are translated at the exchange rate on the balance sheet date. Revenue and expenses are translated at average rates of exchange prevailing during the year. Translation adjustments resulting from this process are recorded to other comprehensive income ("OCI").

Product Revenue and Service and Other Revenue
Product revenue includes sales from operating systems; cross-device productivity applications; server applications; business solution applications; desktop and server management tools; software development tools; video games; and hardware such as PCs, tablets, gaming and entertainment consoles, other intelligent devices, and related accessories.

Service and other revenue includes sales from cloud-based solutions that provide customers with software, services, platforms, and content; solution support; and consulting services. Service and other revenue also includes sales from online advertising and LinkedIn.

Revenue Recognition
Revenue is recognized upon transfer of control of promised products or services to customers in an amount that reflects the consideration we expect to receive in exchange for those products or services.

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We enter into contracts that can include various combinations of products and services, which are generally capable of being distinct and accounted for as separate performance obligations. Revenue is recognized net of allowances for returns and any taxes collected from customers, which are subsequently remitted to governmental authorities.

Nature of Products and Services

Licenses for on-premises software provide the customer with a right to use the software as it exists when made available to the customer. Customers may purchase perpetual licenses or subscribe to licenses, which provide customers with the same functionality and differ mainly in the duration over which the customer benefits from the software. Revenue from distinct on-premises licenses is recognized upfront at the point in time when the software is made available to the customer. In cases where we allocate revenue to software updates, primarily because the updates are provided at no additional charge, revenue is recognized as the updates are provided, which is generally ratably over the estimated life of the related device or license.

Certain volume licensing programs, including Enterprise Agreements, include on-premises licenses combined with Software Assurance (“SA”). SA conveys rights to new software and upgrades released over the contract period and provides support, tools, and training to help customers deploy and use products more efficiently. On-premises licenses are considered distinct performance obligations when sold with SA. Revenue allocated to SA is generally recognized ratably over the contract period as customers simultaneously consume and receive benefits, given that SA comprises distinct performance obligations that are satisfied over time.

Cloud services, which allow customers to use hosted software over the contract period without taking possession of the software, are provided on either a subscription or consumption basis. Revenue related to cloud services provided on a subscription basis is recognized ratably over the contract period. Revenue related to cloud services provided on a consumption basis, such as the amount of storage used in a period, is recognized based on the customer utilization of such resources. When cloud services require a significant level of integration and interdependency with software and the individual components are not considered distinct, all revenue is recognized over the period in which the cloud services are provided.

Revenue from search advertising is recognized when the advertisement appears in the search results or when the action necessary to earn the revenue has been completed. Revenue from consulting services is recognized as services are provided.

Our hardware is generally highly dependent on, and interrelated with, the underlying operating system and cannot function without the operating system. In these cases, the hardware and software license are accounted for as a single performance obligation and revenue is recognized at the point in time when ownership is transferred to resellers or directly to end customers through retail stores and online marketplaces.

Refer to Note 19 – Segment Information and Geographic Data for further information, including revenue by significant product and service offering.

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Significant Judgments
Our contracts with customers often include promises to transfer multiple products and services to a customer. Determining whether products and services are considered distinct performance obligations that should be accounted for separately versus together may require significant judgment. Certain cloud services, such as Office 365, depend on a significant level of integration and interdependency between the desktop applications and cloud services. Judgment is required to determine whether the software license is considered distinct and accounted for separately, or not distinct and accounted for together with the cloud service and recognized over time.

Judgment is required to determine the SSP for each distinct performance obligation. We use a single amount to estimate SSP for items that are not sold separately, including on-premises licenses sold with SA or software updates provided at no additional charge. We use a range of amounts to estimate SSP when we sell each of the products and services separately and need to determine whether there is a discount that needs to be allocated based on the relative SSP of the various products and services.

In instances where SSP is not directly observable, such as when we do not sell the product or service separately, we determine the SSP using information that may include market conditions and other observable inputs. We typically have more than one SSP for individual products and services due to the stratification of those products and services by customers and circumstances. In these instances, we may use information such as the size of the customer and geographic region in determining the SSP.

Due to the various benefits from and the nature of our SA program, judgment is required to assess the pattern of delivery, including the exercise pattern of certain benefits across our portfolio of customers.

Our products are generally sold with a right of return and we may provide other credits or incentives, which are accounted for as variable consideration when estimating the amount of revenue to recognize. Returns and credits are estimated at contract inception and updated at the end of each reporting period as additional information becomes available and only to the extent that it is probable that a significant reversal of any incremental revenue will not occur.

Contract Balances and Other Receivables
Timing of revenue recognition may differ from the timing of invoicing to customers. We record a receivable when revenue is recognized prior to invoicing, or unearned revenue when revenue is recognized subsequent to invoicing. For multi-year agreements, we generally invoice customers annually at the beginning of each annual coverage period. We record a receivable related to revenue recognized for multi-year on premises licenses as we have an unconditional right to invoice and receive payment in the future related to those licenses.

Unearned revenue comprises mainly unearned revenue related to volume licensing programs, which may include SA and cloud services. Unearned revenue is generally invoiced annually at the beginning of each contract period for multi-year agreements and recognized ratably over the coverage period. Unearned revenue also includes payments for consulting services to be performed in the future, subscriptions, and other offerings for which we have been paid in advance and earn the revenue when we transfer control of the product or service.

Refer to Note 13 – Unearned Revenue for further information, including unearned revenue by segment and changes in unearned revenue during the period.

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Payment terms and conditions vary by contract type, although terms generally include a requirement of payment within 30 to 60 days. In instances where the timing of revenue recognition differs from the timing of invoicing, we have determined our contracts generally do not include a significant financing component. The primary purpose of our invoicing terms is to provide customers with simplified and predictable ways of purchasing our products and services, not to receive financing from our customers or to provide customers with financing. Examples include invoicing at the beginning of a subscription term with revenue recognized ratably over the contract period, and multi-year on-premises licenses that are invoiced annually with revenue recognized upfront.

As of June 30, 2022 and 2021, long-term accounts receivable, net of allowance for doubtful accounts, was $3.8 billion and $3.4 billion, respectively, and is included in other long-term assets in our consolidated balance sheets.

Allowance for Doubtful Accounts

The allowance for doubtful accounts reflects our best estimate of probable losses inherent in the accounts receivable balance. We determine the allowance based on known troubled accounts, historical experience, and other currently available evidence. Activity in the allowance for doubtful accounts was as follows:

(In thousands)

Year Ended June 30,	**2022**	**2021**
Balance, beginning of period	**$ 301**	$ 336
Charged to costs and other	**77**	16
Write-offs	**(43)**	(51)
Balance, end of period	**$ 335**	$ 301

Cost of Revenue

Cost of revenue includes manufacturing and distribution costs for products sold and programs licensed; warranty costs; inventory valuation adjustments; costs associated with the delivery of consulting services; and the amortization of capitalized software development costs. Capitalized software development costs are amortized over the estimated lives of the products.

Product Warranty

We provide for the estimated costs of fulfilling our obligations under software warranties at the time the related revenue is recognized. For such warranties, we estimate the costs to provide bug fixes, such as security patches, over the estimated life of the software. We regularly reevaluate our estimates to assess the adequacy of the recorded warranty liabilities and adjust the amounts, as necessary.

Research and Development

Research and development expenses include payroll, employee benefits, and other headcount-related expenses associated with product development. Research and development expenses also include third-party development and programming costs, localization costs incurred to translate software for

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international markets, and the amortization of purchased software code and services content. Such costs related to software development are included in research and development expense until the point that technological feasibility is reached, which for our software products, is generally shortly before the products are released to manufacturing. Once technological feasibility is reached, such costs are capitalized and amortized to cost of revenue over the estimated lives of the products.

Sales and Marketing

Sales and marketing expenses include payroll, employee benefits, stock-based compensation expense, and other headcount-related expenses associated with sales and marketing personnel, and the costs of advertising, promotions, trade shows, seminars, and other programs. Advertising costs are expensed as incurred. Advertising expense was $1.billion and $2 billion, in fiscal years 2022 and 2021, respectively.

Income Taxes

Income tax expense includes U.S. and international income taxes and interest and penalties on uncertain tax positions. Certain income and expenses are not reported in tax returns and financial statements in the same year. The tax effect of such temporary differences is reported as deferred income taxes. Deferred tax assets are reported net of a valuation allowance when it is more likely than not that a tax benefit will not be realized. The deferred income taxes are classified as current or long-term based on the classification of the related asset or liability.

Fair Value Measurements

We account for certain assets and liabilities at fair value. The hierarchy below lists three levels of fair value based on the extent to which inputs used in measuring fair value are observable in the market. We categorize each of our fair value measurements in one of these three levels based on the lowest level input that is significant to the fair value measurement in its entirety. These levels are:

- *Level 1* – inputs are based upon unadjusted quoted prices for identical instruments traded in active markets. Our Level 1 non-derivative investments primarily include U.S. government securities, domestic and international equities, and actively traded mutual funds. Our Level 1 derivative assets and liabilities include those actively traded on exchanges.
- *Level 2* – inputs are based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques (e.g. the Black-Scholes model) for which all significant inputs are observable in the market or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Where applicable, these models project future cash flows and discount the future amounts to a present value using market-based observable inputs including interest rate curves, credit spreads, foreign exchange rates, and forward and spot prices for currencies and commodities. Our Level 2 non-derivative investments consist primarily of corporate notes and bonds, common and preferred stock, mortgage and asset-backed securities, U.S. government and agency securities, and foreign government bonds. Our Level 2 derivative assets and liabilities primarily include certain over-the-counter option and swap contracts.
- *Level 3* – inputs are generally unobservable and typically reflect management's estimates of assumptions that market participants would use in pricing the asset or liability. The fair values are therefore determined using model-based techniques, including option pricing models and discounted cash flow models. Our Level 3 non-derivative assets primarily comprise investments in common and preferred stock and goodwill when it is recorded at fair value due to an impairment charge. Unobservable inputs used in the models are significant to the fair

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values of the assets and liabilities. Our Level 3 derivative assets and liabilities primarily include equity derivatives.

We measure certain assets, including our cost and equity method investments, at fair value on a nonrecurring basis when they are deemed to be other-than-temporarily impaired. The fair values of these investments are determined based on valuation techniques using the best information available, and may include quoted market prices, market comparables, and discounted cash flow projections. An impairment charge is recorded when the cost of the investment exceeds its fair value and this condition is determined to be other-than-temporary.

Our other current financial assets and our current financial liabilities have fair values that approximate their carrying values.

Financial Instruments
We consider all highly liquid interest-earning investments with a maturity of three months or less at the date of purchase to be cash equivalents. The fair values of these investments approximate their carrying values. In general, investments with original maturities of greater than three months and remaining maturities of less than one year are classified as short-term investments. Investments with maturities beyond one year may be classified as short-term based on their highly liquid nature and because such marketable securities represent the investment of cash that is available for current operations. All cash equivalents and short-term investments are classified as available-for-sale and realized gains and losses are recorded using the specific identification method. Changes in market value, excluding other-than-temporary impairments, are reflected in OCI.

Equity and other investments classified as long-term include both debt and equity instruments. With the exception of certain corporate notes that are classified as held-to-maturity, debt and publicly traded equity securities are classified as available-for-sale and realized gains and losses are recorded using the specific identification method. Changes in the market value of available-for-sale securities, excluding other-than-temporary impairments, are reflected in OCI. Held-to-maturity investments are recorded and held at amortized cost. Common and preferred stock and other investments that are restricted for more than one year or are not publicly traded are recorded at cost or using the equity method.

Investments are considered to be impaired when a decline in fair value is judged to be other-than-temporary. Fair value is calculated based on publicly available market information or other estimates determined by management. We employ a systematic methodology on a quarterly basis that considers available quantitative and qualitative evidence in evaluating potential impairment of our investments. If the cost of an investment exceeds its fair value, we evaluate, among other factors, general market conditions, credit quality of debt instrument issuers, the duration and extent to which the fair value is less than cost, and for equity securities, our intent and ability to hold, or plans to sell, the investment. For fixed-income securities, we also evaluate whether we have plans to sell the security or it is more likely than not that we will be required to sell the security before recovery. We also consider specific adverse conditions related to the financial health of and business outlook for the investee, including industry and sector performance, changes in technology, and operational and financing cash flow factors. Once a decline in fair value is determined to be other-than-temporary, an impairment charge is recorded to other income (expense), net and a new cost basis in the investment is established.

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Inventories
Inventories are stated at average cost, subject to the lower of cost or market. Cost includes materials, labor, and manufacturing overhead related to the purchase and production of inventories. We regularly review inventory quantities on hand, future purchase commitments with our suppliers, and the estimated utility of our inventory. If our review indicates a reduction in utility below carrying value, we reduce our inventory to a new cost basis through a charge to cost of revenue. The determination of market value and the estimated volume of demand used in the lower of cost or market analysis require significant judgment.

Property and Equipment
Property and equipment is stated at cost and depreciated using the straight-line method over the shorter of the estimated useful life of the asset or the lease term. The estimated useful lives of our property and equipment are generally as follows: computer software developed or acquired for internal use, three to seven years; computer equipment, two to three years; buildings and improvements, five to 15 years; leasehold improvements, three to 20 years; and furniture and equipment, one to 10 years. Land is not depreciated.

Leases
We determine if an arrangement is a lease at inception. Operating leases are included in operating lease right-of-use ("ROU") assets, other current liabilities, and operating lease liabilities in our consolidated balance sheets. Finance leases are included in property and equipment, other current liabilities, and other long-term liabilities in our consolidated balance sheets.

ROU assets represent our right to use an underlying asset for the lease term and lease liabilities represent our obligation to make lease payments arising from the lease. Operating lease ROU assets and liabilities are recognized at commencement date based on the present value of lease payments over the lease term. As most of our leases do not provide an implicit rate, we generally use our incremental borrowing rate based on the estimated rate of interest for collateralized borrowing over a similar term of the lease payments at commencement date. The operating lease ROU asset also includes any lease payments made and excludes lease incentives. Our lease terms may include options to extend or terminate the lease when it is reasonably certain that we will exercise that option. Lease expense for lease payments is recognized on a straight-line basis over the lease term.

We have lease agreements with lease and non-lease components, which are generally accounted for separately. For certain equipment leases, such as vehicles, we account for the lease and non-lease components as a single lease component. Additionally, for certain equipment leases, we apply a portfolio approach to effectively account for the operating lease ROU assets and liabilities.

Recent Accounting Guidance
Financial Instruments – Credit Losses
In June 2016, the FASB issued a new standard to replace the incurred loss impairment methodology in current GAAP with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. For trade and other receivables, loans, and other financial instruments, we will be required to use a forward-looking expected loss model rather than the incurred loss model for recognizing credit losses which reflects losses that are probable. Credit losses relating to available-for-sale debt securities will also be recorded through an allowance for credit losses rather than as a reduction in the amortized cost basis of the

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securities. The new standard will be effective for us beginning January 1, 2023, with early adoption permitted beginning January 1, 2019. Application of the amendments is through a cumulative-effect adjustment to retained earnings as of the effective date. We are currently evaluating the impact of this standard on our consolidated financial statements.

Accounting for Income Taxes
In December 2019, the Financial Accounting Standards Board issued a new standard to simplify the accounting for income taxes. The guidance eliminates certain exceptions related to the approach for intraperiod tax allocation, the methodology for calculating income taxes in an interim period, and the recognition of deferred tax liabilities for outside basis differences related to changes in ownership of equity method investments and foreign subsidiaries. The guidance also simplifies aspects of accounting for franchise taxes and enacts changes in tax laws or rates and clarifies the accounting for transactions that result in a step-up in the tax basis of goodwill. The new standard will be effective for us beginning July 1, 2022, with early adoption permitted. We estimate that the adoption of the standard will not have a material impact on our consolidated financial statements.

C. Disclosure example – Buildco Inc.

Let us look at the same policy footnote for Buildco, the company which we introduced earlier. Note how the significant accounting policies followed by Buildco differ from those of Techco, given the nature of the different industries in which they operate.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

- Organization.
- Basis of Presentation.
- Use of Estimates.
- Business Acquisitions
- Cash and Cash Equivalents and Concentration of Credit Risk.
- Real Estate Inventories and Cost of Sales.
- Revenue Recognition.
- Warranty Reserves.
- Sales and Marketing Expenses.
- Income Taxes.
- Recently Issued Accounting Standards.

1. Organization and summary of significant accounting policies

Organization
Buildco, Inc. is engaged in the design, construction, and sale of innovative single-family attached and detached homes in the greater Philadelphia region.

Basis of Presentation
The accompanying financial statements have been prepared in accordance with U.S. generally accepted accounting principles (“GAAP”) as contained within the Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”).

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Use of Estimates

Our financial statements have been prepared in accordance with GAAP. The preparation of these financial statements requires our management to make estimates and judgments that affect the reported amounts of assets and liabilities and the disclosures of contingent liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from our estimates.

Business acquisitions

On January 24, 2020, we acquired the operations of Construction Group ("CG"), an offsite construction framing company located in Florida, for $1.04 million, of which $833,000 was paid in January 2020 with additional payments of $104,000 in each of 2021 and 2022. The acquired net assets were recorded at their estimated fair values, including intangible assets of $278,000 associated with customer relationships and $18,000 associated with the CG tradename, which are being amortized over seven- and five-year useful lives, respectively. The acquisition also resulted in $487,000 of tax deductible goodwill. The acquisition of these assets was not material to our results of operations or financial condition.

Cash and Cash Equivalents and Concentration of Credit Risk

We define cash and cash equivalents as cash on hand, demand deposits with financial institutions, and short-term liquid investments with an initial maturity date of less than three months. The Company's cash balances exceed federally insurable limits. The Company monitors the cash balances in its operating accounts and adjusts the cash balances as appropriate; however, these cash balances could be impacted if the underlying financial institutions fail or are subject to other adverse conditions in the financial markets. To date, the Company has experienced no loss or lack of access to cash in its operating accounts.

Real Estate Inventories and Cost of Sales

Real estate inventories consist of land, land under development, homes under construction, completed homes and model homes and are stated at cost, net of impairment losses. We capitalize direct carrying costs, including interest, property taxes, and related development costs to inventories.

Field construction supervision and related direct overhead are also included in the capitalized cost of inventories. Direct construction costs are specifically identified and allocated to homes while other common costs, such as land, land improvements and carrying costs, are allocated to homes within a community based upon their anticipated relative sales or fair value. In accordance with ASC Topic 835, *Interest* ("ASC 835"), homebuilding interest capitalized as a cost of inventories owned is included in costs of sales as related units or lots are sold. To the extent our debt exceeds our qualified assets as defined in ASC 835, we expense a portion of the interest incurred by us.

Qualified assets represent projects that are actively under development. Homebuilding cost of sales is recognized at the same time revenue is recognized and is recorded based upon total estimated costs to be allocated to each home constructed. The estimation of these costs requires a substantial degree of judgment by management.

The estimation process involved in determining relative sales or fair values is inherently uncertain because it involves estimating future sales values of homes before delivery. Additionally, in determining the allocation of costs to a particular land parcel or individual home, we rely on project budgets that are based on a variety of assumptions, including assumptions about construction schedules and future costs

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to be incurred. It is common that actual results differ from budgeted amounts for various reasons, including construction delays, increases in costs that have not been committed or unforeseen issues encountered during construction that fall outside the scope of existing contracts, or costs that come in less than originally anticipated.

While the actual results for a particular construction project are accurately reported over time, a variance between the budget and actual costs could result in the understatement or overstatement of costs and have a related impact on gross margins between reporting periods. To reduce the potential for such variances, we have procedures that have been applied on a consistent basis, including assessing and revising project budgets on a periodic basis, obtaining commitments from subcontractors and vendors for future costs to be incurred and utilizing the most recent information available to estimate costs.

If there are indications of impairment, we perform a detailed budget and cash flow review of our real estate assets to determine whether the estimated remaining undiscounted future cash flows of the community are more or less than the asset's carrying value. If the undiscounted cash flows are more than the asset's carrying value, no impairment adjustment is required. However, if the undiscounted cash flows are less than the asset's carrying value, the asset is deemed impaired and is written down to fair value. These impairment evaluations require us to make estimates and assumptions regarding future conditions, including timing and amounts of development costs and sales prices of real estate assets, to determine if expected future undiscounted cash flows will be sufficient to recover the asset's carrying value.

Revenue Recognition

Home sale revenues – Home sale revenues and related profit are generally recognized when title to and possession of the home are transferred to the buyer at the home closing date. Our performance obligation to deliver the agreed-upon home is generally satisfied in less than one year from the original contract date. Home sale contract assets consist of cash from home closings held in escrow for our benefit, typically for less than five days, which are considered deposits in-transit and classified as cash. Contract liabilities include customer deposit liabilities related to sold but undelivered homes, which totaled $254.6 million and $250.8 million at December 31, 2022 and 2021, respectively. Substantially all of our home sales are scheduled to close and be recorded to revenue within one year from the date of receiving a customer deposit.

Land sale revenues – We periodically elect to sell parcels of land to third parties in the event such assets no longer fit into our strategic operating plans or are zoned for commercial or other development. Land sales are generally outright sales of specified land parcels with cash consideration due on the closing date, which is generally when performance obligations are satisfied. During 2021, we closed on a number of land sale transactions that generated gains totaling $31.4 million, as the proceeds from the sales exceeded the cost basis of the land. Substantially all performance obligations related to these transactions were satisfied at closing.

Financial services revenues – Loan origination fees, commitment fees, and certain direct loan origination costs are recognized as incurred. Expected gains and losses from the sale of residential mortgage loans and their related servicing rights are included in the measurement of written loan commitments that are accounted for at fair value through Financial Services revenues at the time of commitment. Subsequent changes in the fair value of these loans are reflected in Financial Services revenues as they occur. Interest income is accrued from the date a mortgage loan is originated until the loan is sold. Mortgage servicing fees represent fees earned for servicing loans for various investors.

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Servicing fees are based on a contractual percentage of the outstanding principal balance and are credited to income when related mortgage payments are received, or the sub-servicing fees are earned. Revenues associated with our title operations are recognized as closing services are rendered and title insurance policies are issued, both of which generally occur as each home is closed. Insurance brokerage commissions relate to commissions on home and other insurance policies placed with third party carriers through various agency channels. Our performance obligations for policy renewal commissions are considered satisfied upon issuance of the initial policy, and related contract assets for estimated future renewal commissions are included in other assets and totaled $30.8 million at December 31, 2022.

Warranty Reserves
In the normal course of business, we incur warranty-related costs associated with homes that have been delivered to homebuyers. Estimated future direct warranty costs are accrued and charged to cost of sales in the period when the related home sales revenues are recognized while indirect warranty overhead salaries and related costs are charged to cost of sales in the period incurred. Factors that affect the warranty accruals include the number of homes delivered, historical and anticipated rates of warranty claims and cost per claim. Our primary assumption in estimating the amounts we accrue for warranty costs is that historical claims experience is a strong indicator of future claims experience. In addition, we maintain general liability insurance designed to protect us against a portion of our risk of loss from construction-related claims. Included in our warranty reserve accrual are allowances to cover our estimated costs of self-insured retentions and deductible amounts under these policies and estimated costs for claims that may not be covered by applicable insurance or indemnities. Estimation of these accruals include consideration of our claims history, including current claims and estimates of claims incurred but not yet reported.

Although we consider the warranty accruals reflected in our consolidated balance sheet to be adequate, actual future costs could differ significantly from our currently estimated amounts. Our warranty accrual is included in accrued expenses and other liabilities in the accompanying consolidated balance sheets.

Sales and Marketing Expense
Sales and marketing costs incurred to sell real estate projects are capitalized if they are reasonably expected to be recovered from the sale of the project or from incidental operations and are incurred for tangible assets that are used directly through the selling period to aid in the sale of the project or services that have been performed to obtain regulatory approval of sales. All other selling expenses and other marketing costs are expensed in the period incurred.

Income Taxes
We account for income taxes in accordance with ASC Topic 740, *Income Taxes* (“ASC 740”). Deferred tax assets and liabilities are recorded based on future tax consequences of both temporary differences between the amounts reported for financial reporting purposes and the amounts deductible for income tax purposes and are measured using enacted tax rates expected to apply in the years in which the temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in earnings in the period when the changes are enacted.

Each quarter we assess our deferred tax assets to determine whether all or any portion of the assets is more likely than not unrealizable under ASC 740. We are required to establish a valuation allowance for any portion of the asset we conclude is more likely than not to be unrealizable. Our assessment

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considers, among other things, the nature, frequency and severity of our current and cumulative losses, forecasts of our future taxable income, the duration of statutory carryforward periods and tax planning alternatives. Due to uncertainties inherent in the estimation process, it is possible that actual results may vary from estimates.

We classify any interest and penalties related to income taxes as part of income tax expense.

Leases

We determine if an arrangement is a lease at inception. Operating leases are included in operating lease right-of-use ("ROU") assets, other current liabilities, and operating lease liabilities in our balance sheets. Finance leases are included in property and equipment, other current liabilities, and other long-term liabilities in our consolidated balance sheets.

ROU assets represent our right to use an underlying asset for the lease term and lease liabilities represent our obligation to make lease payments arising from the lease. Operating lease ROU assets and liabilities are recognized at commencement date based on the present value of lease payments over the lease term. As most of our leases do not provide an implicit rate, we generally use our incremental borrowing rate based on the estimated rate of interest for collateralized borrowing over a similar term of the lease payments at commencement date. The operating lease ROU asset also includes any lease payments made and excludes lease incentives. Our lease terms may include options to extend or terminate the lease when it is reasonably certain that we will exercise that option. Lease expense for lease payments is recognized on a straight-line basis over the lease term. The depreciable lives of leasehold improvements are limited to the expected lease term. Certain of our lease agreements include rental payments based on a pro-rata share of the lessor's operating costs, which are variable in nature. Our lease agreements do not contain any residual value guarantees or material restrictive covenants.

New Accounting Pronouncements

Financial Instruments – Credit Losses

In June 2016, the FASB issued a new standard to replace the incurred loss impairment methodology in current GAAP with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. For trade and other receivables, loans, and other financial instruments, we will be required to use a forward-looking expected loss model rather than the incurred loss model for recognizing credit losses which reflects losses that are probable. Credit losses relating to available-for-sale debt securities will also be recorded through an allowance for credit losses rather than as a reduction in the amortized cost basis of the securities. The new standard will be effective for us beginning January 1, 2023, with early adoption permitted beginning January 1, 2019. Application of the amendments is through a cumulative-effect adjustment to retained earnings as of the effective date. We are currently evaluating the impact of this standard on our consolidated financial statements.

On January 1, 2020, we adopted ASU No. 2017-04, "Intangibles - Goodwill and Other (Topic 350): Simplifying the Accounting for Goodwill Impairment", which removed the requirement to perform a hypothetical purchase price allocation to measure goodwill impairment. Under the new standard, goodwill impairment is determined by evaluating the amount by which a reporting unit's carrying value exceeds its fair value, not to exceed the carrying amount of goodwill. The standard was followed in the previously mentioned assessment of the CG goodwill.

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Question to Ponder:

How does the accounting policy footnote in these examples compare to the one which is included in your company's financial statements? Are there areas where the disclosures are more or less detailed?

VI. Chapter summary

In this chapter, we began with a brief overview of the FASB Accounting Standards Codification™ since it will serve as the primary foundation upon which to build our overall understanding of the general principles of financial statement disclosures. We then touched upon the FASB's Statement of Financial Accounting Concepts No. 8, *Conceptual Framework for Financial Reporting*, and the key role risk factors play in financial statement disclosures. We concluded the chapter by reviewing the "Summary of Significant Accounting Policies" financial statement disclosure.

A. SFAC No. 8, *Conceptual Framework for Financial Reporting*

The FASB issued its first Statement of Financial Accounting Concepts (SFAC), *Objectives of Financial Reporting by Business Enterprises*, back in November 1978. Then in September 2010, it issued its most recent Concepts Statement, SFAC No. 8, *Conceptual Framework for Financial Reporting*, which superseded SFAC No. 1 (and SFAC No. 2, *Qualitative Characteristics of Accounting Information*).

In a nutshell, what the FASB is doing with its original Concepts Statements now is superseding them with individual chapters in SFAC No. 8 in a coordinated project with the International Accounting Standards Board (IASB) to improve and converge both of their conceptual frameworks for financial reporting. For example, chapter 1 of SFAC No. 8 is now the old SFAC No. 1 and chapter 3 is now the old SFAC No. 2 (chapter 2 is being reserved for the chapter on the reporting entity).

The conceptual framework is intended to set the objectives and fundamental concepts that will be the basis for developing financial accounting and reporting guidance. The objectives are meant to identify the goals and purposes of financial reporting, and the fundamental concepts are those underlying financial accounting, such as:

- Concepts that guide the selection of transactions and other events and conditions to be accounted for;
- Their recognition and measurement; and
- The means of summarizing and communicating them to interested parties.

Concepts of this type are fundamental in the sense that other concepts flow from them and repeated reference to them will be necessary in establishing, interpreting, and applying accounting and reporting guidance. Establishment of objectives and identification of fundamental concepts will not directly solve financial accounting and reporting problems. Rather, objectives give direction, and concepts are the tools to be used to solve problems.

It is very important to note here that Concepts Statements are not part of the FASB Accounting Standards Codification™ discussed above, which as we said, is now the single authoritative source of nongovernmental U.S. GAAP. Instead, Concepts Statements describe concepts that will underlie guidance on future financial accounting practices and in due course will serve as a basis for evaluating existing guidance and practices.

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The FASB is currently in the midst of a multi-faceted project to review its decision-making framework related to financial statement disclosures as well as to implement this framework in a select group of topics.

B. Risk – A key element in financial statement disclosures

Discussing risk is a key element in financial statement disclosures. In general, the following principles are the "backbone" of integrating risk factors into financial statement disclosures:

- **Consistency** – Disclosures should be consistent with management's approach to risk management.
- **Focus** – Disclosures should focus on how risk within an entity changes over time.
- **Responsiveness** – Disclosures should be responsive to changes in internal practices.
- **Balanced** – Disclosures should be balanced between quantitative and qualitative information.

1. Risks and uncertainties in the financial statements

ASC 275, *Risks and Uncertainties*, provides the accounting guidance and disclosure requirements relating to risk and uncertainties in the financial statements. According to ASC 275, financial statements provide information about certain current conditions and trends that help users in predicting a reporting entity's 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 the entity's operations and of the information about those operations that financial reporting provides.

The disclosures required by ASC 275 focus primarily on risks and uncertainties that could significantly affect the amounts reported in the financial statements in the "near term," which is defined as a period of time not to exceed one year from the date of the financial statements. These risks and uncertainties generally stem from:

- The nature of the entity's operations;
- The use of estimates in the preparation of the entity's financial statements; and
- Significant concentrations in certain aspects of the entity's operations.

2. Disclosure example – Buildco Inc.

- Nature of Operations
- Use of Estimates
- Concentration Risk

C. Summary of significant accounting policies

Financial statement disclosures (notes to the financial statements) are an integral part of an entity's financial reporting process. Indeed, the phrase: *The accompanying notes are an integral part of these consolidated financial statements* or *See notes to the financial statements* appears on all financial statements and is intended as an "alert" to users about the importance of such disclosures.

According to the authoritative accounting literature, a complete set of financial statements includes "notes, comprising a summary of significant accounting policies and other explanatory information." In this material, we focused our attention on the "Summary of Significant Accounting Policies Disclosure." To illustrate this critical financial statement disclosure, we used example excerpts from Microsoft's 2013 and Apple's 2013 published financial statements for your review.

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1. ASC 235, Notes to Financial Statements

ASC 235, *Notes to Financial Statements*, applies to all entities and addresses the content and usefulness of disclosures by an entity of the accounting policies judged by management to be most appropriate to fairly present the entity's financial statements.

ASC 235 specifically notes:

> 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 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.

2. Disclosure example – Techco Inc.

NOTE 1 – ACCOUNTING POLICIES

- Accounting Principles.
- Principles of Consolidation.
- Estimates and Assumptions.
- Foreign Currencies.
- Revenue Recognition.
- Cost of Revenue.
- Product Warranty.
- Research and Development.
- Sales and Marketing.
- Income Taxes.
- Fair Value Measurements.
- Financial Instruments.
- Allowance for Doubtful Accounts.
- Inventories.
- Property and Equipment.
- Recent Accounting Guidance.

3. Disclosure example – Buildco Inc.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

- Organization.
- Basis of Presentation.
- Use of Estimates.
- Cash and Cash Equivalents and Concentration of Credit Risk.
- Real Estate Inventories and Cost of Sales.
- Revenue Recognition.
- Warranty Reserves.
- Sales and Marketing Expenses.
- Income Taxes.
- Recently Issued Accounting Standards.

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The “Fab Five”

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The "Fab Five"

Learning objectives

After completing this chapter, you should be familiar with:
- The following five general financial statement disclosures in accordance with U.S. GAAP:
    1. Accounting changes and error corrections;
    2. Commitments;
    3. Contingencies;
    4. Related party transactions; and
    5. Subsequent events.

I. Introduction

As we said in the previous chapter's introduction, according to the authoritative accounting literature, a complete set of financial statements includes "notes, comprising a summary of significant accounting policies and other explanatory information."

In this chapter, we will focus our attention on the following five "other explanatory information":
- Accounting changes and error corrections;
- Commitments;
- Contingencies;
- Related party transactions; and
- Subsequent events.

To illustrate each of the above disclosures, example excerpts from recently published financial statements will be presented for your review. Again, since there are literally thousands of such examples available, the examples included here are only meant as a sample of the many possible alternatives typically seen in practice today.

II. Accounting changes and error corrections

FASB Accounting Standards Codification (ASC) 250, *Accounting Changes and Error Corrections*, provides the authoritative requirements and guidance on accounting for and reporting of accounting changes and error corrections.

Accounting changes come in three basic varieties:
1. A change in accounting principle (e.g., LIFO to FIFO);
2. A change in accounting estimate (e.g., from 5-year estimated useful life to 10 years); and
3. A change in reporting entity (e.g., acquiring an entity in a business combination and then consolidating the two entities).

An error correction is not an accounting change but reporting it does involve making adjustments to previously issued financial statements similar to those generally applicable to reporting an accounting change retrospectively.

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A. Change in accounting principle

A reporting entity should only change the use of an accounting principle if it is required by a newly issued Codification update (which constitutes sufficient support for making the change) or the entity can justify the use of an allowable alternative accounting principle on the basis that it is preferable. Unfortunately, the term “preferable” in this context is not defined in the authoritative accounting literature.

It is interesting to note however, that although there is no difference in the meaning of preferable between public and private entities and the disclosure requirements for a change in accounting principle are the same for these entities, the SEC requires U.S. registrants to file a “preferability letter” issued by the entity’s independent accountant indicating whether the change in accounting principle is, in the auditor’s judgment, preferable under the circumstances.

The accountant must still perform adequate procedures to determine the preferability of the principle regardless of whether the entity is a public or private entity A sample preferability letter for a change in the goodwill impairment measurement date is as follows.

Sample Preferability Letter on Change in Accounting Principle

November 26, 2022

Members of the Audit Committee
Of the Board of Directors of Sample Inc.

To the Board of Directors of Sample Inc.:

We are providing this letter to you for inclusion as an exhibit to your Form 10-K filing pursuant to Item 601 of Regulation S-K.

We have audited the consolidated financial statements included in the Company’s Annual Report on Form 10-K for the year ended September 30, 2022 and issued our report thereon dated November 26, 2022. Note 2 to the financial statements describes a change in accounting principle related to the change in the timing of the Company’s annual goodwill impairment testing date from September 30 to July 1. It should be understood that the preferability of one acceptable method of accounting over another for a change in the annual goodwill impairment testing date has not been addressed in any authoritative accounting literature, and in expressing our concurrence below we have relied on management’s determination that this change in accounting principle is preferable. Based on our reading of management’s stated reasons and justification for this change in accounting principle in the Form 10-K, and our discussions with management as to their judgment about the relevant business planning factors relating to the change, we concur with management that such change represents, in the Company’s circumstances, the adoption of a preferable accounting principle in conformity with Accounting Standards Codification 250, *Accounting Changes and Error Corrections*.

Very truly yours,

/s/ Accounting Firm LLP

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1. Disclosure requirements

According to ASC 250, all of the following disclosures should be made in the period in which an entity makes a change in accounting principle:

a. The nature of and reason for the change in accounting principle, including an explanation of why the newly adopted accounting principle is preferable.

b. The method of applying the change, including all of the following:

   (i) A description of the prior-period information that has been retrospectively adjusted, if any.

   (ii) The effect of the change on income from continuing operations, net income, any other affected financial statement line item, and any affected per-share amounts for the current period and any prior periods retrospectively adjusted. Presentation of the effect on financial statement subtotals and totals other than income from continuing operations and net income is not required.

   (iii) The cumulative effect of the change on retained earnings or other components of equity or net assets in the statement of financial position as of the beginning of the earliest period presented.

   (iv) If retrospective application to all prior periods is impracticable, disclosure of the reasons therefore, and a description of the alternative method used to report the change.

c. If indirect effects of a change in accounting principle are recognized both of the following should be disclosed:

   (i) A description of the indirect effects of a change in accounting principle, including the amounts that have been recognized in the current period, and the related per-share amounts, if applicable.

   (ii) Unless impracticable, the amount of the total recognized indirect effects of the accounting change and the related per-share amounts, if applicable, that are attributable to each prior period presented. Compliance with this disclosure requirement is practicable unless an entity cannot comply with it after making every reasonable effort to do so.

   "Indirect effects of a change in accounting principle" is defined as any changes to current or future cash flows of an entity that result from making a change in accounting principle that is applied retrospectively. An example of an indirect effect is a change in a nondiscretionary profit sharing or royalty payment that is based on a reported amount such as revenue or net income.

Financial statements of subsequent periods do not need to repeat the disclosures required above. However, if a change in accounting principle that has no material effect in the period of change is reasonably certain to have a material effect in later periods, the disclosures required by (a) above should be provided whenever the financial statements of the period of change are presented.

An entity that issues interim financial statements should provide the required disclosures in the financial statements of both the interim period of the change and the annual period of the change. In the fiscal year in which a new accounting principle is adopted, financial information reported for interim periods after the date of adoption should disclose the effect of the change on income from continuing operations, net income, and related per-share amounts, if applicable, for those post-change interim periods.

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2. Disclosure example – CVS Health Inc.

CHANGE IN ACCOUNTING PRINCIPLE

Effective January 1, 2015, the Company changed its methods of accounting for "front store" inventories in the Retail/LTC Segment. Prior to 2015, the Company valued front store inventories at the lower of cost or market on a first-in, first-out ("FIFO") basis in retail stores using the retail inventory method and in distribution centers using the FIFO cost method. Effective January 1, 2015, all front store inventories in the Retail/LTC Segment have been valued at the lower of cost or market using the weighted average cost method. These changes affected approximately 36 percent of consolidated inventories.

These changes were made primarily to provide the Company with better information to manage its retail front store operations and to bring all of the Company's inventories to a common inventory valuation methodology. The Company believes the weighted average cost method is preferable to the retail inventory method and the FIFO cost method because it results in greater precision in the determination of cost of revenues and inventories at the stock keeping unit ("SKU") level and results in a consistent inventory valuation method for all of the Company's inventories as all of the Company's remaining inventories, which consist of prescription drugs, were already being valued using the weighted average cost method.

The Company recorded the cumulative effect of these changes in accounting principle as of January 1, 2015. The Company determined that retrospective application for periods prior to 2015 is impracticable, as the period-specific information necessary to value front store inventories in the Retail/LTC Segment under the weighted average cost method is unavailable. The Company implemented a new perpetual inventory system to manage front store inventory at the SKU level and valued front store inventory as of January 1, 2015 and calculated the cumulative impact. The effect of these changes in accounting principle as of January 1, 2015, was a decrease in inventories of $7 million, an increase in current deferred income tax assets of $3 million and a decrease in retained earnings of $4 million.

Had the Company not made these changes in accounting principle, for the year ended December 31, 2015, income from continuing operations would have been lower by $27 million. Basic and diluted earnings per share from continuing operations attributable to CVS Health would have been approximately $0.02 per share lower for the year ended December 31, 2015.

Note: Per-share information would not be required for non-public entities.

3. Adopting a Private Company Counsel (PCC) alternative disclosure example

In 2016, the Company adopted a new accounting alternative available to private companies for the subsequent measurement of goodwill. Under the newly adopted policy, goodwill is amortized on a straight-line basis for 10 years and analyzed for impairment at the entity level if a triggering event occurs. Goodwill amortization began prospectively as of January 1, 2016. As of December 31, 2016, and for the year then ended, the effect of adopting the new standard is a decrease in the net book value of goodwill, an increase in expenses and a decrease in net income in the amount of $97,500.

Goodwill presented in the balance sheet as of December 31, 2016, consists of the following:

Goodwill	$975,000
Less: Accumulated amortization	(97,500)
Goodwill, net	$877,500

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During the year ended December 31, 20X3, no triggering events occurred requiring impairment testing. As such, no impairment loss was recorded.

B. Change in accounting estimate

A change in accounting estimate is a “restatement” of or revision to an accounting assumption or forecast, for example, changing the estimated useful life or residual value of a fixed asset. A change in accounting estimate is accounted for prospectively; that is to say, a change in accounting estimate is accounted for in the period of change if it affects that period only or in the period of change and future periods if it affects both. A change in accounting estimate should not be accounted for by restating or retrospectively adjusting amounts reported in financial statements of prior periods or by reporting pro forma amounts for prior periods.

1. Disclosure requirements

According to ASC 250, the effect on income from continuing operations, net income, and any related per-share amounts of the current period should be disclosed for a change in estimate that affects several future periods, such as a change in service lives of depreciable assets. Disclosure of those effects is not necessary for estimates made each period in the ordinary course of accounting for items such as uncollectible accounts or inventory obsolescence; however, disclosure is required if the effect of a change in the estimate is material. When an entity effects a change in estimate by changing an accounting principle, the disclosures discussed above relating to a change in accounting principle also are required. If a change in estimate does not have a material effect in the period of change but it is reasonably certain to have a material effect in later periods, a description of that change in estimate should be disclosed whenever the financial statements of the period of change are presented.

Note that as entities update the fair value of certain assets for the impact of COVID-19 on their recoverability, they may utilize a different approach to estimating fair value from that which they were using prior. Under ASC Topic 820, this is allowable, as long as the method provides an appropriate estimate of the asset’s fair value. However, this change in estimation would require disclosure in the financial statements as a change in accounting estimate.

Disclosures concerning changes in accounting estimates are similar for public and private entities, with public entities disclosing the per share impact as well.

2. Disclosure example – Harris Corporation

CHANGE IN ACCOUNTING ESTIMATE
In the fourth quarter of fiscal 2013, we recorded a $17.8 million write-off of the capitalized software in Healthcare Solutions as a change in accounting estimate, resulting from high-risk development issues and substantial revisions to the logic of Carefx’s primary software product based on the realization that the software would require more features and better functionality. These changes to the software were such that the initial detail program design was no longer sufficient to establish technological feasibility.

3. Sample disclosure example – Change in depreciable lives

CHANGES IN ESTIMATES
As a result of our annual reviews to evaluate the reasonableness of the depreciable lives for our property, plant, and equipment, effective January 2014, we changed the estimates of the remaining economic lives of certain switch and circuit network equipment. These changes resulted in a net increase in depreciation

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expense of approximately $78 million for the year ended December 31, 2014. This net increase in depreciation expense, net of tax, reduced consolidated net income by approximately $48 million.

4. Disclosure example – Arcbest Corporation

CHANGE IN ACCOUNTING ESTIMATE – IMPAIRMENT

CRITICAL ACCOUNTING POLICIES

Impairment Assessment of Long-Lived Assets

We review our long-lived assets, including property, plant and equipment and capitalized software, which are held and used in our operations, for impairment whenever events or changes in circumstances indicate that the carrying amount of the asset may not be recoverable. If such an event or change in circumstances is present, we will estimate the undiscounted future cash flows expected to result from the use of the asset and its eventual disposition. If the sum of the undiscounted future cash flows is less than the carrying amount of the related assets, we will recognize an impairment loss. The evaluation of future cash flows requires management's judgment and the use of estimates and assumptions. Assumptions require considerable judgment because changes in broad economic factors and industry factors can result in variable and volatile values. Economic factors and the industry environment were considered in assessing recoverability of long-lived assets, including revenue equipment (primarily tractors and trailers used in our Asset-Based operations and trailers used in our Truckload-Dedicated operations). Our strict equipment maintenance schedules have served to mitigate declines in the value of revenue equipment.

During 2016, as part of our corporate restructuring (as discussed further in Note N to our consolidated financial statements included in Part II, Item 8 of this Annual Report on Form 10-K), we identified capitalized software applications with no future use due to the combination of certain operations within the organization and recorded a non-cash impairment charge of $6.2 million related to acquired software and other applications for the year ended December 31, 2016. The impairment charge included the write-down of $5.5 million of acquired software in the ArcBest segment to its fair value, reflecting estimated reproduction costs less than an obsolescence allowance.

Goodwill and Intangible Assets

Goodwill is recorded as the excess of an acquired entity's purchase price over the value of the amounts assigned to identifiable assets acquired and liabilities assumed. As of December 31, 2017, goodwill totaled $108.3 million, of which $107.7 million is related to acquisitions in the ArcBest segment. Goodwill is not amortized, but rather is evaluated for impairment annually or more frequently if indicators of impairment exist. The annual impairment testing on the goodwill balances were performed as of October 1, 2017, and it was determined that the estimated fair value of each of the reporting units exceeded the recorded balances by an amount greater than 25 percent of the carrying value.

Our measurement of goodwill impairment involves a comparison of the estimated fair value of a reporting unit to its carrying value. If the result of this comparison indicates that the fair value of the reporting unit is less than the carrying value, an estimate of the current fair values of all assets and liabilities is made to determine the amount of implied goodwill (referred to as Step 2 of the goodwill impairment test) and, consequently, the amount of any goodwill impairment. (See the Recent Accounting Pronouncements section of MD&A for a discussion of changes in the goodwill impairment test that are effective for us on January 1, 2018.)

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The evaluation of goodwill impairment requires management's judgment and the use of estimates and assumptions to determine the fair value of the reporting unit. Assumptions require considerable judgment because changes in broad economic factors and industry factors can result in variable and volatile fair values. Changes in key estimates and assumptions that impact the fair value of the operations could materially affect the impairment analysis.

In evaluating goodwill for impairment, the aggregate carrying amount of the reporting unit is compared to its fair value, which is derived with the assistance of a third-party valuation firm and utilizing a combination of valuation methods, including EBITDA and revenue multiples (market approach) and the present value of discounted cash flows (income approach). Incorporation of the two methods into the impairment test supported the reasonableness of conclusions reached. With the assistance of the valuation firm, we incorporated EBITDA and revenue multiples that were observed for recent acquisitions and those of publicly traded companies which have similar operations. For the 2017 annual impairment tests of goodwill, market data suggests comparable companies are valued in the 0.40 to 0.90 times revenue range, and the EBITDA multiples for our reporting units were in the 6.2 to 8.8 times range. The discounted cash flow models utilized in the income approach incorporate discount rates, terminal multiples, and projections of future revenue, operating margins, and net capital expenditures. The projections used have changed over time based on historical performance and changing business conditions. Assumptions with respect to rates used to discount cash flows are dependent upon market interest rates and the cost of capital for us and the industry at a point in time. We include a cash flow period of six years in the income approach and an annual revenue growth rate assumption that is generally consistent with average historical trends. Changes in cash flow assumptions or other factors that negatively impact the fair value of the operations would influence the evaluation.

As of December 31, 2017, indefinite-lived intangible assets totaled $32.3 million related to the Panther trade name. The indefinite-lived intangible assets are also not amortized but rather are evaluated for impairment annually or more frequently if indicators of impairment exist. If the carrying amount of the intangible asset exceeds its fair value, an impairment loss shall be recognized in an amount equal to that excess. The annual impairment testing on the indefinite-lived intangible assets was performed as of October 1, 2017, and it was determined that the fair value of the Panther trade name was greater than 10 percent over the recorded balance.

The Panther trade name valuation model utilizes the relief from royalty method, whereby the value is determined by calculating the after-tax cost savings associated with owning the trade name and, therefore, not having to pay royalties for its use for the remainder of its estimated useful life. The evaluation of intangible asset impairment requires management's judgment and the use of estimates and assumptions to determine the fair value of the indefinite-lived intangible assets. Assumptions require considerable judgment because changes in broad economic factors and industry factors can result in variable and volatile fair values. Changes in key estimates and assumptions that impact the operations and resulting revenues, royalty rates, and discount rates could materially affect the intangible asset impairment analysis.

Our finite-lived intangible assets consist primarily of customer relationship intangible assets, which totaled $41.2 million net of accumulated amortization as of December 31, 2017 and are amortized over their respective estimated useful lives. Finite-lived intangible assets are also evaluated for impairment whenever events or changes in circumstances indicate that the carrying value may not be recoverable. In reviewing finite-lived intangible assets for impairment, the carrying amount of the asset is compared to the

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estimated undiscounted future cash flows expected from the use of the asset and its eventual disposition. If such cash flows are not sufficient to support the recorded value, an impairment loss to reduce the carrying value of the asset to its estimated fair value will be recognized in operating income. Management determined that finite-lived intangible assets were not impaired as of December 31, 2017.

In its impairment assessment of goodwill and intangible assets, management also considered the total market capitalization, which was noted to increase from the prior year assessment date. The increase in our market capitalization as of October 1, 2017 was believed to be attributable to improved operating results, general market conditions and the general state of the economy. We believe that there is no basis for adjustment of asset values at this time.

C. Change in reporting entity

ASC 250 defines a change in reporting entity as:

> A change that results in financial statements that, in effect, are those of a different reporting entity. A change in the reporting entity is limited mainly to the following:
>
> a. Presenting consolidated or combined financial statements in place of financial statements of individual entities.
> b. Changing specific subsidiaries that make up the group of entities for which consolidated financial statements are presented.
> c. Changing the entities included in combined financial statements.
>
> Neither a business combination accounted for by the acquisition method nor the consolidation of a variable interest entity (VIE) pursuant to Topic 810 [Consolidation] is a change in reporting entity.

When accounting for a change in reporting entity, the change should be retrospectively applied to the financial statements of all prior periods presented to show financial information for the new reporting entity for those periods. Previously issued interim financial information should be presented on a retrospective basis.

1. Disclosure requirements

According to ASC 250, when there has been a change in reporting entity, the financial statements of the period of the change should describe the nature of the change and the reason for it. In addition, the effect of the change on income before extraordinary items, net income, other comprehensive income, and any related per-share amounts should be disclosed for all periods presented. Financial statements of subsequent periods need not repeat the disclosures required. If a change in reporting entity does not have a material effect in the period of change but it is reasonably certain to have a material effect in later periods, the nature of and reason for the change should be disclosed whenever the financial statements of the period of change are presented.

2. Disclosure example (Created)

CHANGE IN REPORTING ENTITY

On January 1, 20X5, the Company transferred its road-building business segment and contributed certain assets and liabilities, totaling $62 million and $17 million, respectively, to a newly formed joint venture named RBB, LLC. The Company’s equity interest in the joint venture is 30 percent. As a result, the 20X4 statement of income, which included the accounts of the road-building business segment on a consolidated basis, has been retrospectively restated to reflect adjustment of line items for revenue and costs applicable to the road-building business segment transferred to the joint venture and to reflect the

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losses of this business on the equity method of accounting. The effect of this change increased income before extraordinary items, net income, and other comprehensive income for 20X1 by $1.9 million, $1.6 million, and $.3 million, respectively.

D. Error corrections

As we said previously, an error correction is not an accounting change, but reporting it does involve making adjustments to previously issued financial statements similar to those generally applicable to reporting an accounting change retrospectively. Any material error in the financial statements of a prior period discovered after the financial statements are issued or are available to be issued should be reported as an error correction, by restating the prior-period financial statements. Restatement in this case requires all of the following:

a. The cumulative effect of the error on periods prior to those presented should be reflected in the carrying amounts of assets and liabilities as of the beginning of the first period presented.
b. An offsetting adjustment, if any, should be made to the opening balance of retained earnings for that period.
c. Financial statements for each individual prior period presented should be adjusted to reflect correction of the period-specific effects of the error.

In determining whether an error is material for the purpose of reporting the correction of an error, amounts should be related to the estimated income for the full fiscal year and also to the effect on the trend of earnings.

In single period financial statements, error corrections should be reflected as adjustments of the opening balance of retained earnings. When comparative financial statements are presented, corresponding adjustments should be made of the amounts of net income (and the components thereof) and retained earnings balances (as well as of other affected balances) for all of the periods reported, to reflect the retrospective application of the error corrections.

1. Disclosure requirements

According to ASC 250, when financial statements are restated to correct an error, the entity should disclose that its previously issued financial statements have been restated, along with a description of the nature of the error. The entity should also disclose both of the following:

a. The effect of the correction on each financial statement line item and any per-share amounts affected for each prior period presented.
b. The cumulative effect of the change on retained earnings or other appropriate components of equity in the statement of financial position, as of the beginning of the earliest period presented.

When prior-period adjustments are recorded, the resulting effects (both gross and net of applicable income tax) on the net income of prior periods should be disclosed in the annual financial statements for the year in which the adjustments are made and in interim financial statements issued during that year after the date of recording the adjustments.

If financial statements for only a single period are presented, the disclosure should indicate the effects of such restatement on the balance of retained earnings at the beginning of the period and on the net income of the immediately preceding period. When financial statements for more than one period are

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presented, the disclosure should include the effects for each of the periods included in the financial statements. Such disclosures should include the amounts of income tax applicable to the prior period adjustments. Disclosure of restatements in annual financial statements issued after the first such post-revision disclosure would ordinarily not be required.

2. Private company disclosure example – Single-year financial statement presentation

CORRECTION OF AN ERROR

Certain errors resulting in an overstatement of previously reported inventories were discovered during the current year. Accordingly, an adjustment of $820,000 was made during 20X5 to write down inventories as of the beginning of the year. A corresponding entry was made to reduce previously reported retained earnings by $483,000 (net of the related income tax benefits of $337,000) and to record the refund relating to the tax benefit. The effect of the restatement on net earnings of 20X4 is not determinable.

3. Disclosure example – First Solar Inc.

During the three months ended September 30, 2015, we revised our previously issued financial statements from 2011 to 2014 to properly record a liability associated with an uncertain tax position, including penalties, related to income of a foreign subsidiary along with corresponding adjustments in each successive period for the effect of changes in foreign currency exchange rates associated with the liability. The prior periods also include revisions for previously disclosed errors from 2012 primarily related to "cut-off" of our inventories and balance of systems ("BoS") parts and foreign tax credits. Additional revisions were made for previously identified errors related to sales taxes, use taxes, share-based compensation, and miscellaneous items that were corrected in a period subsequent to the period in which the error originated. As several of these errors affected the estimated costs for systems business sales arrangements accounted for under the percentage-of-completion method, we also recorded adjustments to revenue for the changes in the percentage completion of the affected projects.

We evaluated the aggregate effects of the errors to our previously issued financial statements in accordance with SEC Staff Accounting Bulletins No. 99 and No. 108 and, based upon quantitative and qualitative factors, determined that the errors were not material to our previously issued financial statements. As part of this evaluation, we considered a number of qualitative factors, including, among others, that the errors did not change a net loss into net income or vice versa, did not have an impact on our long-term debt covenant compliance, and did not mask a change in earnings or other trends when considering the overall competitive and economic environment within the industry during the periods. However, the cumulative effect of the errors, including the uncertain tax position matter identified during the three months ended September 30, 2015, was significant to our financial results for the year ended December 31, 2015. Accordingly, we revised our historical financial statements, which resulted in decreases to our accumulated earnings of $36.0 million, $35.0 million, and $32.7 million as of December 31, 2014, 2013, and 2012, respectively.

All financial information presented in the accompanying notes to these consolidated financial statements was revised to reflect the correction of these errors. Periods not presented herein will be revised, as applicable, as they are included in future filings.

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The following table presents the effect of the aforementioned revisions on our consolidated balance sheet as of December 31, 2014 (in thousands):

	December 31, 2014		
	As Reported	Adjustment	As Revised
Other liabilities	$ 284,584	$ 36,000	$ 320,584
Total liabilities	1,693,504	36,000	1,729,504
Accumulated earnings	2,279,689	(36,000)	2,243,689
Total stockholders' equity	5,027,487	(36,000)	4,991,487

The following tables present the effect of the aforementioned revisions on our consolidated statements of operations for the years ended December 31, 2014 and 2013 (in thousands, except per share amounts):

	Year Ended December 31, 2014		
	As Reported	Adjustment	As Revised
Net sales	$ 3,391,814	$ (627)	$ 3,391,187
Cost of sales	2,564,709	1,537	2,566,246
Gross profit	827,105	(2,164)	824,941
Operating income	424,163	(2,164)	421,999
Foreign currency loss, net	(3,017)	1,556	(1,461)
Other expense, net	(5,203)	718	(4,485)
Income before taxes and equity in earnings of unconsolidated affiliates	431,991	110	432,101
Income tax expense	(30,124)	(1,064)	(31,188)
Net income	396,918	(954)	395,964
Comprehensive income	472,834	(954)	471,880
Basic net income per share	$ 3.97	$ (0.01)	$ 3.96
Diluted net income per share	$ 3.91	$ (0.01)	$ 3.90

	Year Ended December 31, 2013		
	As Reported	Adjustment	As Revised
Net sales	$ 3,308,989	$ 627	$ 3,309,616
Cost of sales	2,446,235	(1,251)	2,444,984
Gross profit	862,754	1,878	864,632
Operating income	368,529	1,878	370,407
Foreign currency (loss) gain, net	(259)	1,152	893
Other expense, net	(4,758)	(431)	(5,189)
Income before taxes and equity in earnings of unconsolidated affiliates	378,380	2,599	380,979
Income tax expense	(25,179)	(4,919)	(30,098)
Net income	353,038	(2,320)	350,718
Comprehensive income	317,083	(2,320)	314,763
Basic net income per share	$ 3.77	$ (0.03)	$ 3.74
Diluted net income per share	$ 3.70	$ (0.03)	$ 3.67

The following tables present the effect of the aforementioned revisions on our consolidated statements of cash flows for the years ended December 31, 2014 and 2013 (in thousands):

	Year Ended December 31, 2014		
	As Reported	Adjustment	As Revised
Net income	$ 396,918	$ (954)	$ 395,964
Adjustments to reconcile net income to cash provided by operating activities:			
Remeasurement of monetary assets and liabilities	8,772	(1,556)	7,216
Changes in operating assets and liabilities:			
Accounts receivable, trade, unbilled and retainage	453,826	8,804	462,630
Prepaid expenses and other current assets	(19,947)	(16,858)	(36,805)
Project assets and deferred project costs	141,908	1,139	143,047
Accounts payable	(52,339)	(718)	(53,057)
Income taxes payable	(989)	(142)	(1,131)

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Accrued expenses and other liabilities	(452,438)	10,285	(442,153)
Net cash provided by operating activities	680,989	—	680,989

	Year Ended December 31, 2013		
	As Reported	Adjustment	As Revised
Net income	$ 353,038	$ (2,320)	$ 350,718
Adjustments to reconcile net income to cash provided by operating activities:			
Share-based compensation	55,079	(494)	54,585
Remeasurement of monetary assets and liabilities	(15,109)	(1,152)	(16,261)
Changes in operating assets and liabilities:			
Accounts receivable, trade, unbilled and retainage	564,964	5,767	570,731
Prepaid expenses and other current assets	109,126	10,115	119,241
Project assets and deferred project costs	(316,022)	(683)	(316,705)
Accounts payable	(93,259)	431	(92,828)
Income taxes payable	36,307	85	36,392
Accrued expenses and other liabilities	(138,937)	(11,749)	(150,686)
Net cash provided by operating activities	856,126	—	856,126

4. Disclosure example for pending restatement – Checkpoint Systems Inc.

On March 17, 2014, the Audit Committee of the Board of Directors (the "Audit Committee") of Checkpoint Systems, Inc. (the "Company") concluded that the financial statements contained in the Company's Annual Reports on Form 10-K for the fiscal years ended on December 25, 2011, December 30, 2012, and Quarterly Reports on Form 10-Q for the three months ended March 31, June 30, and September 29, 2013 should no longer be relied upon due to the combined effect of financial statement errors that the Audit Committee believes are material and are primarily attributable to the timing of the recognition of income related to a transaction previously reported in the Company's current report on Form 8-K filed on June 17, 2011. The Company believes that the restatement will have no effect on cash received from the transaction.

The Company intends to file as soon as practicable restated financial statements for fiscal 2011 and 2012 in the Company's Annual Report on Form 10-K for the year ended December 29, 2013 (the "2013 Form 10-K"). In addition, the Company intends to include in the 2013 Form 10-K restated quarterly financial data for the first three quarters of fiscal 2013 and all quarters within fiscal 2012 and Selected Financial Data for fiscal 2011 and 2012. Based on the information regarding prior years that the Company intends to include in its 2013 Form 10-K, the Company does not intend to file amendments to its 2011 or 2012 Form 10-K or to any of its previously filed Form 10-Qs.

The Audit Committee of the Company has discussed the matters disclosed in this Form 8-K pursuant to this Item 4.02(a) with the Company's independent registered public accounting firm, PricewaterhouseCoopers LLP.

Management is assessing the effect of the restatement on the Company's internal control over financial reporting and disclosure controls and procedures and will report its conclusion regarding the Company's internal control over financial reporting and the effectiveness of its disclosure controls and procedures in the 2013 Form 10-K.

5. Disclosure example – Madison Technologies – Correction of an error in previously issued financial statements

Note 2 Summary of Significant Accounting Policies

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Financial Instruments and Correction of Error

Fair Value

The Company's financial instruments consisting of cash, account payable and accrued liabilities, notes payable and accrued interest and related party advances are carried at face which approximates fair value because of their short-term nature.

During the year, the Company changed the accounting policy by which it accounts for its convertible debt. Previously, the Company based its policy on the fact that the promissory notes have been issued without an interest component and, assuming the reason for investing is the pursuit of profit, the total value of these instruments had been allocated to the equity component as this is the only logical reason for investment. Promissory note issuances were included in additional paid-in capital and were amortized and charged to interest on an effective interest rate basis.

During the year, the Company corrected this policy and adopted FASB ASC Topic 470, "*Debt with Conversions and Other Options,*" which requires that convertible debt with no beneficial conversion feature be allocated in totality to debt and that no amount be allocated to equity. This change has been applied retroactively to the financial statements and the effect on the financial statements is described in Note 9. None of the Company's convertible notes had a beneficial conversion feature.

III. Commitments

From an accounting perspective, commitments typically encompass agreements with customers, suppliers, employers, or other entities that involve "uncompleted" transactions or uncertainties that affect the entity's business. For example, Boeing enters into commitments with various airlines for the future delivery of aircraft. Most financial statements include a "commitments" disclosure which is used to alert users to the fact that a variety of actual and potential future obligations exist that do not meet the FASB's criteria for recognition as liabilities at the balance sheet date.

There is also another type of commitment we should be aware of before we move on to the disclosure requirements of this particular topic – an unconditional purchase obligation (UPO).

A UPO is an obligation to transfer funds in the future for fixed or minimum amounts or quantities of goods or services at fixed or minimum prices, for example, a "take-or-pay" contract, under which a company either takes the product from the supplier or pays the supplier a penalty. Take-or-pay contracts are very common in the energy industry, particularly for sales of gas. Also, many smaller entities enter into such agreements in order to secure raw materials.

A. Disclosure requirements

According to ASC 440, *Commitments*, notwithstanding more explicit disclosures required elsewhere in the Codification, all of the following items should be disclosed in the financial statements:

a. Unused letters of credit.
b. Leases.
c. Assets pledged as security for loans.
d. Pension plans.
e. The existence of cumulative preferred stock dividends in arrears.

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f. Commitments, including:
   - A commitment for plant acquisition;
   - An obligation to reduce debts;
   - An obligation to maintain working capital; and
   - An obligation to restrict dividends.

The disclosure requirements for UPOs come in two varieties – for those UPOs that have not been recorded on the purchaser's balance sheet and for those that have been.

For UPOs that have not been recorded on the purchaser's balance sheet, also referred to as "unrecognized commitments," the purchaser should disclose all of the following:

a. The nature and term of the obligation.
b. The amount of the fixed and determinable portion of the obligation as of the date of the latest balance sheet presented, in the aggregate and, if determinable, for each of the five succeeding fiscal years.
c. The nature of any variable components of the obligation.
d. The amounts purchased under the obligation for each period for which an income statement is presented.

These disclosures can be omitted only if the aggregate commitment for all such obligations not disclosed is immaterial.

For UPOs that have been recorded on the purchaser's balance sheet, also referred to as "recognized commitments," the purchaser should disclose for each of the five years following the date of the latest balance sheet presented the aggregate amount of payments for UPOs that meet the following criteria:

a. It is noncancelable, or cancelable only in any of the following circumstances:
   - Upon the occurrence of some remote contingency;
   - With the permission of the other party;
   - If a replacement agreement is signed between the same parties; or
   - Upon payment of a penalty in an amount such that continuation of the agreement appears reasonably assured.
b. It was negotiated as part of arranging financing for the facilities that will provide the contracted goods or services or for costs related to those goods or services, for example, carrying costs for contracted goods. A purchaser is not required to investigate whether a supplier used an unconditional purchase obligation to help secure financing if the purchaser would otherwise be unaware of that fact.
c. It has a remaining term in excess of one year.

Future minimum lease payments under leases that meet the above conditions do not need to be disclosed in accordance with the above requirements if those future minimum lease payments are disclosed in accordance with the requirements in ASC 842, *Leases*.

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B. Disclosure example – AutoNation, Inc.

RESTRICTIONS AND COVENANTS

Our credit agreement, the indentures for our 6.75-percent Senior Notes due 2018 and 5.5 percent Senior Notes due 2020, our vehicle floorplan facilities, and our mortgage facility contain numerous customary financial and operating covenants that place significant restrictions on us, including our ability to incur additional indebtedness or prepay existing indebtedness, to create liens or other encumbrances, to sell (or otherwise dispose of) assets, and to merge or consolidate with other entities.

Under our credit agreement we are required to remain in compliance with a maximum leverage ratio and maximum capitalization ratio. The leverage ratio is a contractually defined amount principally reflecting non-vehicle debt divided by a contractually defined measure of earnings with certain adjustments. The capitalization ratio is a contractually defined amount principally reflecting vehicle floorplan payable and non-vehicle debt divided by our total capitalization including vehicle floorplan payable. Under the credit agreement, the maximum leverage ratio is 3.75 x and the maximum capitalization ratio is 65.0 percent. In calculating our leverage and capitalization ratios, we are not required to include letters of credit in the definition of debt (except to the extent of letters of credit in excess of $150.0 million). In addition, in calculating our capitalization ratio, we are permitted to add back to shareholders' equity all goodwill, franchise rights, and long-lived asset impairment charges subsequent to September 30, 2011, plus $1.52 billion.

The indentures for our 6.75 percent Senior Notes due 2018 and 5.5 percent Senior Notes due 2020 contain certain limited covenants, including limitations on liens and sale and leaseback transactions. Our mortgage facility contains covenants regarding maximum cash flow leverage and minimum interest coverage.

Our failure to comply with the covenants contained in our debt agreements could permit acceleration of all of our indebtedness. Our debt agreements have cross-default provisions that trigger a default in the event of an uncured default under other material indebtedness of AutoNation.
respectively.

C. Disclosure Example – Unconditional purchase obligation

TAKE-OR-PAY CONTRACT

In order to assure its supply of raw materials when needed, the company has entered into a contract with a supplier to purchase 50 percent of the supplier's output of engineered I-beam lumber used in the construction of its residential properties through 2029. The company is required to make minimum annual payments as follows, whether or not it takes delivery:

Year Ended [date of financial statements]	Amount
2023	$200,000
2024	210,000
2025	231,000
2026	254,100
2027	1,279,510
Subsequent to 2027	615,000
Total minimum payments	1,789,610
Less: Amount representing interest	(72,500)
Present value of minimum payments	**$1,717,110**

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In addition, the company is required to reimburse the supplier for increases in real estate taxes in the manufacturing facility over the 2020 amount, and for certain other operating expenses that exceed specified amounts. Purchases during 2022 and 2021 under the contract were $181,000 and $165,000, respectively.

IV. Contingencies

First – The jargon:

Contingency – An existing condition, situation, or set of circumstances involving uncertainty as to possible gain (gain contingency) or loss (loss contingency) to an entity that will ultimately be resolved when one or more future events occur or fail to occur.

Gain contingency – An existing condition, situation, or set of circumstances involving uncertainty as to possible gain to an entity that will ultimately be resolved when one or more future events occur or fail to occur.

Loss contingency – An existing condition, situation, or set of circumstances involving uncertainty as to possible loss to an entity that will ultimately be resolved when one or more future events occur or fail to occur. The term loss is used for convenience to include many charges against income that are commonly referred to as expenses and others that are commonly referred to as losses.

Second – What are NOT contingencies:

Depreciation – The fact that estimates are used to allocate the known cost of a depreciable asset over the period of use by an entity does not make depreciation a contingency; the eventual expiration of the utility of the asset is not uncertain. Thus, depreciation of assets is not a contingency, nor are such matters as recurring repairs, maintenance, and overhauls, which interrelate with depreciation.

Estimates used in accruals – Amounts owed for services received, such as advertising and utilities, are not contingencies even though the accrued amounts may have been estimated; there is nothing uncertain about the fact that those obligations have been incurred.

Changes in tax law – The possibility of a change in the tax law in some future year is not an uncertainty.

Third – Back to Accounting 101 for handling loss contingencies:

Condition	Probable	Reasonably Possible	Remote
Able to estimate	Record as liability	Disclose in note	Not disclosed
Unable to estimate	Disclose in note	Disclose in note	Not disclosed

Probable - likely to occur

Reasonably possible - more than remote but less than likely

Remote - slight (not likely)

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Okay, with all that said, contingencies are in some respects similar to commitments that we just discussed in that they both have to do with uncertainties. In the case of contingencies, resolution of the uncertainty might confirm any of the following:

a. The acquisition of an asset.
b. The reduction of a liability.
c. The loss or impairment of an asset.
d. The incurrence of a liability.

Not all uncertainties inherent in the accounting process give rise to contingencies. Estimates are required in financial statements for many ongoing and recurring activities of an entity; and the mere fact that an estimate is involved does not of itself constitute the type of uncertainty referred to in the definitions of a gain contingency or a loss contingency above.

Likewise, not all transactions fall under the contingencies topic in the FASB Codification, for example, the recognition and initial measurement of assets or liabilities arising from contingencies that are measured at fair value or assets arising from contingencies measured at an amount other than fair value on the acquisition date in a business combination under the requirements of ASC 805, *Business Combinations*.

A. Gain contingencies

According to ASC 450, *Contingencies*, a contingency that might result in a gain usually should not be reflected in the financial statements because to do so might be to recognize revenue before its realization. However, adequate disclosure should be made of a contingency that might result in a gain, but care should be exercised to avoid misleading implications as to the likelihood of realization.

With regard to the financial impact of the COVID-19 pandemic, entities may file claims to recover from insurance the loss attributable to the impairment of an asset or the incurrence of a liability. Further, an entity may recover lost profits from future operations through business interruption insurance. Lastly, they may enter into litigation in order to recover damages from other stakeholders related to COVID-19.

While an entity can disclose the nature of the contingency in the footnote to the financial statements, note that recovery through an insurance claim is not recorded until it is deemed probable. Further, recoveries under business interruption insurance is considered a gain contingency and would not be recognized until the gain contingency is resolved, generally through receipt of the insurance proceeds.

1. Disclosure example – Generic gain contingency disclosure

FAVORABLE JUDGMENT RECEIVED
The company filed suit in Delaware County, PA Court of Common Pleas against a competitor for alleged violations of the company's patents related to its manufacturing of its ELITE brand of efficiency windows. On April 7, 2023, the jury returned a verdict against the competitor and awarded the company $1,250,000 in actual and punitive damages. The competitor has appealed the decision and, accordingly, the amount of damages plus interest has not been reflected in the accompanying financial statements.

No date has been set for the appeal to be heard by the Appellate Division of the Delaware County Court of Common Pleas.

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2. Disclosure example – Universal Health Services, Inc.

GAIN CONTINGENCY – ACCOUNTING FOR MEDICARE AND MEDICAID ELECTRONIC HEALTH RECORDS

In July 2010, the Department of Health and Human Services published final regulations implementing the health information technology provisions of the American Recovery and Reinvestment Act. The regulation defines the "meaningful use" of Electronic Health Records ("EHR") and established the requirements for the Medicare and Medicaid EHR payment incentive programs. The implementation period for these new Medicare and Medicaid incentive payments started in federal fiscal year 2011 and can end as late as 2016 for Medicare and 2021 for the state Medicaid programs. We recognize income related to Medicare and Medicaid incentive payments using a gain contingency model that is based upon when our eligible hospitals have demonstrated "meaningful use" of certified EHR technology for the applicable period and the cost report information for the full cost report year that will determine the final calculation of the incentive payment is available.

Medicare EHR incentive payments: Federal regulations require that Medicare EHR incentive payments be computed based on the Medicare cost report that begins in the federal fiscal period in which a hospital meets the applicable "meaningful use" requirements. Since the annual Medicare cost report periods for each of our acute care hospitals ends on December 31st, we will recognize Medicare EHR incentive income for each hospital during the fourth quarter of the year in which the facility meets the "meaningful use" criteria and during the fourth quarter of each applicable subsequent year.

Medicaid EHR incentive payments: Medicaid EHR incentive payments are determined based upon prior period cost report information available at the time our hospitals met the "meaningful use" criteria. Therefore, the majority of the Medicaid EHR incentive income recognition occurred in the period in which the applicable hospitals were deemed to have met initial "meaningful use" criteria. Upon meeting subsequent fiscal year "meaningful use" criteria, our hospitals may become entitled to additional Medicaid EHR incentive payments which will be recognized as incentive income in future periods. Medicaid EHR incentive payments received prior to our hospitals meeting the "meaningful use" criteria were included in other current liabilities (as deferred EHR incentive income) in our consolidated balance sheet.

B. Loss contingencies

From our Accounting 101 matrix above, we know that loss contingencies that are probable and can be reasonably estimated should be recorded in the financial statements with an accrual against income.

Examples of typical loss contingencies include:

- Injury or damage caused by products sold.
- Risk of loss or damage of property by fire, explosion, or other hazards.
- Actual or possible claims and assessments.
- Threat of expropriation of assets.
- Pending or threatened litigation.

Oftentimes, when dealing with a loss contingency, especially lawsuits, an entity will develop a range of the estimated loss. If this is the case, ASC 450 requires the entity to accrue the amount that appears to be a better estimate than any other estimate within the range or accrue the minimum amount in the range if no amount within the range is a better estimate than any other amount.

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It should also be noted that general or unspecified business risks do not meet the above conditions for accrual and therefore no loss accrual or disclosure should be made for them (however, ASC 275, *Risks and Uncertainties*, requires disclosure of certain business risks). In addition, disclosure of noninsured or underinsured risks is not required by ASC 450, although disclosure in appropriate circumstances is not discouraged.

1. Disclosure requirements for accrued loss contingencies

According to ASC 450, disclosure of the nature of an accrued loss contingency, and in some circumstances the amount accrued, may be necessary so the financial statements are not misleading. Terminology used in this respect should be descriptive of the nature of the accrual, such as "estimated liability" or "liability of an estimated amount;" the term *reserve* should not be used for an accrued loss contingency.

An interesting twist on the disclosure requirements for accrued loss contingencies under ASC 450 comes out of the disclosure requirements in ASC 275, which states:

> Disclosure regarding an estimate should be made when known information available before the financial statements are issued or are available to be issued 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.

If these two criteria are met, ASC 275 requires disclosure of an indication that it is at least reasonably possible that a change in an entity's estimate of its probable liability could occur in the near term. This would then trigger a disclosure in accordance with ASC 450, for example:

> On March 15, 20X1, ABC, Inc. filed a suit against the Company claiming patent infringement. While the Company believes it has meritorious defenses against the suit, the ultimate resolution of the matter, which is expected to occur within one year, could result in a loss of up to $25 million in excess of the amount accrued.

2. Disclosure example – Litigation with accrual made but exposure above the amount disclosed

LITIGATION: BREACH OF CONTRACT ALLEGATION

The company is a defendant in a lawsuit filed by one of its customers for alleged breach of contract. The suit asks for actual and punitive damages totaling $125,000. The lawsuit alleges that the company improperly installed a new roof on the plaintiff's residential property, resulting in the roof's leaking during a recent period of inclement weather. As a result of this leakage, the plaintiff alleges damage to certain structural components of the residence as well as damage to furniture and other fixtures in the residence. The lawsuit requests for the company to reimburse the plaintiff for the cost of reinstalling a new roof, repair and/or replacement of certain floor joists which were damaged during the leakage as well as cleaning, repairing or replacement, as appropriate of certain furniture which the plaintiff alleges was damaged due to the leakage.

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The company has proposed a settlement in the amount of $50,000, which has been charged to operations in the accompanying financial statements for 2021. If the settlement offer is not accepted and the case goes to trial, the amount of the ultimate loss to the company, if any, may equal the amount of damages sought by the plaintiff. However, amounts ultimately payable by the company due to this litigation may be offset, at least in part, by recoveries under general liability insurance coverage which the company maintains.

3. Disclosure example – PULTEGROUP, Inc.

SELF-INSURED RISKS

We maintain, and require our subcontractors to maintain, general liability insurance coverage. We also maintain builders' risk, property, errors and omissions, workers compensation, and other business insurance coverage. These insurance policies protect us against a portion of the risk of loss from claims. However, we retain a significant portion of the overall risk for such claims either through our own self-insured per occurrence and aggregate retentions, deductibles, policies issued by our captive insurance subsidiaries, and any potential claims in excess of available insurance policy limits.

Our general liability insurance includes coverage for certain construction defects. While construction defect claims may relate to a variety of issues, the majority of our claims relate to alleged problems with siding, windows, roofing, and foundations. The availability of general liability insurance for the homebuilding industry and its subcontractors has become increasingly limited, and the insurance policies available require companies to retain significant per occurrence and aggregate retention levels. In certain instances, we may offer our subcontractors the opportunity to purchase general liability insurance through one of our captive insurance subsidiaries or participate in a project-specific insurance program. Policies issued by our captive insurance subsidiaries represent self-insurance of these risks by us. This self-insured exposure is limited by reinsurance policies that we purchase. General liability coverage for the homebuilding industry is complex, and our coverage varies from policy year to policy year. Our insurance coverage requires a per occurrence retention up to an overall aggregate amount. Amounts paid to resolve insured claims apply to our per occurrence and aggregate retention obligations. Any amounts incurred in excess of the occurrence or aggregate retention levels are covered by insurance up to the purchased coverage levels. Our insurance policies, including the captive insurance subsidiaries' reinsurance policies, are maintained with highly-rated carriers for whom we believe counterparty default risk is not significant.

At any point in time, we are managing numerous individual claims related to general liability, property, errors and omission, workers compensation, and other business insurance coverage. We reserve for costs associated with these claims (including expected claims management expenses) on an undiscounted basis at the time revenue is recognized for each home closing and evaluate the recorded liabilities based on actuarial analyses of our historical claims. The actuarial analyses calculate estimates of the ultimate net cost of all unpaid losses, including estimates for incurred but not reported losses ("IBNR"). IBNR represents losses related to claims incurred but not yet reported plus development on reported claims.

Our recorded reserves for all such claims totaled $635.9 million and $627.1 million at December 31, 2022 and 2021, respectively, the vast majority of which relate to general liability claims. The recorded reserves include loss estimates related to both (i) existing claims and related claim expenses and (ii) IBNR and related claim expenses. Liabilities related to IBNR and related claim expenses represented approximately 74% and 70% of the total general liability reserves at December 31, 2022 and 2021, respectively. The actuarial analyses that determine the IBNR portion of reserves consider a variety of factors, including the frequency and severity of losses, which are based on our historical claims experience supplemented by industry data. The actuarial analyses of the reserves also consider historical third party recovery rates and claims management expenses.

Volatility in both national and local housing market conditions may affect the frequency and cost of construction defect claims. Additionally, IBNR estimates comprise the majority of our liability and are subject to a high degree of uncertainty due to a variety of factors, including changes in claims reporting and resolution patterns, third party recoveries, insurance industry practices, the regulatory environment, and legal precedent. State regulations vary, but construction defect claims are reported and resolved over an extended time period often exceeding ten years. Changes in the frequency and timing of reported claims and estimates of specific claim values can impact the underlying inputs and trends utilized in the actuarial analyses, which could have a material impact on the recorded reserves. Because of the inherent uncertainty in estimating future losses and the timing of such losses related to these claims, actual costs could differ significantly from estimated costs.

Adjustments to reserves are recorded in the period in which the change in estimate occurs. During 2022, 2021, and 2020, we reduced reserves, primarily general liability reserves, by $65.0 million, $81.1 million, and $93.4 million,

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respectively, as a result of changes in estimates resulting from actual claim experience observed being less than anticipated in previous actuarial projections. The changes in actuarial estimates were driven by changes in actual claims experience that, in turn, impacted actuarial estimates for potential future claims. These changes in actuarial estimates did not involve any significant changes in actuarial methodology but did impact the development of estimates for future periods, which resulted in adjustments to the IBNR portion of our recorded liabilities. There were no material adjustments to individual claims. Rather, the adjustments reflect an overall lower level of losses related to construction defect claims in recent years as compared with our previous experience. We attribute this favorable experience to a variety of factors, including improved construction techniques, rising home values, and increased participation from our subcontractors in resolving claims. Costs associated with our insurance programs are classified within selling, general, and administrative expenses. Changes in these liabilities were as follows ($000's omitted):

	2022	2021	2020
Balance, beginning of period	$ 627,067	$ 641,779	$ 709,798
Reserves provided	111,067	90,863	83,912
Adjustments to previously recorded reserves	(64,965)	(81,131)	(93,431)
Payments, net *(a)*	(37,312)	(24,444)	(58,500)
Balance, end of period	$ 635,857	$ 627,067	$ 641,779

(a) Includes net changes in amounts expected to be recovered from our insurance carriers, which are recorded in other assets (see below).

In certain instances, we have the ability to recover a portion of our costs under various insurance policies or from subcontractors or other third parties. Estimates of such amounts are recorded when recovery is considered probable. As reflected in Note 10, our receivables from insurance carriers totaled $43.7 million and $57.5 million at December 31, 2022 and 2021, respectively. The insurance receivables relate to costs incurred or to be incurred to perform corrective repairs, settle claims with customers, and other costs related to the continued progression of both known and anticipated future construction defect claims that we believe to be insured related to previously closed homes. Given the complexity inherent with resolving construction defect claims in the homebuilding industry as described above, there typically is a significant lag between our payment of claims and our reimbursements from applicable insurance carriers. In addition, disputes between homebuilders and carriers over coverage positions relating to construction defect claims are common. Resolution of claims with carriers takes time, involves the exchange of significant amounts of information, and frequently involves legal action.

In 2020, we recorded reserves against insurance receivables of $17.8 million in connection with policy settlement negotiations with certain of our carriers. We believe collection of our recorded insurance receivables is probable based on the legal merits of our positions after review by legal counsel, the high credit ratings of our carriers, and our long history of collecting significant amounts of insurance reimbursements under similar insurance policies related to similar claims. While the outcomes of these matters cannot be predicted with certainty, we do not believe that the resolution of such matters will have a material adverse impact on our results of operations, financial position, or cash flows.

4. Disclosure example – Environmental liability with amount accrued and additional exposure in excess of amount accrued

ENVIRONMENTAL LIABILITY

The company has determined that it has incurred a liability for environmental remediation costs resulting from the leak of home heating fuel from its delivery truck which occurred on March 27, 2016. The leak occurred while the company's truck was making a delivery of home heating fuel to a residential customer and consisted of approximately 50 gallons of home heating fuel. While the company was able to dike the spilled fuel, a portion of the leaked fuel both seeped into the ground surrounding the residence as well as flowed into a nearby storm drainage system which empties into the Chester Creek Watershed (Watershed). The company notified appropriate local and PA Department of Environmental Protection (DEP) officials immediately of the spill and was able to estimate the amount of fuel which leaked into the Watershed to be negligible. DEP officials concurred and required no active remediation of the Watershed but held the company responsible for possible fines and cost reimbursement related to the DEP assessment.

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Additionally, local and DEP officials determined that the company must remediate the contaminated portion of the residential property on which the spill occurred. This consisted of both an asphalt driveway and adjoining grass and dirt lawn. The remediation effort consisted of excavation and removal of the impacted materials, totaling approximately 10 square feet of dirt, and its transportation to an approved land fill. Costs of this effort are estimated at $50,000.

Accordingly, the company accrued a liability in the amount of $60,000 as of March 31, 2022, and a provision for loss in a corresponding amount has been charged to operations for 2022. This amount represents the aforementioned remediation efforts and an estimate of potential fines due to the DEP. However, the company is responsible for any additional remediation of the property which may be required following ongoing site assessment and testing. Additionally, the amount of the fine and expense reimbursement amount from the DEP has not been finalized. A final determination has not been made concerning the company's ultimate obligation in this matter, and it is not possible to estimate whether an additional liability will need to be recorded in the future. The company’s accrual represents its current estimate of the most likely amount that it expects to pay due to this incident.

5. Disclosure example – 3M Company

LEGAL PROCEEDINGS

The Company and some of its subsidiaries are involved in numerous claims and lawsuits, principally in the United States, and regulatory proceedings worldwide. These include various products liability (involving products that the Company now or formerly manufactured and sold), intellectual property, and commercial claims and lawsuits, including those brought under the antitrust laws, and environmental proceedings. Unless otherwise stated, the Company is vigorously defending all such litigation.

<u>Process for Disclosure and Recording of Liabilities and Insurance Receivables Related to Legal Proceedings</u>

Many lawsuits and claims involve highly complex issues relating to causation, scientific evidence, and whether there are actual damages and are otherwise subject to substantial uncertainties. Assessments of lawsuits and claims can involve a series of complex judgments about future events and can rely heavily on estimates and assumptions. The Company complies with the requirements of ASC Topic 450, *Contingencies*, and related guidance, and records liabilities for legal proceedings in those instances where it can reasonably estimate the amount of the loss and where liability is probable. Where the reasonable estimate of the probable loss is a range, the Company records the most likely estimate of the loss, or the low end of the range if there is no one best estimate. The Company either discloses the amount of a possible loss or range of loss in excess of established accruals if estimable, or states that such an estimate cannot be made. The Company discloses significant legal proceedings even where liability is not probable or the amount of the liability is not estimable, or both, if the Company believes there is at least a reasonable possibility that a loss may be incurred.

The Company estimates insurance receivables based on an analysis of its numerous policies, including their exclusions, pertinent case law interpreting comparable policies, its experience with similar claims, and assessment of the nature of the claim and remaining coverage, and records an amount it has concluded is likely to be recovered. For those insured matters where the Company has taken an accrual, the Company also records receivables for the amount of insurance that it expects to recover under the Company’s insurance program. For those insured matters where the Company has not taken an accrual because the liability is not probable or the amount of the liability is not estimable, or both, but where the

Company has incurred an expense in defending itself, the Company records receivables for the amount of insurance that it expects to recover for the expense incurred.

Because litigation is subject to inherent uncertainties, and unfavorable rulings or developments could occur, there can be no certainty that the Company may not ultimately incur charges in excess of presently recorded liabilities. A future adverse ruling, settlement, or unfavorable development could result in future charges that could have a material adverse effect on the Company's results of operations or cash flows in the period in which they are recorded. The Company currently believes that such future charges, if any, would not have a material adverse effect on the consolidated financial position of the Company. Based on experience and developments, the Company reexamines its estimates of probable liabilities and associated expenses and receivables each period, and whether it is able to estimate a liability previously determined to be not estimable and/or not probable. Where appropriate, the Company makes additions to or adjustments of its estimated liabilities. As a result, the current estimates of the potential impact on the Company's consolidated financial position, results of operations and cash flows for the legal proceedings and claims pending against the Company could change in the future.

The following table shows the major categories of significant legal matters – respirator mask/asbestos litigation, environmental remediation and other environmental liabilities – for which the Company has been able to estimate its probable liability and for which the Company has recorded accruals and the related insurance receivables:

Liability and Receivable Balances At December 31 (Millions)	2013	2012	2011
Respirator mask/asbestos liabilities	**$ 152**	$ 154	$ 130
Respirator mask/asbestos insurance receivables	**58**	87	121
Environmental remediation liabilities	**$ 27**	$ 29	$ 28
Environmental remediation insurance receivables	**11**	11	15
Other environmental liabilities	**$ 48**	$ 57	$ 75
Other environmental insurance receivables	**15**	15	—

6. Disclosure requirements for unrecognized contingencies

According to ASC 450, disclosure of a contingency should be made if there is at least a reasonable possibility that a loss (or an additional loss) might have been incurred and either of the following conditions exists:

a. An accrual is not made for the loss contingency because it cannot be reasonably estimated.

b. An exposure to loss exists in excess of the amount accrued.

In this case, the disclosure should include the nature of the contingency and an estimate of the possible loss or range of loss or a statement that such an estimate cannot be made.

Disclosure is not required of a loss contingency involving an unasserted claim or assessment if there has been no manifestation by a potential claimant of an awareness of a possible claim or assessment unless it is considered probable that a claim will be asserted and there is a reasonable possibility that the outcome will be unfavorable.

These disclosure requirements do not apply to loss contingencies arising from an entity's recurring estimation of its allowance for credit losses (bad debt expense).

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7. Disclosure example – Litigation with no accrual made

LITIGATION: BREACH OF CONTRACT ALLEGATION

The company is a defendant in a lawsuit filed by one of its customers for alleged breach of contract related to the installation of a heating system at the customer's residence. The customer alleges that the installed system has not performed at a level as was predicted by the company when the customer selected the installed system from others presented by the company. The company believes that it adequately and accurately described the performance from the system, which the customer should expect from the heating system following its installation.

The suit asks for actual and punitive damages totaling $50,000, including the cost for the removal of the current heating system as well as the cost to replace that system with another one. The company believes the suit is completely without merit and intends to vigorously defend its position.

8. Disclosure example – Harley-Davidson, Inc.

ENVIRONMENTAL PROTECTION AGENCY NOTICE

In December 2009, the Company received formal, written requests for information from the United States Environmental Protection Agency (EPA) regarding: (i) certificates of conformity for motorcycle emissions and related designations and labels, (ii) aftermarket parts, and (iii) warranty claims on emissions related components. The Company promptly submitted written responses to the EPA's inquiry and has engaged in discussions with the EPA. Since that time, the EPA has delivered various additional requests for information to which the Company has responded. It is possible that a result of the EPA's investigation will be some form of enforcement action by the EPA that will seek a fine or other relief. However, at this time the Company does not know and cannot reasonably estimate the impact of any remedies the EPA might seek.

V. Related party transactions

When we hear the term "related party" or "related party transaction," we typically think about a small business owner and his or her company, or a parent company and its subsidiaries. But there is a bit more to it than just that.

Related parties include:

- Principal owners of the entity and members of their immediate families.
- Management of the entity and members of their immediate families.
- Other parties that can control or significantly influence the management or operating policies of the entity.
- Affiliates of the entity.
- Equity method entities (absent the election of the fair value option).
- Trusts for the benefit of employees managed by or under the trusteeship of management.

Related party transactions that commonly occur in the normal course of business include, for example:

- Sales, purchases, and transfers of real and personal property.
- Services received or furnished, such as accounting and legal services.
- Use of property and equipment by lease or otherwise.
- Borrowings, lendings, and guarantees.
- Filing consolidated tax returns.

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ASC 850, *Related Party Disclosures*, provides the disclosure requirements for related party transactions; and while some related party transactions might 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, ASC 850 requires their disclosure, nonetheless.

A. Disclosure requirements

According to ASC 850, financial statements should include the disclosure of material related party transactions, other than compensation arrangements, expense allowances, and other similar items in the ordinary course of business (disclosure of transactions that are eliminated when preparing consolidated or combined financial statements is also not required).

The disclosures should include:

- The nature of the relationship involved.
- A description of the transactions, including transactions to which no amounts or nominal amounts were ascribed, for each period for which an income statement is presented, and such other information deemed necessary to an understanding of the effects of the transactions on the financial statements.
- The dollar amounts of transactions for each period for which an income statement is presented and the effects of any change in the method of establishing the terms from that used in the preceding period.
- 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.

In addition, an entity that is a member of a group that files a consolidated tax return should disclose in its separately issued financial statements:

- The aggregate amount of current and deferred tax expense for each statement of earnings presented and the amount of any tax-related balances due to or from affiliates as of the date of each statement of financial position presented.
- The principal provisions of the method by which the consolidated amount of current and deferred tax expense is allocated to members of the group and the nature and effect of any changes in that method (and in determining related balances to or from affiliates) during the years for which the above disclosures are presented.

Other disclosure requirements include:

- 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.
- 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, should 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.

In some cases, aggregation of similar transactions by the type of related party might be appropriate, for example, the owner of the business. Sometimes, the effect of the relationship between the parties is 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 should be disclosed.

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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.

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 should be disclosed even though there are no transactions between the entities.

B. Disclosure example – Sample related-party disclosure

RELATED PARTY TRANSACTION

The Company leases its manufacturing and administrative facilities from the owner of the Company, pursuant to a 20-year lease on the facilities (“lease”). Under the terms of the lease agreement, the Company pays its owner $500,000 in fixed lease payments, plus an annual adjustment representing the change in the Consumer Price Index (CPI) for real estate in the market where the Company operates. The amount of the annual lease payment is determined at the beginning of the year and is payable at the beginning of each month. Additionally, under the terms of the lease, the Company is responsible for all utility expenses incurred while operating the leased facilities while the lessor is responsible for building maintenance and repairs which were not caused by the negligence of the Company.

The lease is non-cancellable and expires on December 31, 2030. The lease contains an automatic renewal option, whereby it is automatically renewed for an additional five-year period, unless either party gives the other notice of its intent to not renew the lease at least 90 days prior to the expiration date of the lease.

The lease is accounted for as an operating lease under the guidance of ASC Topic 842, *Leases, and a lease liability of $6,300,000 is recorded as of 2021 and 2020.*

Payments of approximately $525,000 were made in 2021 and 2020.

C. Large company disclosure example – Tyson Foods

RELATED PARTY TRANSACTIONS

We have related party leases for two wastewater facilities with an entity owned by the Donald J. Tyson Revocable Trust (for which Mr. John Tyson, Chairman of the Company, is a trustee), Berry Street Waste Water Treatment Plant, LP (90% of which is owned by the TLP), and the sisters of Mr. Tyson. As of October 1, 2022 and October 2, 2021, one lease was classified as a finance lease with a debt balance of $7 million which is primarily recognized as Long-term debt in our Consolidated Balance Sheet. The other lease was classified as an operating lease with a lease liability balance of $3 million as of October 1, 2022 and October 2, 2021, respectively, which is primarily recognized within Other Liabilities in our Consolidated Balance Sheet. Total payments of approximately $1 million in each of fiscal 2022, 2021 and 2020 were paid to lease the facilities.

As of October 1, 2022, the TLP, of which John Tyson and director Barbara Tyson are general partners, owned 70 million shares, or 99.985% of our outstanding Class B stock and, along with the members of

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the Tyson family, owned 6.7 million shares of Class A stock, giving it control of approximately 71.15% of the total voting power of our outstanding voting stock.

In fiscal 2022, 2021 and 2020, the Company provided administrative services to the TLP, the beneficial owner of 70 million shares of Class B stock, and the TLP, through TLP Investment, L.P., reimbursed the Company $0.2 million in each of fiscal 2022, 2021 and 2020.

VI. Subsequent events

Subsequent events are events or transactions that occur after the balance sheet date but before the financial statements have been issued or are available to be issued. ASC 855, *Subsequent Events*, provides the requirements and guidance for the disclosure of subsequent events.

There are two types of subsequent events – "recognized" subsequent events and "nonrecognized" subsequent events.

Recognized subsequent events are also referred to as "Type 1" subsequent events and unrecognized subsequent events are also referred to as "Type 2" subsequent events.

Recognized subsequent events are far less common than unrecognized subsequent events and include events or transactions that provide additional evidence about conditions that existed at the balance sheet date, including the estimates inherent in the process of preparing financial statements.

An entity should recognize the effects of all recognized subsequent events in the financial statements.

Unrecognized subsequent events include events that provide evidence about conditions that <u>did not exist</u> at the balance sheet date but instead arose after the balance sheet date.

An entity should not recognize the effects of any unrecognized subsequent events in the financial statements.

Examples of recognized or Type 1 subsequent events include:

- A lawsuit underway before the balance sheet date that is settled after the balance sheet date but before the financial statements are issued or available to be issued. In this case, if the actual settlement amount is different from the accrued liability recorded on the books, the settlement amount should be the amount of liability recognized in the financial statements at the balance sheet date.
- A bankruptcy filing by a customer after the balance sheet date but before the financial statements are issued or available to be issued. In this case, the assumed loss on an uncollectible trade account receivable as a result of the customer's bankruptcy will ordinarily be indicative of conditions existing at the balance sheet date. Thus, the effects of the customer's bankruptcy filing should be considered in determining the amount of uncollectible trade accounts receivable recognized in the financial statements at balance sheet date.

Examples of unrecognized or Type 2 subsequent events include:

- The sale of bonds or issuance of capital stock after the balance sheet date but before the financial statements are issued or available to be issued.

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- A business combination that occurs after the balance sheet date but before financial statements are issued or available to be issued.
- The 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 available to be issued.
- The 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 available to be issued.
- The loss 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 available to be issued. Notice that the condition here is not one of an ongoing nature like bankruptcy proceedings included in the above example.
- 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 available to be issued.
- 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 available to be issued.

A. Disclosure requirements

According to ASC 855, entities that are not SEC filers should disclose of the date through which subsequent events have been evaluated and whether that date is the date that the financial statements were issued or the date that the financial statements were available to be issued. SEC filers are not required to disclose the date through which subsequent events have been evaluated.

In addition, some nonrecognized subsequent events might be of such a nature that they must be disclosed to keep the financial statements from being misleading. For such events, an entity should disclose the nature of the event and an estimate of its financial effect, or a statement that such an estimate cannot be made.

An entity should also consider supplementing the historical financial statements with pro forma financial data if a nonrecognized subsequent event is so significant that disclosure can best be made by means of pro forma financial data. In this case, the data should give effect to the event as if it had occurred on the balance sheet date. In some situations, an entity should also consider presenting pro forma statements, usually a balance sheet only, in columnar form on the face of the historical statements.

Unless the entity is an SEC filer, an entity that issues revised financial statements should disclose the dates through which subsequent events have been evaluated in both the issued or available-to-be-issued financial statements, and the revised financial statements. (Revised financial statements are considered reissued financial statements.)

B. Sample disclosure example – Type 1 subsequent event

On April 22, 2022, a major customer of the company declared bankruptcy under the provisions of Chapter 11 of the Federal Bankruptcy Law (Law). Under this provision, the customer expressed its intent to reorganize itself under the protection of the Law. At the date of this filing, the customer owed the company approximately $125,000 related to its purchase of building materials from the company. Following the customer's declaration, the company both refused to sell additional materials to the

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customer except on a cash basis and recorded a 25 percent reserve, $31,250, against its receivable balance, based on the company's expected outcome of the bankruptcy proceedings.

However, following its inability to develop a reorganization plan which was acceptable to its creditors, on January 22, 2023, the customer announced its intent to cease operations and amended its bankruptcy filing. This amended filing, under Chapter 7 of the Law, will result in the liquidation of its net assets in order to pay its creditors. As a result of this amended filing, the company has assessed that it will not recover any of the $125,000 which is due from this customer and established an additional reserve of $93,750 against this receivable. This results in the amount receivable from this customer being 100 percent reserved.

As the customer's financial distress existed as of December 31, 2022, the date of the company's financial statements and the bankruptcy filing occurred before the release of those financial statements, the company determined the Chapter 7 bankruptcy filing to be a subsequent event that required recognition in the company's December 31, 2022 financial statements. Accordingly, a charge of $93,750 has been included in Bad Debt Expense for the year then ended as well as in the company's Allowance for Doubtful Accounts as of December 31, 2022. The company will continue to monitor the bankruptcy proceedings to determine if a further adjustment needs to be made to this reserve.

C. Type 2 subsequent event sample disclosure example – Property loss

LOSS DUE TO FLOOD

On February 22, 2023, a tornado damaged one of the company's distribution facilities in Tennessee. The loss, due primarily to structural damage to the facility and damaged inventory, is estimated to be approximately $250,000. While the company maintains property and casualty insurance coverage, it maintains a policy deductible of $100,000 per claim. Accordingly, the amount of the deductible, $100,000, will be charged to operations during the first quarter of 2023.

D. Type 2 subsequent event disclosure example – ATMEL Corporation

PENDING ACQUISITION OF ATMEL BY MICROCHIP TECHNOLOGY

On January 19, 2016, Atmel entered into an Agreement and Plan of Merger (the "Merger Agreement") with Microchip Technology Incorporated ("Microchip"), and Hero Acquisition Corporation, a wholly owned subsidiary of Microchip ("Merger Sub"), after terminating a previously announced merger agreement with Dialog Semiconductor plc.

Under the terms of the Merger Agreement, the acquisition of Atmel will be accomplished through a merger of Merger Sub with and into Atmel (the "Merger"), with Atmel being the surviving corporation (the "Surviving Corporation").

At the effective time of the Merger (the "Effective Time"), each share of Atmel's common stock issued and outstanding immediately prior to the Merger (other than dissenting shares and shares held by Microchip, Merger Sub, Atmel or any of their respective subsidiaries) will be converted into the right to receive (1) $7.00 in cash and (2) a fraction of a share of Microchip common stock having a value of $1.15, based on a ten-day average of the closing price of Microchip's common stock measured as of the day before the closing of the Merger (with cash being substituted for Microchip common stock to the extent that the aggregate number of shares of Microchip stock issued in exchange for Atmel stock would exceed 13 million shares) (the "Merger Consideration").

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Each of Microchip's and Atmel's respective obligation to consummate the Merger is subject to a number of conditions specified in the Merger Agreement, including the following: (1) adoption of the Merger Agreement by Atmel's stockholders, (2) effectiveness under the Securities Act of 1933 of the Registration Statement on Form S-4 to be filed with the U.S. Securities and Exchange Commission (the "SEC") by Microchip in connection with the Microchip common stock issuable to Atmel stockholders in the Merger; (3) approval for listing on The NASDAQ Stock Market of the Microchip common stock issuable to Atmel stockholders in the Merger; (4) expiration or termination of the waiting period under the Hart-Scott-Rodino Antitrust Improvements Act of 1976 and receipt of antitrust clearances in Germany and South Korea (the "Antitrust Condition"); (5) absence of laws, orders, judgments and injunctions that enjoin or otherwise prohibit consummation of the Merger and any proceedings instituted by a governmental entity with competent jurisdiction seeking any of the foregoing; (6) subject to certain materiality-related standards contained in the Merger Agreement, the accuracy of the respective representations and warranties made by Atmel and Microchip and material compliance with the respective covenants of Atmel and Microchip in the Merger Agreement and (7) the absence of a material adverse effect with respect to the other party. The consummation of the Merger is not subject to a financing condition.

The Merger Agreement contains customary representations, warranties and covenants by the parties and requires the payment of termination fees under specified conditions.

The foregoing description of the Merger and the Merger Agreement does not purport to be complete and is qualified in its entirety by reference to the Merger Agreement.

In the year ended December 31, 2015, Atmel recorded transaction-related costs of approximately $11.6 million, principally for outside financial advisory, legal, and related fees and expenses associated with the strategic transaction process. These costs were recorded in selling, general and administrative expense included in the Consolidated Statements of Operations for the year ended December 31, 2015. Additional transaction-related costs are expected to be incurred through the closing of the Merger.

E. Type 2 subsequent event disclosure example – W. R. GRACE & CO.

SUBSEQUENT EVENTS – REORGANIZATION

1. Basis of Presentation and Summary of Significant Accounting and Financial Reporting Policies (in part)

W. R. Grace & Co., through its subsidiaries, is engaged in specialty chemicals and specialty materials businesses on a global basis through three operating segments: Grace Catalysts Technologies, which includes catalysts and related products and technologies used in refining, petrochemical, and other chemical manufacturing applications; Grace Materials Technologies, which includes packaging technologies and engineered materials used in consumer, industrial, coatings, and pharmaceutical applications; and Grace Construction Products, which includes specialty construction chemicals and specialty building materials used in commercial, infrastructure and residential construction.

W. R. Grace & Co. conducts all of its business through a single wholly owned subsidiary, W. R. Grace & Co.—Conn. ("Grace—Conn."). Grace—Conn. owns all of the assets, properties and rights of W. R. Grace & Co. on a consolidated basis, either directly or through subsidiaries.

As used in these notes, the term "Company" refers to W. R. Grace & Co. The term "Grace" refers to the Company and/or one or more of its subsidiaries and, in certain cases, their respective predecessors.

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Separation Transaction

On February 5, 2015, Grace announced a plan to separate into two independent, publicly traded companies, intended to improve Grace's strategic focus, simplify its operating structure, and allow for more efficient capital allocation. On January 27, 2016, Grace entered into a separation agreement with GCP Applied Technologies Inc., then a wholly owned subsidiary of Grace ("GCP"), pursuant to which Grace agreed to transfer its Grace Construction Products operating segment and the packaging technologies business, operated under the "Darex" name, of its Grace Materials Technologies operating segment to GCP (the "Separation"). The Separation occurred on February 3, 2016, by means of a pro rata distribution to Grace stockholders of all of the outstanding shares of GCP common stock (the "Distribution"). Under the Distribution, one share of GCP common stock was distributed for each share of Grace common stock held as of the close of business on January 27, 2016. No fractional shares were distributed. As a result of the Distribution, GCP is now an independent public company and its common stock is listed under the symbol "GCP" on the New York Stock Exchange.

2. Debt (in part)

Credit Agreement (in part)

On February 3, 2014, Grace entered into a Credit Agreement (the "Credit Agreement") in connection with its exit financing. The Credit Agreement provides for:

(a) A $700 million term loan due in 2021, with interest at LIBOR +225 bps with a 75 bps floor;

(b) A €150 million term loan due in 2021, with interest at EURIBOR +250 bps with a 75 bps floor;

(c) A $400 million revolving credit facility due in 2019, with interest at LIBOR +175 bps; and

(d) A $250 million delayed draw term loan facility available for 12 months, with amounts drawn due in 2021, with interest at LIBOR +225 bps with a 75-bps floor.

During the fourth quarter, Grace entered into an amendment to the Credit Agreement to permit the Separation. The amendment, which became effective upon completion of the Separation, revised certain covenants, reduced the revolving credit facility limit to $300 million and extended the facility's term to November 1, 2020.

In connection with the Separation, GCP distributed $750 million to Grace. Using a portion of these proceeds, Grace repaid $500 million of its Euro and U.S. dollar term loans. See Note 21 for information related to the Separation.

F. Type 2 subsequent event disclosure example – Sturm, Ruger & Company, Inc.

SUBSEQUENT EVENTS

On February 11, 2014, the Company's Board of Directors authorized a dividend of 54¢ per share to shareholders of record on March 14, 2014.

On February 12, 2014, the Company announced that its Board of Directors expanded its stock repurchase program from $8 million to $25 million.

The Company's management has evaluated transactions occurring subsequent to December 31, 2013 and determined that there were no events or transactions during that period that would have a material impact on the Company's results of operations or financial position.

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G. Subsequent event considerations related to the COVID-19 Pandemic

Given the general state of knowledge at the time, the financial statement impact of the COVID-19 pandemic was generally considered to be a Type 2, disclosure only subsequent event for entities with December 31, 2019 year-ends. However, in years subsequent to December 31, 2019, the effects of events happening after the balance sheet date are more likely to relate to conditions that existed at the balance sheet date, resulting in a Type 1, or reportable subsequent event. Impacts from the COVID-19 pandemic of which entities became aware of after March 31, 2020 would be deemed to be events that existed at March 31, 2020 and thereby require recognition as well as disclosure.

In its March 18, 2020 Special Report, Consequences of COVID-19: Financial Reporting Considerations, the AICPA's Center for Plain English Accounting provided the following examples of subsequent event disclosures of SEC registrants who filed Form 10-K in March 2020 for the December 31, 2019 financial statements. Each treated the impact of COVID-19 as a Type 2 subsequent event:

Subsequent event disclosure – Chico's (March 2020 10-K)
In recent days, the COVID-19 outbreak in the United States has resulted in reduced customer traffic and the temporary reduction of operating hours for our stores as well as temporary store closures where government mandated. These recent developments are expected to result in lower sales and gross margin than provided in our previous outlook.

Subsequent event disclosure – BankCorp (March 2020 10-K)
The Company evaluated its December 31, 2019 consolidated financial statements for subsequent events through the date the consolidated financial statements were issued. As a result of the spread of the COVID-19 coronavirus, economic uncertainties have arisen which are likely to negatively impact net interest income. Other financial impact could occur though such potential impact is unknown at this time.

The following is an example of a subsequent footnote for an entity with a February 1, 2020 year-end, Kohl's Department Stores. While Kohl's treats the impact of the COVID-19 pandemic as a Type 2 subsequent event at its year-end, its subsequent event disclosure is more robust, reflecting the evolving and deteriorating impact of the pandemic

Subsequent event disclosure – Kohl's Department Stores (March 2020 10-K)
In March 2020, the World Health Organization declared the outbreak of a novel coronavirus (COVID-19) as a pandemic, which continues to spread throughout the United States. As a result, we have temporarily closed some retail locations, reduced store operating hours, and have seen a reduction in consumer traffic, all resulting in a negative impact to Company sales. While the disruption is currently expected to be temporary, there is uncertainty around the duration. Therefore, while we expect this matter to negatively impact our business, results of operations, and financial position, the related financial impact cannot be reasonably estimated at this time. As a result, the Company is leveraging its balance sheet and has fully drawn its $1 billion unsecured credit facility to increase its cash position and help preserve its financial flexibility.

In a review of select public company 10-K filings for December 31, 2022, disclosures related to the impact of COVID-19 continued for certain companies due to its continued potential impact on supply chain and certain asset values.

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Question to Ponder:

Subsequent events disclosures occur very frequently in many entities' financial statements. What experiences do you have with such disclosures at your company? Consider the process that the company went through in determining the appropriate disclosure to make.

VII. Substantial doubt about an entity's ability to continue as a going concern

A. Disclosure requirements

In August 2014, the FASB issued ASU No. 2014-15, *Presentation of Financial Statements–Going Concern* (Subtopic 205-40): *Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern*, in order to add guidance GAAP regarding management's responsibility to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern and to provide related footnote disclosures.

ASU No. 2014-15 is effective now for all entities.

ASU No. 2014-15 requires management to assess an entity's ability to continue as a going concern, incorporating and expanding upon certain principles that are currently in U.S. auditing standards.

If conditions or events raise substantial doubt about an entity's ability to continue as a going concern, but the substantial doubt is alleviated as a result of consideration of management's plans that are intended to mitigate those conditions or events, the entity should disclose information that enables users of the financial statements to understand all of the following (or refer to similar information disclosed elsewhere in the footnotes):

a. Principal conditions or events that raised substantial doubt about the entity's ability to continue as a going concern (before consideration of management's plans);
b. Management's evaluation of the significance of those conditions or events in relation to the entity's ability to meet its obligations; and
c. Management's plans that alleviated substantial doubt about the entity's ability to continue as a going concern.

If conditions or events raise substantial doubt about an entity's ability to continue as a going concern, and substantial doubt is not alleviated after consideration of management's plans, an entity should include a statement in the footnotes indicating that there is substantial doubt about the entity's ability to continue as a going concern within one year after the date that the financial statements are issued (or available to be issued).

Additionally, the entity should disclose information that enables users of the financial statements to understand all of the following:

a. Principal conditions or events that raise substantial doubt about the entity's ability to continue as a going concern;
b. Management's evaluation of the significance of those conditions or events in relation to the entity's ability to meet its obligations; and
c. Management's plans that are intended to mitigate the conditions or events that raise substantial doubt about the entity's ability to continue as a going concern.

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B. Sample disclosure example – Going concern risk is mitigated

The company's management has performed cash flow forecasts that demonstrate that the company will be facing significant cash flow issues over the next 12 months which, if not mitigated, will result in the inability of the company to continue its operations. These liquidity issues relate primarily to the cash flows required to bring on-line its new e-commerce interface with customers. While expecting the venture to ultimately be profitable, the company is incurring significant expenditures to make the platform operational. As such, the company has determined that substantial doubt exists concerning its ability to continue as a going concern.

In response to this liquidity risk, the company's Board of Director's, which has the requisite authority, approved a plan in January 2019 to sell the e-commerce platform to a competitor, who can fund the remaining efforts to operationalize the platform. The sale is expected to close in April 2019 and is expected to raise $1.2 million.

The expected proceeds of the sale, along with the foregone expenditures which would have been incurred by the company in order to operationalize the e-commerce platform, are sufficient for the company to meet its expected cash flow requirements for at least a year form March 15, 2019, the date which the company's 2018 financial statements were released to the public. Accordingly, the company deems it probable that the plan will be effectively implemented, and that the cash proceeds generated from this transaction will mitigate the company's liquidity concerns.

VIII. Chapter summary

In this chapter, we focused our attention on the following five general financial statement disclosures in accordance with U.S. generally accepted accounting principles:

- Accounting changes and error corrections;
- Commitments;
- Contingencies;
- Related party transactions;
- Subsequent events;
- Substantial doubt about an entity's ability to continue as a going concern.

Examples illustrating these disclosures included those from the published financial statements of:

- Change in accounting principle
    - CVS Health
    - Sample disclosure – Adopting a Private Company Counsel (PCC) alternative
- Change in accounting estimate
    - Harris Corporation
    - Sample disclosure example – Change in depreciable lives
    - Visteon Corporation
- Change in reporting entity
    - Created
- Error corrections
    - First Solar, Inc.
    - Private company disclosure example – Single year financial statement presentation
    - Checkpoint Systems, Inc.

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- Commitments
  - AutoNation, Inc.
  - Flowers Foods, Inc.
  - Disclosure example – Unconditional purchase obligation – Take-or-pay contract
- Contingencies
  - Disclosure example – Generic gain contingency disclosure – Favorable judgment received
  - Universal Health Services, Inc. (gain contingency)
  - Disclosure example – Litigation with accrual made but exposure above the amount disclosed
  - PULTEGROUP, Inc.
  - Disclosure example – Environmental liability with amount accrued and additional exposure in excess of amount accrued
  - 3M Company
  - Harley-Davidson, Inc.
  - AXIALL Corporation
- Related party transactions
  - Disclosure example – Sample related-party disclosure
  - Charter Communications
- Subsequent events
  - Sample Disclosure example – Type 1 subsequent event
  - ATMEL Corporation
  - Sample disclosure example – Property loss
  - W.R. Grace & Co.
  - Sturm, Ruger & Company, Inc.
- Substantial doubt about an entity's ability to continue as a going concern
  - Sample disclosure example – Going concern risk mitigated by management's plans

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Balance Sheet Disclosures – Assets

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Balance Sheet Disclosures – Assets

Learning objective

After completing this chapter, you should be familiar with:

- Disclosures related to several key balance sheet assets in accordance with U.S. GAAP.

I. Introduction

In this chapter we will review disclosures related to several key balance sheet assets. To illustrate these disclosures, example excerpts from recently published financial statements will be presented for your review. Again, since there are literally thousands of such examples available, the examples included here are only meant as a sample of the many possible alternatives typically seen in practice today.

II. Presentation of financial statements

In accordance with U.S. GAAP, a full set of financial statements for a period should show an entity's financial position at the end of the period; and in any one year it is ordinarily desirable that the statement of financial position be presented for one or more preceding years, as well as for the current year.

FASB Accounting Standards Codification (ASC) 205, *Presentation of Financial Statements*, describes the benefits of presenting comparative financial statements instead of single-period financial statements, and addresses how the comparative information should be presented and the required disclosures.

According to ASC 205, presenting 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. Presenting comparative financial statements also 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 really just a piece of what is essentially a continuous financial history.

It is important to note here, that prior-year figures shown for comparative purposes should in fact be comparable with those shown for the current period and that any exceptions to comparability should clearly be brought out as described in ASC 250, *Accounting Changes and Error Corrections* (which we discussed in the prior chapter of this course material).

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 should 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 should be disclosed.

In addition, to the extent that they continue to be of significance, notes to the financial statements for the preceding years should be repeated, or at least referred to, in the comparative statements.

ASC 210, *Balance Sheet*, provides the general guidance for classifying items appearing on the balance sheet but also includes the following disclosure issue:

> 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

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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.

ASC 305 through 360 provides the detailed requirements and guidance relating to balance sheet disclosures surrounding assets, which we will review in this chapter. Liability and equity disclosures are covered in the next chapter of this course material.

III. Asset disclosures

A. Cash and cash equivalents

ASC 305, *Cash and Cash Equivalents*, defines the terms *cash* and *cash equivalent* as follows:

> **Cash –** Consistent with common usage, cash includes not only currency on hand but demand deposits with banks or other financial institutions. Cash also includes other kinds of accounts that have the general characteristics of demand deposits in that the customer may deposit additional funds at any time and also effectively may withdraw funds at any time without prior notice or penalty. All charges and credits to those accounts are cash receipts or payments to both the entity owning the account and the bank holding it. For example, a bank's granting of a loan by crediting the proceeds to a customer's demand deposit account is a cash payment by the bank and a cash receipt of the customer when the entry is made.
>
> **Cash Equivalent –** Cash equivalents are short-term, highly liquid investments that have both of the following characteristics: (i) they are readily convertible to known amounts of cash; and (ii) are 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).

1. Disclosure requirements

ASC 305 does not prescribe any specific disclosure requirements relating to cash and cash equivalents; however, the following disclosures are considered informative to financial statement users and are a best practice when dealing with legally restrictive compensating balance agreements:

- The terms of the compensating balance agreement;
- The amount of the compensating balance requirement;
- The amount required to be maintained to assure future credit availability and the terms of that agreement; and
- The maintenance of compensating balances for the benefit of a related party.

According to Rule 5-02.1, *Cash and Cash Items*, of the SEC's Regulation S-X, separate disclosure should be made of the cash and cash items that are restricted as to withdrawal or usage and the provisions of any restrictions should be described in a note to the financial statements. Restrictions may include legally

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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 that legally restrict the use of cash amounts shown on the balance sheet, the arrangements and the amounts involved (if determinable) should be described in the notes to the financial statements for the most recent audited balance sheet required and for any subsequent unaudited balance sheet required. Compensating balances that are maintained under an agreement to assure future credit availability should be disclosed in the notes to the financial statements along with the amount and terms of such agreement.

2. Sample disclosure – Generic cash and cash equivalents example

CASH EQUIVALENTS

For purposes of the statement of cash flows, the Company considers all short-term debt securities purchased with a maturity of three months or less to be cash equivalents.

3. Sample disclosure – Generic restricted cash example

RESTRICTIONS ON THE USE OF CASH

Under the terms of the joint venture agreement which governs the operations of the company, there are restrictions on the amount of company funds which may be distributed to the joint venture partners. Only amounts in excess of these restricted amounts are available for distribution. These restricted balances are as follows:

Cash restricted for distribution to joint venture participants is as follows:

Cash and money market fund	$90,250
Less restrictions:	
Escrowed taxes and insurance	32,460
One month's note amortization	14,250
Emergency	10,000
	56,710
Cash available for distribution	$33,540

4. Disclosure example – The Clorox Company

CASH AND CASH EQUIVALENTS

Cash equivalents consist of highly liquid instruments, time deposits and money market funds with an initial maturity at purchase of three months or less. The fair value of cash and cash equivalents approximates the carrying amount.

The Company’s cash position includes amounts held by foreign subsidiaries and, as a result, the repatriation of certain cash balances from some of the Company’s foreign subsidiaries could result in additional tax costs in the United States and certain foreign jurisdictions. However, these cash balances are generally available without legal restriction to fund local business operations. In addition, a portion of the Company’s cash balance is held in U.S. dollars by foreign subsidiaries, whose functional currency is their local currency. Such U.S. dollar balances are reported on the foreign subsidiaries’ books, in their functional currency, with the impact from foreign currency exchange rate differences recorded in other expense (income), net. The Company’s cash holdings were as follows as of June 30:

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	2022	2021
U.S. dollar balances held by U.S. dollar functional currency subsidiaries and at parent	$221	$180
Non-U.S. dollar balances held by non-U.S. dollar functional currency subsidiaries	142	132
U.S. dollar balances held by non-U.S. dollar functional currency subsidiaries	19	12
Non-U.S. dollar balances held by U.S. dollar functional currency subsidiaries	--	5
Total	$382	$329

B. Marketable securities

In January 2016, as part of its broader review of the accounting guidance related to financial instruments, the FASB issued ASU No. 2016-01, *Financial Instruments–Overall* (Subtopic 825-10): *Recognition and Measurement of Financial Assets and Financial Liabilities*, which impacts the recording, financial statement presentation, and disclosure of certain equity investments in several significant ways. We will discuss the disclosure impact of the changes expected to have the greatest impact, especially on smaller, private companies, in the discussion that follows.

Broadly, ASU No. 2016-01 eliminates the classification of "available for sale" equity investments and requires changes in fair value of non-equity method or consolidated equity investments with readably determinable market values to be recorded in net income. This replaces the current practice of recording such changes as part of Other Comprehensive Income. Additionally, there are several other changes that impact financial statement disclosure, especially for a nonpublic entity. The impact on the reporting and disclosure of equity financial investments will be large.

ASU No. 2016-01 became effective for public entities beginning in 2018 and one year later for nonpublic entities.

As a result of this new guidance, there is now separate accounting and disclosure guidance for debt and equity securities. We will discuss both now.

ASC 320, *Investments–Debt Securities*, addresses the accounting and reporting for investments in debt securities.

Debt Security – Any security representing a creditor relationship with an entity. The term debt security also includes all of the following:

a. Preferred stock that by its terms either must be redeemed by the issuing entity or is redeemable at the option of the investor.
b. A collateralized mortgage obligation (or other instrument) that is issued in equity form but is required to be accounted for as a nonequity instrument regardless of how that instrument is classified (that is, whether equity or debt) in the issuer's statement of financial position.
c. U.S. Treasury securities.
d. U.S. government agency securities.
e. Municipal securities.
f. Corporate bonds.
g. Convertible debt.
h. Commercial paper.

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i. All securitized debt instruments, such as collateralized mortgage obligations and real estate mortgage investment conduits.
j. Interest-only and principal-only strips.

The term debt security excludes all of the following:

a. Option contracts.
b. Financial futures contracts.
c. Forward contracts.
d. Lease contracts.
e. Receivables that do not meet the definition of security and, so, are not debt securities (unless they have been securitized, in which case they would meet the definition of a security), for example: trade accounts receivable arising from sales on credit by industrial or commercial entities and loans receivable arising from consumer, commercial, and real estate lending activities of financial institutions.

The primary issue surrounding debt and equity investments is the appropriate use of fair value measurements. U.S. GAAP requires that investments in equity securities that have readily determinable fair values and all investments in debt securities be classified into the following three distinct categories:

1. Available-for-sale securities – which are debt and equity securities that do not meet the criteria to be classified as held-to-maturity or trading securities and are accounted for at fair value with unrealized holding gains and losses reported in other comprehensive income and nontemporary losses charged to earnings.
2. Held-to-maturity securities – which are debt securities that the entity has the positive intent and ability to hold to maturity, and are accounted for at amortized cost, reduced for nontemporary losses that are charged to earnings (other unrealized gains or losses should not be recognized).
3. Trading securities – which are debt and equity securities bought and held primarily for sale in the near term, and accounted for at fair value, with unrealized holding gains and losses included in earnings.

Also, in June 2016, the FASB issued ASU No. 2016-13, *Financial Instruments—Credit Losses (Topic 326)*. This Update will change the method which entities measure impairment losses on financial assets which are measured at amortized cost, namely loans, debt securities, trade receivables, net investments in leases, off-balance-sheet credit exposures, reinsurance receivables, and any other financial assets not excluded from the scope that have the contractual right to receive cash. Additionally, the Update introduces a new model for measuring impairment losses for available-for-sale debt securities. The Update became effective for public entities that are SEC registrants for fiscal years beginning after December 15, 2019, and one year later for public business entities which are not SEC registrants. ASC 326 will be effective for non-public business entities for fiscal years beginning on or after December 15, 2022.

With the effective date of ASU No. 2016-13, certain disclosures related to debt securities will change.

1. ASC 320 Debt securities disclosure requirements

The following disclosure requirements in accordance with ASC 320 are required for securities held at the end of all interim and annual periods presented in the financial statements. With the effective date of ASU No. 2016-01, these disclosure requirements are now only applicable for debt securities.

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According to ASC 320, major security types should be based on the nature and risks of the security. Entities should consider disaggregation based on common characteristics.

In determining whether disclosure for a particular security type is necessary and whether it is necessary to further separate a particular security type into greater detail, an entity should consider all of the following: shared activity or business sector, vintage, geographic concentration, credit quality, and economic characteristics.

For securities classified as available-for-sale, all reporting entities should disclose all of the following by major security type as of each date for which a statement of financial position is presented:

- Amortized cost basis;
- Aggregate fair value;
- Total other-than-temporary impairment recognized in accumulated other comprehensive income;
- Total gains for securities with net gains in accumulated other comprehensive income;
- Total losses for securities with net losses in accumulated other comprehensive income; and
- Information about the contractual maturities of those securities as of the date of the most recent statement of financial position presented (maturity information may be combined in appropriate groupings). Securities not due at a single maturity date, such as mortgage-backed securities, can be disclosed separately rather than allocated over several maturity groupings (if allocated, the basis for allocation should be disclosed).

Upon adoption of 2016-13 the following disclosures will replace those above:

- Amortized cost basis
- Aggregate fair value
- Total allowance for credit losses
- Total unrealized gains for securities with net gains in accumulated other comprehensive income
- Total unrealized losses for securities with net losses in accumulated other comprehensive income
- Information about the contractual maturities of those securities as of the date of the most recent statement of financial position presented.

For securities classified as held-to-maturity, all reporting entities should disclose all of the following by major security type as of each date for which a statement of financial position is presented:

- Amortized cost basis;
- Net carrying amount;
- Total other-than-temporary impairment recognized in accumulated other comprehensive income;
- Gross gains and losses in accumulated other comprehensive income for any derivatives that hedged the forecasted acquisition of the held-to-maturity securities;
- Information about the contractual maturities of those securities as of the date of the most recent statement of financial position presented (maturity information may be combined in appropriate groupings.) In complying with this requirement, financial institutions [see paragraph 942-320-50-1] shall disclose the net carrying amount of debt securities on the basis of at least the following four maturity groupings:

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1. Within one year
2. After one year through five years
3. After 5 years through 10 years
4. After 10 years.

Securities not due at a single maturity date, such as mortgage-backed securities, may be disclosed separately rather than allocated over several maturity groupings; if allocated, the basis for allocation also shall be disclosed.)

Upon adoption of 2016-13 the disclosures below will replace those above:

- Amortized cost basis
- Total allowance for credit losses
- Net carrying amount
- Gross gains and losses in accumulated other comprehensive income for any derivatives that hedged the forecasted acquisition of the held-to-maturity securities

Information about the contractual maturities of those securities as of the date of the most recent statement of financial position presented. (Maturity information may be combined in appropriate groupings. In complying with this requirement, financial institutions [see paragraph 942-320-50-1] shall disclose the net carrying amount of debt securities on the basis of at least the following four maturity groupings:

1. Within one year
2. After one year through five years
3. After 5 years through 10 years
4. After 10 years.

Securities not due at a single maturity date, such as mortgage-backed securities, may be disclosed separately rather than allocated over several maturity groupings; if allocated, the basis for allocation also shall be disclosed.)

For all investments in an unrealized loss position for which other-than-temporary impairments have not been recognized in earnings (including investments for which a portion of an other-than-temporary impairment has been recognized in other comprehensive income), an entity should disclose all of the following in its interim and annual financial statements:

a. As of each date for which a statement of financial position is presented, quantitative information, aggregated by category of investment – each major security type that the entity discloses in accordance with ASC 320 and cost-method investments – in tabular form:
    1. The aggregate related fair value of investments with unrealized losses; and
    2. The aggregate amount of unrealized losses (that is, the amount by which amortized cost basis exceeds fair value).
b. As of the date of the most recent statement of financial position, additional information (in narrative form) that provides sufficient information to allow financial statement users to understand the quantitative disclosures and the information that the entity considered (both positive and negative) in reaching the conclusion that the impairment or impairments are not other than temporary. The disclosures required may be aggregated

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by investment categories, but individually significant unrealized losses generally should not be aggregated. This disclosure could include all of the following:

1. The nature of the investment;
2. The cause of the impairment;
3. The number of investment positions that are in an unrealized loss position;
4. The severity and duration of the impairment;

- Other evidence considered by the investor in reaching its conclusion that the investment is not other-than-temporarily impaired an allowance for credit losses is not necessary, including, for example, any of the following:
  - Performance indicators of the underlying assets in the security, including any of the following:
    - Default rates
    - Delinquency rates
    - Percentage of nonperforming assets.
    - Debt-to-collateral-value ratios
    - Third-party guarantees
    - Current levels of subordination
    - Vintage
    - Geographic concentration
    - Industry analyst reports
    - Credit ratings
    - Volatility of the security's fair value
    - Interest rate changes since purchase xi. Any other information that the investor considers relevant

The disclosures in (a)(1) and (a)(2) above should be segregated by those investments that have been in a continuous unrealized loss position for less than 12 months and those that have been in a continuous unrealized loss position for 12 months or longer. The reference point for determining how long an investment has been in a continuous unrealized loss position is the balance sheet date of the reporting period in which the impairment is identified. For entities that do not prepare interim financial information, the reference point is the annual balance sheet date of the period during which the impairment was identified. The continuous unrealized loss position ceases upon the recognition of the total amount by which amortized cost basis exceeds fair value as an other-than-temporary impairment in earnings; or the investor becoming aware of a recovery of fair value up to (or beyond) the amortized cost basis of the investment during the period.

For interim and annual periods in which an other-than-temporary impairment of a debt security is recognized and only the amount related to a credit loss was recognized in earnings, an entity should disclose by major security type, the methodology and significant inputs used to measure the amount related to credit loss.

For each interim and annual reporting period presented, an entity should disclose a tabular rollforward of the amount related to credit losses recognized in earnings in accordance with ASC 320-10-35-34D, which should include at a minimum, all of the following:

- The beginning balance of the amount related to credit losses on debt securities held by the entity at the beginning of the period for which a portion of an other-than-temporary impairment was recognized in other comprehensive income;

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- Additions for the amount related to the credit loss for which an other-than-temporary impairment was not previously recognized;
- Reductions for securities sold during the period (realized);
- Reductions for securities for which the amount previously recognized in other comprehensive income was recognized in earnings because the entity intends to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis;
- If the entity does not intend to sell the security and it is not more likely than not that the entity will be required to sell the security before recovery of its amortized cost basis, additional increases to the amount related to the credit loss for which an other-than-temporary impairment was previously recognized;
- Reductions for increases in cash flows expected to be collected that are recognized over the remaining life of the security; and
- The ending balance of the amount related to credit losses on debt securities held by the entity at the end of the period for which a portion of an other-than-temporary impairment was recognized in other comprehensive income.

In addition to the details above, for each period for which the results of operations are presented, an entity should disclose all of the following:

a. The proceeds from sales of available-for-sale securities and the gross realized gains and gross realized losses that have been included in earnings as a result of those sales;
b. The basis on which the cost of a security sold or the amount reclassified out of accumulated other comprehensive income into earnings was determined (that is, specific identification, average cost, or other method used);
c. The gross gains and gross losses included in earnings from transfers of securities from the available-for-sale category into the trading securities category;
d. The amount of the net unrealized holding gain or loss on available-for-sale securities for the period that has been included in accumulated other comprehensive income and the amount of gains and losses reclassified out of accumulated other comprehensive income into earnings for the period; and
e. The portion of trading gains and losses for the period that relates to trading securities still held at the reporting date.

For any sales of or transfers from securities classified as held-to-maturity, an entity should disclose all of the following in the notes to the financial statements for each period for which the results of operations are presented:

a. The net carrying amount of the sold or transferred security;
b. The net gain or loss in accumulated other comprehensive income for any derivative that hedged the forecasted acquisition of the held-to-maturity security;
c. The related realized or unrealized gain or loss; and
d. The circumstances leading to the decision to sell or transfer the security.

ASC 320-10-25-14 sets forth the conditions under which sales of debt securities may be considered as maturities for purposes of the disclosure requirements above. All sales or transfers of held-to-maturity securities are subject to the disclosure requirements above regardless of the treatment of remaining held-to-maturity securities.

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The disclosures in ASC 320 are required to be made in all complete sets of financial statements for interim periods, for example, in conjunction with a securities registration statement.

The minimum disclosure requirements for summarized interim financial information issued by publicly traded entities are established by ASC 270, *Interim Reporting*. Summarized financial information does not need to include the disclosures.

The portion of trading gains and losses for the period related to trading securities still held at the reporting date is calculated as follows:

Net gains and losses recognized during the period on trading securities	$100
Less: net gains and losses recognized during the period on trading securities sold during the period	(25)
Unrealized gains and losses recognized during the reporting period on trading securities still held at the reporting date	$75

Additionally, entities should consider the disclosures required by ASC 825, *Financial Instruments*, and by ASC 820, *Fair Value Measurements*. Investments in debt and equity securities are financial instruments and ASC 825, *Financial Instruments*, requires disclosure of the fair value of those investments for which it is practicable to estimate that value, the methods and assumptions used in estimating the fair value of marketable securities, and a description of any changes in the methods and assumptions during the period. Under ASC 825-10-50-3, the fair value disclosures are optional for certain nonpublic entities with assets less than $100 million.

For assets and liabilities measured at fair value, whether on a recurring or nonrecurring basis, ASC 820 specifies the required disclosures concerning the inputs used to measure fair value. ASC 820-10-50-1 explains that the reporting entity should disclose information that enables users of its financial statements to assess the following: (a) for assets and liabilities measured at fair value on a recurring or nonrecurring basis in the statement of financial position after initial recognition, the valuation techniques and inputs used to develop those measurements; and (b) for recurring fair value measurements using significant unobservable inputs (Level 3), the effect of the measurements on earnings or other comprehensive income for the period.

Further, ASC 820-10-50-2 states that the reporting entity should disclose all of the following information for each interim and annual period separately for each class of assets and liabilities:

a. The fair value measurement at the reporting date.
b. The level within the fair value hierarchy in which the fair value measurement in its entirety falls (quoted prices in active markets for identical assets or liabilities—Level 1, significant other observable inputs—Level 2; significant unobservable inputs—Level 3).
c. The amounts of significant transfers between Level 1 and Level 2 and the reasons for the transfers.
d. For Level 3 measurements, a reconciliation of beginning and ending balances showing gains and losses for the period (realized and unrealized), purchases, sales, issuances, and settlements, and transfers in or out of Level 3 and reasons for those transfers.
e. For Level 3 measurements, the amount of total gains or losses for the period that are attributable to the change in unrealized gains or losses relating to those assets and

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liabilities still held at the reporting date and a description of where those unrealized gains or losses are reported in the statement of income (or activities).

f. For Level 2 and Level 3 measurements, a description of the valuation technique and the inputs used in determining the fair values of each class of assets or liabilities.

g. For recurring fair value measurements in Level 3, a narrative description of the sensitivity of the fair value measurement to changes in unobservable inputs if a change in those inputs to a different amount might result in a significantly higher or lower fair value measurement.

h. For recurring and nonrecurring fair value measurements, if the highest and best use of a nonfinancial asset differs from its current use, the reason why the asset is being used in a manner that differs from its highest and best use.

ASC 825 permits entities to choose to measure at fair value many financial instruments and certain other items that are not currently required to be measured at fair value. Further, under ASC 825, a business entity should report unrealized gains and losses on eligible items for which the fair value option has been elected in earnings at each subsequent reporting date. The irrevocable election of the fair value option is made on an instrument-by-instrument basis, with certain exceptions, and applied to the entire instrument, not only to specified risks, specific cash flows, or portions of that instrument. ASC 825 also establishes presentation and disclosure requirements designed to facilitate comparison between entities that choose different measurement attributes for similar types of assets and liabilities. The required disclosures are optional for certain nonpublic entities.

Clearly disclosures for marketable securities are voluminous, with the required disclosures concerning fair value potentially difficult to develop, especially for many smaller and medium-sized entities and for private entities. However, to a major degree, an entity can control the amount and complexity of the disclosures which it is required to make by its selection of marketable securities in which to invest and its policy toward managing its portfolio.

In our disclosure examples, we will provide a simplified example of the quantitative disclosures required under ASC 825. Then we will look at the actual disclosures for an SEC registrant, realizing that its disclosure will be more detailed than that for most smaller and medium-sized entities.

2. ASC 321 Equity securities disclosure requirements

The disclosure requirements for marketable equity securities are found in ASC 321-10-50. The disclosures in this codification section are for all interim and annual periods, as applicable.

ASC 321 defines an Equity Security any security representing an ownership interest in an entity (for example, common, preferred, or other capital stock) or the right to acquire (for example, warrants, rights, and call options) or dispose of (for example, put options) an ownership interest in an entity at fixed or determinable prices. The term equity security does not include any of the following:

a. Written equity options (because they represent obligations of the writer, not investments).

b. Cash-settled options on equity securities or options on equity-based indexes (because those instruments do not represent ownership interests in an entity).

c. Convertible debt or preferred stock that by its terms either must be redeemed by the issuing entity or is redeemable at the option of the investor.

ASC 321 use the following definition of marketable securities with Readily Determinable Fair Value:

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- An equity security has a readily determinable fair value if it meets any of the following conditions:
    a. The fair value of an equity security is readily determinable if sales prices or bid-and-asked quotations are currently available on a securities exchange registered with the U.S. Securities and Exchange Commission (SEC) or in the over-the-counter market, provided that those prices or quotations for the over-the-counter market are publicly reported by the National Association of Securities Dealers Automated Quotations systems or by Pink Sheets LLC. Restricted stock meets that definition if the restriction terminates within one year.
    b. The fair value of an equity security traded only in a foreign market is readily determinable if that foreign market is of a breadth and scope comparable to one of the U.S. markets referred to above.
    c. The fair value of an investment in a mutual fund is readily determinable if the fair value per share (unit) is determined and published and is the basis for current transactions.

An entity that applies the guidance in paragraph 321-10-35-2 for equity securities without readily determinable fair values shall disclose all of the following:

a. The carrying amount of investments without readily determinable fair values;
b. The amount of impairments and downward adjustments, if any, both annual and cumulative;
c. The amount of upward adjustments, if any, both annual and cumulative; and
d. As of the date of the most recent statement of financial position, additional information (in narrative form) that is sufficient to permit financial statement users to understand the quantitative disclosures and the information that the entity considered in reaching the carrying amounts and upward or downward adjustments resulting from observable price changes.

For each period for which the results of operations are presented, an entity shall disclose the portion of unrealized gains and losses for the period that relates to equity securities still held at the reporting date. The portion of unrealized gains and losses for the period related to equity securities still held at the reporting date is calculated as follows.

Net gains and losses recognized during the period on equity securities	$105
Less: net gains and losses recognized during the period on equity securities sold during the period	(80)
Unrealized gains and losses recognized during the reporting period on equity securities still held at the reporting date	$25

3. Sample disclosure – ASC 825 quantitative example for debt securities

Note: One year presented only for illustrative purposes.

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AVAILABLE-FOR-SALE SECURITIES

The following table summarizes the unrealized positions for available-for-sale fixed maturity securities, by class of investment, as of December 31, 2021:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Total OTTI in AOCI
U.S. Treasury Securities	125	10	3	132	0
Corporate Bonds	200	20	5	215	5
Asset-Backed Securities	30	10	3	37	3
Total Fixed Maturities	**355**	**40**	**11**	**384**	**8**

The following table summarizes the unrealized positions for held-to-maturity securities, disaggregated by class of instrument, as of December 31, 2021:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Treasury Securities	75	17	7	85
Corporate Bonds	125	15	10	130
Asset-Backed Securities	35	7	2	40
Total Fixed Maturities	**235**	**39**	**19**	**255**

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The following table summarizes the fair value and amortized cost of available-for-sale and held-to-maturity securities by contractual maturity, as of December 31, 2021:

	Available-for-Sale		Held-to-Maturity	
	Amortized Cost	**Fair Value**	**Amortized Cost**	**Fair Value**
Due within One Year	50	51	75	82
Due After One Year Through Five Years	40	42	40	43
Due After Five Years Through Ten Years	125	134	30	32
Due After Ten Years	110	120	55	58
Asset Backed Securities	30	37	35	40
Total	**355**	**384**	**235**	**255**

The following table summarizes the fair value and gross unrealized losses aggregated by category and length of time that individual securities have been in a continuous unrealized loss position, for the year ended December 31, 2021:

	Less than 12 months		Greater than 12 months		Total	
	Fair Value	**Gross Unrealized Loss**	**Fair Value**	**Gross Unrealized Loss**	**Fair Value**	**Gross Unrealized Loss**
U.S. Treasury Securities	190	8	27	2	217	10
Corporate Bonds	300	11	45	4	345	15
Asset-Backed Securities	60	4	17	1	77	5
Total Debt Securities	**550**	**23**	**89**	**7**	**639**	**30**

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The following table summarizes the gross unrealized gains and losses from sales or maturities of available-for-sale securities, for the year ended December 31, 2021:

	Gross Realized Gains	Gross Realized Losses	Gross Proceeds from Sales	Gross Proceeds from Maturities
Fixed-Maturity AFS Securities	12	19	43	0

4. Disclosure example – Caterpillar Inc.

Investments in debt and equity securities

We have investments in certain debt and equity securities, which we record at fair value and primarily include in Other assets.

We classify debt securities primarily as available-for-sale. We include the unrealized gains and losses arising from the revaluation of available-for-sale debt securities, net of applicable deferred income taxes, in equity (accumulated other comprehensive income). We include the unrealized gains and losses arising from the revaluation of the equity securities in Other income (expense) in Statement 1. We generally determine realized gains and losses on sales of investments using the specific identification method for available-for-sale debt and equity securities and include them in Other income (expense) in Statement 1.

The cost basis and fair value of available-for-sale debt securities with unrealized gains and losses included in equity (AOCI in Statement 3) were as follows:

Available-for-sale debt securities	December 31, 2022			December 31, 2021		
(Millions of dollars)	Cost Basis	Unrealized Pretax Net Gains (Losses)	Fair Value	Cost Basis	Unrealized Pretax Net Gains (Losses)	Fair Value
Government debt securities						
U.S. treasury bonds	$ 9	$ —	$ 9	$ 10	$ —	$ 10
Other U.S. and non-U.S. government bonds	60	(5)	55	61	—	61
Corporate debt securities						
Corporate bonds and other debt securities	2,561	(95)	2,466	1,027	19	1,046
Asset-backed securities	187	(5)	182	175	1	176
Mortgage-backed debt securities						
U.S. governmental agency	364	(31)	333	319	6	325
Residential	3	(1)	2	4	—	4
Commercial	127	(10)	117	98	1	99
Total available-for-sale debt securities	$ 3,311	$ (147)	$ 3,164	$ 1,694	$ 27	$ 1,721

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Available-for-sale debt securities in an unrealized loss position:

(Millions of dollars)	December 31, 2022					
	Less than 12 months [1]		12 months or more [1]		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Government debt securities						
Other U.S. and non-U.S. government bonds	$ 19	$ 1	$ 20	$ 4	$ 39	$ 5
Corporate debt securities						
Corporate bonds	1,815	46	357	50	2,172	96
Asset-backed securities	75	2	55	3	130	5
Mortgage-backed debt securities						
U.S. governmental agency	229	16	98	15	327	31
Residential	2	—	1	1	3	1
Commercial	63	5	54	5	117	10
	$ 2,203	$ 70	$ 585	$ 78	$ 2,788	$ 148

(Millions of dollars)	December 31, 2021					
	Less than 12 months [1]		12 months or more [1]		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Corporate debt securities						
Corporate bonds	$ 270	$ 4	$ 33	$ 1	$ 303	$ 5
Mortgage-backed debt securities						
U.S. governmental agency	89	1	22	—	111	1
Total	$ 359	$ 5	$ 55	$ 1	$ 414	$ 6

[1] Indicates the length of time that individual securities have been in a continuous unrealized loss position.

The unrealized losses on our investments in government debt securities, corporate debt securities, and mortgage-backed debt securities relate to changes in interest rates and credit-related yield spreads since time of purchase. We do not intend to sell the investments, and it is not likely that we will be required to sell the investments before recovery of their respective amortized cost basis. In addition, we did not expect credit-related losses on these investments as of December 31, 2022.

The cost basis and fair value of available-for-sale debt securities at December 31, 2022, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to prepay and creditors may have the right to call obligations.

(Millions of dollars)	December 31, 2022	
	Cost Basis	Fair Value
Due in one year or less	**$ 844**	**$ 834**
Due after one year through five years	**1,642**	**1,568**
Due after five years through ten years	**260**	**241**
Due after ten years	**71**	**69**
U.S. governmental agency mortgage-backed securities	**364**	**333**
Residential mortgage-backed securities	**3**	**2**
Commercial mortgage-backed securities	**127**	**117**
Total debt securities – available-for-sale	**$ 3,311**	**$ 3,164**

Sales of available-for-sale debt securities:

(Millions of dollars)	Years Ended December 31,		
	2022	2021	2020
Proceeds from the sale of available-for-sale securities	**$ 767**	$ 454	$ 290
Gross gains from the sale of available-for-sale securities	**$ —**	$ 4	$ 2
Gross losses from the sale of available-for-sale securities	**$ 5**	$ —	$ 1

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We did not have any investments classified as held-to-maturity debt securities as of December 31, 2022. We had $964 million of investments in time deposits classified as held-to-maturity debt securities as of December 31, 2021. All these investments mature within one year and we include them in Prepaid expenses and other current assets in Statement 3. We record held-to-maturity debt securities at amortized cost, which approximates fair value.

For the years ended December 31 2022 and 2021, the net unrealized gains (losses) for equity securities held at December 31, 2022 and 2021 were $(49) million and $105 million, respectively.

Fair value measurements

The guidance on fair value measurements defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants. This guidance also specifies a fair value hierarchy based upon the observability of inputs used in valuation techniques. Observable inputs (highest level) reflect market data obtained from independent sources, while unobservable inputs (lowest level) reflect internally developed market assumptions. In accordance with this guidance, fair value measurements are classified under the following hierarchy:

- Level 1 – Quoted prices for identical instruments in active markets.
- Level 2 – Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations in which all significant inputs or significant value-drivers are observable in active markets.
- Level 3 – Model-derived valuations in which one or more significant inputs or significant value-drivers are unobservable.

When available, we use quoted market prices to determine fair value, and we classify such measurements within Level 1. In some cases where market prices are not available, we make use of observable market based inputs to calculate fair value, in which case the measurements are classified within Level 2. If quoted or observable market prices are not available, fair value is based upon valuations in which one or more significant inputs are unobservable, including internally developed models that use, where possible, current market-based parameters such as interest rates, yield curves and currency rates. These measurements are classified within Level 3.

We classify fair value measurements according to the lowest level input or value-driver that is significant to the valuation. We may therefore classify a measurement within Level 3 even though there may be significant inputs that are readily observable.

Fair value measurement includes the consideration of nonperformance risk. Nonperformance risk refers to the risk that an obligation (either by a counterparty or Caterpillar) will not be fulfilled. For financial assets traded in an active market (Level 1 and certain Level 2), the nonperformance risk is included in the market price. For certain other financial assets and liabilities (certain Level 2 and Level 3), our fair value calculations have been adjusted accordingly.

Investments in debt and equity securities We have investments in certain debt and equity securities that are recorded at fair value. Fair values for our U.S. treasury bonds and large capitalization value and smaller company growth equity securities are based upon valuations for identical instruments in active markets. Fair values for other government debt securities, corporate debt securities and mortgage-backed

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debt securities are based upon models that take into consideration such market based factors as recent sales, risk-free yield curves and prices of similarly rated bonds.

We also have investments in time deposits classified as held-to-maturity debt securities. The fair value of these investments is based upon valuations observed in less active markets than Level 1. These investments have a maturity of less than one year and are recorded at amortized costs, which approximate fair value.

In addition, Insurance Services has an equity investment in a real estate investment trust (REIT) which is recorded at fair value based on the net asset value (NAV) of the investment and is not classified within the fair value hierarchy.

See Note 11 for additional information on our investments in debt and equity securities.

Derivative financial instruments
The fair value of interest rate contracts is primarily based on a standard industry accepted valuation model that utilizes the appropriate market-based forward swap curves and zero-coupon interest rates to determine discounted cash flows. The fair value of foreign currency and commodity forward, option and cross currency contracts is based on standard industry accepted valuation models that discount cash flows resulting from the differential between the contract price and the market-based forward rate.

See Note 4 for additional information

Assets and liabilities measured on a recurring basis at fair value included in Statement 3 as of December 31, 2022 and 2021 were as follows:

	December 31, 2022				
(Millions of dollars)	**Level 1**	**Level 2**	**Level 3**	**Measured at NAV**	**Total Assets / Liabilities, at Fair Value**
Assets					
Debt securities					
Government debt securities					
U.S. treasury bonds	$ 9	$ —	$ —	$ —	$ 9
Other U.S. and non-U.S. government bonds	—	55	—	—	55
Corporate debt securities					
Corporate bonds and other debt securities	—	2,416	50	—	2,466
Asset-backed securities	—	182	—	—	182
Mortgage-backed debt securities					
U.S. governmental agency	—	333	—	—	333
Residential	—	2	—	—	2
Commercial	—	117	—	—	117
Total debt securities	9	3,105	50	—	3,164
Equity securities					
Large capitalization value	203	—	—	—	203
Smaller company growth	31	—	—	—	31
REIT	—	—	—	207	207
Total equity securities	234	—	—	207	441
Derivative financial instruments - assets					
Foreign currency contracts - net	—	328	—	—	328
Commodity contracts - net	—	15	—	—	15
Total assets	$ 243	$ 3,448	$ 50	$ 207	$ 3,948
Liabilities					
Derivative financial instruments - liabilities					
Interest rate contracts - net	—	195	—	—	195
Total liabilities	$ —	$ 195	$ —	$ —	$ 195

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(Millions of dollars)	December 31, 2021 Level 1	Level 2	Level 3	Measured at NAV	Total Assets / Liabilities, at Fair Value
Assets					
Debt securities					
Government debt securities					
U.S. treasury bonds	$ 10	$ —	$ —	$ —	$ 10
Other U.S. and non-U.S. government bonds	—	61	—	—	61
Corporate debt securities					
Corporate bonds and other debt securities	—	1,046	—	—	1,046
Asset-backed securities	—	176	—	—	176
Mortgage-backed debt securities					
U.S. governmental agency	—	325	—	—	325
Residential	—	4	—	—	4
Commercial	—	99	—	—	99
Total debt securities	10	1,711	—	—	1,721
Equity securities					
Large capitalization value	217	—	—	—	217
Smaller company growth	98	—	—	—	98
REIT	—	—	—	167	167
Total equity securities	315	—	—	167	482
Derivative financial instruments - assets					
Foreign currency contracts - net	—	168	—	—	168
Interest rate contracts - net	—	23	—	—	23
Commodity contracts - net	—	21	—	—	21
Total Assets	$ 325	$ 1,923	$ —	$ 167	$ 2,415

In addition to the amounts above, certain Cat Financial loans are subject to measurement at fair value on a nonrecurring basis and are classified as Level 3 measurements. A loan is measured at fair value when management determines that collection of contractual amounts due is not probable and the loan is individually evaluated. In these cases, an allowance for credit losses may be established based either on the present value of expected future cash flows discounted at the receivables' effective interest rate, the fair value of the collateral for collateral-dependent receivables, or the observable market price of the receivable. In determining collateral value, Cat Financial estimates the current fair market value of the collateral less selling costs. Cat Financial had loans carried at fair value of $68 million and $100 million as of December 31, 2022 and 2021, respectively.

Fair values of financial instruments

In addition to the methods and assumptions we use to record the fair value of financial instruments as discussed in the Fair value measurements section above, we use the following methods and assumptions to estimate the fair value of our financial instruments:

Cash and cash equivalents

Carrying amount approximates fair value. We classify cash and cash equivalents as Level 1. See Statement 3.

Restricted cash and short-term investments

Carrying amount approximates fair value. We include restricted cash and short-term investments in Prepaid expenses and other current assets in Statement 3. We classify these instruments as Level 1 except for time deposits which are Level 2, and certain corporate debt securities which are Level 3. See Note 11 for additional information.

Finance receivables

We estimate fair value by discounting the future cash flows using current rates, representative of receivables with similar remaining maturities.

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Wholesale inventory receivables
We estimate fair value by discounting the future cash flows using current rates, representative of receivables with similar remaining maturities.

Short-term borrowings
Carrying amount approximates fair value. We classify short-term borrowings as Level 1. See Note 13 for additional information.

Long-term debt
We estimate fair value for fixed and floating rate debt based on quoted market prices.

Guarantees
The fair value of guarantees is based upon our estimate of the premium a market participant would require to issue the same guarantee in a stand-alone arms-length transaction with an unrelated party. If quoted or observable market prices are not available, fair value is based upon internally developed models that utilize current market-based assumptions. We classify guarantees as Level 3. See Note 21 for additional information.

Our financial instruments not carried at fair value were as follows:

	2022		2021			
(Millions of dollars)	**Carrying Amount**	**Fair Value**	Carrying Amount	Fair Value	Fair Value Levels	Reference
Assets at December 31,						
Finance receivables–net (excluding finance leases [1])	**$ 13,965**	**$ 13,377**	$ 13,837	$ 13,836	3	Notes 7 & 19
Wholesale inventory receivables–net (excluding finance leases [1])	**827**	**778**	773	753	3	Notes 7 & 19
Liabilities at December 31,						
Long-term debt (including amounts due within one year):						
Machinery, Energy & Transportation	**9,618**	**9,240**	9,791	12,420	2	Note 14
Financial Products	**21,418**	**20,686**	22,594	22,797	2	Note 14

[1] Represents finance leases and failed sale leasebacks of $7,325 million and $8,083 million at December 31, 2022 and 2021, respectively.

5. ASU No. 2018-13: Fair Value Measurement (Topic 820): Disclosure Framework—Changes to the Disclosure Requirements for Fair Value Measurement

The amendments in this Update are the result of the FASB's final deliberations of the concepts in the Concepts Statement as they relate to fair value measurement disclosures.

The purpose of the FASB's Disclosure Framework Project and its subsequent update of FASB Concepts Statement, *Conceptual Framework for Financial Reporting—Chapter 8: Notes to Financial Statements,* is discussed under the discussion of ASU No. 2018-14.

The amendments in this Update apply to all entities that are required, under existing GAAP, to make disclosures about recurring or nonrecurring fair value measurements.
ASU No. 2018-13 modifies the disclosure requirements on fair value measurements in Topic 820, *Fair Value Measurement*, based on the concepts in the Concepts Statement, including the consideration of costs and benefits.

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The following disclosure requirements were removed from Topic 820:

- The amount of and reasons for transfers between Level 1 and Level 2 of the fair value hierarchy.
- The policy for timing of transfers between levels.
- The valuation processes for Level 3 fair value measurements.
- For nonpublic entities, the changes in unrealized gains and losses for the period included in earnings for recurring Level 3 fair value measurements held at the end of the reporting period.

The following disclosure requirements were modified in Topic 820:

- In lieu of a rollforward for Level 3 fair value measurements, a nonpublic entity is required to disclose transfers into and out of Level 3 of the fair value hierarchy and purchases and issues of Level 3 assets and liabilities.
- For investments in certain entities that calculate net asset value, an entity is required to disclose the timing of liquidation of an investee's assets and the date when restrictions from redemption might lapse only if the investee has communicated the timing to the entity or announced the timing publicly.
- The amendments clarify that the measurement uncertainty disclosure is to communicate information about the uncertainty in measurement as of the reporting date.

The following disclosure requirements were added to Topic 820; however, the disclosures are not required for nonpublic entities:

- The changes in unrealized gains and losses for the period included in other comprehensive income for recurring Level 3 fair value measurements held at the end of the reporting period.
- The range and weighted average of significant unobservable inputs used to develop Level 3 fair value measurements. For certain unobservable inputs, an entity may disclose other quantitative information (such as the median or arithmetic average) in lieu of the weighted average if the entity determines that other quantitative information would be a more reasonable and rational method to reflect the distribution of unobservable inputs used to develop Level 3 fair value measurements.

In addition, the amendments eliminate "at a minimum" from the phrase "an entity shall disclose at a minimum" to promote the appropriate exercise of discretion by entities when considering fair value measurement disclosures and to clarify that materiality is an appropriate consideration of entities and their auditors when evaluating disclosure requirements.

The amendments in the Update became effective for all 2020 calendar year-end reporting entities.

The amendments on changes in unrealized gains and losses, the range and weighted average of significant unobservable inputs used to develop Level 3 fair value measurements, and the narrative description of measurement uncertainty should be applied prospectively for only the most recent interim or annual period presented in the initial fiscal year of adoption.

All other amendments should be applied retrospectively to all periods presented upon their effective date.

C. Receivables

ASC 310, *Receivables*, includes extensive requirements and guidance on a variety of accounting and disclosure issues related to receivables. However, these disclosures will vary greatly based on the complexity of an entity's business, especially with regard to the types of credit that an entity offers to its customers. Additionally, with the issuance of ASU No. 2016-13, entities will apply the current estimate of

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credit losses approach (CECL) to their receivables balances. However, as many were already using elements of the CECL approach in following applicable accounting guidance, the move from an incurred loss model is likely to not result in a significant change in accounting policy. As we discussed earlier, entities should consider the disclosure of the potential impact of adopting new accounting standards, and we will discuss the disclosure requirements of ASC 326 (which were brought about by ASU 2016-13) in more detail below.

Receivables can arise from credit sales, loans, or other transactions. For financial statement purposes, receivables are generally classified as *trade receivables* or *nontrade receivables*.

Trade receivables are amounts owed by customers for goods and services sold in the normal course of business operations, for example, open credit accounts and installment contracts. Nontrade receivables arise outside the normal course of business operations, for example, advances to officers and employees, interest and dividend receivables, and receivables from the sale of assets. Valuation allowances for losses/impairments on receivables should be recorded if a loss is probable and the amount of the loss can be reasonably estimated and should be deducted from the related receivables.

One thing to note before we dive into the disclosure requirements – in accordance with ASC 825, *Financial Instruments*, no disclosure is required for trade receivables if their carrying amount approximates their fair value.

1. Disclosure requirements

As we said, ASC 310 provides extensive disclosure guidance for receivables, including those covering:

- Accounting policies for loans and trade receivables
- Assets serving as collateral
- Foreclosed and repossessed assets
- Risks and uncertainties
- Fair value disclosures
- Modifications.

2. Accounting policies for loans and trade receivables

According to ASC 310, the “summary of significant accounting policies” disclosure should include:

- The basis for accounting for loans and trade receivables
- The method used in determining the lower of amortized cost basis or fair value of nonmortgage loans held for sale (that is, aggregate or individual asset basis)
- The classification and method of accounting for interest-only strips, loans, other receivables, or retained interests in securitizations that can be contractually prepaid or otherwise settled in a way that the holder would not recover substantially all of its recorded investment

The method for recognizing interest income on loan and trade receivables, including a statement about the entity's policy for treatment of related fees and costs, including the method of amortizing net deferred fees or costs.

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In addition:

- If major categories of loans or trade receivables are not presented separately in the balance sheet, they should be presented in the notes to the financial statements.
- The allowance for credit losses and, as applicable, any unearned income, any unamortized premiums and discounts, and any net unamortized deferred fees and costs, shall be disclosed in the financial statements.

3. Accounting policies for off-balance-sheet credit exposures

ASC 326 requires an entity to disclose a description of the accounting policies and methodology the entity used to estimate its liability for off-balance-sheet credit exposures (credit exposures on off-balance-sheet loan commitments, standby letters of credit, financial guarantees, and other similar instruments, except for instruments within the scope of ASC 815, *Derivatives and Hedging*) and related charges for those credit exposures. Such a description should identify the factors that influenced management's judgment, for example, historical losses and existing economic conditions, and a discussion of risk elements relevant to particular categories of financial instruments.

4. Foreclosed and repossessed assets

ASC 310-10-45-3 (other presentation matters) states that foreclosed and repossessed assets included in other assets on the balance sheet should have separate disclosures in the notes to financial statements

5. Allowance for credit losses

ASC 326 requires an entity to provide information that enables a financial statement user to do the following:

- Understand management's method for developing its allowance for credit losses
- Understand the information that management used in developing its current estimate of expected credit losses
- Understand the circumstances that caused changes to the allowance for credit losses, thereby affecting the related credit loss expense (or reversal) reported for the period.

To meet the objectives, an entity shall disclose all of the following by portfolio segment and major security type:

- A description of how expected loss estimates are developed
- A description of the entity's accounting policies and methodology to estimate the allowance for credit losses, as well as a discussion of the factors that influenced management's current estimate of expected credit losses, including:
    - Past events
    - Current conditions
    - Reasonable and supportable forecasts about the future.
- A discussion of risk characteristics relevant to each portfolio segment
- A discussion of the changes in the factors that influenced management's current estimate of expected credit losses and the reasons for those changes (for example, changes in portfolio composition, underwriting practices, and significant events or conditions that affect the current estimate but were not contemplated or relevant during a previous period)
- Identification of changes to the entity's accounting policies, changes to the methodology from the prior period, its rationale for those changes, and the quantitative effect of those changes
- Reasons for significant changes in the amount of write-offs, if applicable

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- A discussion of the reversion method applied for periods beyond the reasonable and supportable forecast period
- The amount of any significant purchases of financial assets during each reporting period
- The amount of any significant sales of financial assets or reclassifications of loans held for sale during each reporting period.

ASC 326 explains that a creditor that measures expected credit losses based on a discounted cash flow method is permitted to report the entire change in present value as credit loss expense (or reversal of credit loss expense) but also may report the change in present value attributable to the passage of time as interest income. Creditors that choose the latter alternative shall disclose the amount recorded to interest income that represents the change in present value attributable to the passage of time.

Furthermore, to enable a financial statement user to understand the activity in the allowance for credit losses for each period, an entity shall separately provide by portfolio segment and major security type the quantitative disclosures of the activity in the allowance for credit losses for applicable financial assets, including all of the following:

- The beginning balance in the allowance for credit losses
- Current-period provision for expected credit losses
- The initial allowance for credit losses recognized on financial assets accounted for as purchased financial assets with credit deterioration (including beneficial interests that meet the criteria in paragraph 325-40-30-1A), if applicable
- Write-offs charged against the allowance
- Recoveries of amounts collected
- The ending balance in the allowance for credit losses.

Past Due Status

To enable a financial statement user to understand the extent of financial assets that are past due, an entity shall provide an aging analysis of the amortized cost basis for financial assets that are past due as of the reporting date, disaggregated by class of financing receivable and major security type. An entity also shall disclose when it considers a financial asset to be past due.

The requirements above to disclose past-due status do not apply to receivables measured at the lower of amortized cost basis or fair value, or trade receivables due in one year or less, except for credit card receivables, that result from revenue transactions within the scope of ASC 606 on revenue from contracts with customers.

Nonaccrual Status

To enable a financial statement user to understand the credit risk and interest income recognized on financial assets on nonaccrual status, an entity shall disclose all of the following, disaggregated by class of financing receivable and major security type:

- The amortized cost basis of financial assets on nonaccrual status as of the beginning of the reporting period and the end of the reporting period
- The amount of interest income recognized during the period on nonaccrual financial assets
- The amortized cost basis of financial assets that are 90 days or more past due, but are not on nonaccrual status as of the reporting date
- The amortized cost basis of financial assets on nonaccrual status for which there is no related allowance for credit losses as of the reporting date.

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An entity's summary of significant accounting policies for financial assets within the scope of this Subtopic shall include all of the following:

- Nonaccrual policies, including the policies for discontinuing accrual of interest, recording payments received on nonaccrual assets (including the cost recovery method, cash basis method, or some combination of those methods), and resuming accrual of interest, if applicable
- The policy for determining past-due or delinquency status
- The policy for recognizing write-offs within the allowance for credit losses.

The requirements to disclose nonaccrual status do not apply to receivables measured at lower of amortized cost basis or fair value, or trade receivables due in one year or less, except for credit card receivables, that result from revenue transactions within the scope of ASC 606 on revenue from contracts with customers.

6. Credit quality information

An entity shall provide information that enables a financial statement user to do both of the following:

- Understand how management monitors the credit quality of its financial assets
- Assess the quantitative and qualitative risks arising from the credit quality of its financial assets.

To meet the objectives, an entity shall provide quantitative and qualitative information by class of financing receivable and major security type about the credit quality of financial assets, including all of the following:

- A description of the credit quality indicator(s)
- The amortized cost basis, by credit quality indicator
- For each credit quality indicator, the date or range of dates in which the information was last updated for that credit quality indicator.

When disclosing credit quality indicators of financing receivables and net investment in leases (except for reinsurance recoverables and funded or unfunded amounts of line-of-credit arrangements, such as credit cards), an entity shall present the amortized cost basis within each credit quality indicator by year of origination (that is, vintage year). For purchased financing receivables and net investment in leases, an entity shall use the initial date of issuance to determine the year of origination, not the date of acquisition. For origination years before the fifth annual period, an entity may present the amortized cost basis of financing receivables and net investments in leases in the aggregate. For interim-period disclosures, the current year-to-date originations in the current reporting period are considered to be the current-period originations. The requirement to present the amortized cost basis within each credit quality indicator by year of origination is not required for an entity that is not a public business entity.

An entity shall present the amortized cost basis of line-of-credit arrangements that are converted to term loans in a separate column. An entity shall disclose in each reporting period, by class of financing receivable, the amount of line-of-credit arrangements that are converted to term loans in each reporting period.

An entity shall use the guidance in paragraphs 310-20-35-9 through 35-12 when determining whether a modification, extension, or renewal of a financing receivable should be presented as a current-period origination. An entity shall use the guidance in paragraphs 842-10-25-8 through 25-9 when determining whether a lease modification should be presented as a current-period origination.

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Except as provided in paragraph 326-20-50-6A, an entity shall use the guidance in paragraphs 310-20-35-9 through 35-12 when determining whether a modification, extension, or renewal of a financing receivable should be presented as a current-period origination. An entity shall use the guidance in paragraphs 842-10-25-8 through 25-9 when determining whether a lease modification should be presented as a current-period origination.

If an entity discloses internal risk ratings, then the entity shall provide qualitative information on how those internal risk ratings relate to the likelihood of loss.

The requirements to disclose credit quality indicators do not apply to receivables measured at the lower of amortized cost basis or fair value, or trade receivables due in one year or less, except for credit card receivables, that result from revenue transactions within the scope of ASC 606 on revenue from contracts with customers.

7. Modifications

According to ASC 310, for each period for which a statement of income is presented, an entity shall disclose the following about troubled debt restructurings of financing receivables that occurred during the period:

a. By class of financing receivable, qualitative and quantitative information, including both of the following:
    - How the financing receivables were modified
    - The financial effects of the modifications.
b. By portfolio segment, qualitative information about how such modifications are factored into the determination of the allowance for credit losses.

In addition, for each period for which a statement of income is presented, an entity shall disclose the following for financing receivables modified as troubled debt restructurings within the previous 12 months and for which there was a payment default (after the restructuring) during the period:

a. By class of financing receivable, qualitative and quantitative information about those defaulted financing receivables, including both of the following:
    - The types of financing receivables that defaulted
    - The amount of financing receivables that defaulted.
b. By portfolio segment, qualitative information about how such defaults are factored into the determination of the allowance for credit losses.

This guidance does not apply to troubled debt restructurings of the following financing receivables:

- Receivables measured at fair value with changes in fair value reported in earnings.
- Receivables measured at lower of amortized cost basis or fair value.
- Except for credit card receivables, trade accounts receivable that have a contractual maturity of one year or less that arose from the sale of goods or services.
- Participant loans in defined contribution pension plans.

8. Disclosure example – Generic disclosure for trade receivables

BASIS OF ACCOUNTING FOR TRADE RECEIVABLES

Trade receivables are carried at their estimated collectible amounts. Trade credit is generally extended on a short-term basis; thus trade receivables do not bear interest, although a finance charge

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may be applied to such receivables that are more than 30 days past due.

METHOD FOR ESTIMATING ALLOWANCES FOR CREDIT LOSSES
Trade accounts receivable are periodically evaluated for credit losses based on past credit history with customers, their current financial condition, current economic conditions, and trends for each major source of revenue.

Actual write-offs are charged against the allowance for credit losses.

Activity in the Allowance for credit losses was as follows (in thousands):

Year ended December 31	**2022**	2021
Balance, beginning of the year	**$250**	$272
Charged to costs	**25**	30
Write-offs	**(32)**	(52)
Balance, end of period	**$243**	$250

9. Disclosure example – Cisco Systems, Inc.

Generally, entities which have financing receivables are larger entities which tend to be SEC registrants. These entities tend to have a high amount of revenue per transaction, resulting in the need to finance the receivables balance over a longer period of time. While examples from such entities are generally less applicable to smaller and medium-sized entities, the following serves as a good example of the complexity of the detail that is required for such disclosures.

FINANCING RECEIVABLES

Summary of Significant Accounting Policies (in part)

(f) Allowance for Accounts Receivable, Contract Assets and Financing Receivables
We estimate our allowances for credit losses using relevant available information from internal and external sources, related to past events, current conditions and reasonable and supportable forecasts. Historical credit loss experience provides the basis for the estimation of expected credit losses. When assessing for credit losses, we determine collectability by pooling our assets with similar characteristics.

The allowances for credit losses are each measured on a collective basis when similar risk characteristics exist. Our internal credit risk ratings are categorized as 1 through 10, with the lowest credit risk rating representing the highest quality. Assets that do not share risk characteristics are evaluated on an individual basis. The allowances for credit losses are each measured by multiplying the exposure probability of default, the probability the asset will default within a given time frame, by the loss given default rate, the percentage of the asset not expected to be collected due to default, based on the pool of assets.

Probability of default rates are published quarterly by third-party credit agencies. Adjustments to our internal credit risk ratings may take into account including, but not limited to, various customer-specific factors, the potential sovereign risk of the geographic locations in which the customer is operating and macroeconomic conditions. These factors are updated regularly or when facts and circumstances indicate that an update is deemed necessary.

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(g) Financing Receivables and Guarantees

We provide financing arrangements, including leases and loans and financed service contracts, for certain qualified end-user customers to build, maintain, and upgrade their networks. Lease receivables primarily represent sales-type and direct-financing leases. Leases have on average a four-year term and are usually collateralized by a security interest in the underlying assets. Loan receivables and financed service contracts include customers financing purchases of our hardware, software and services, and also may include additional funds for other costs associated with network installation and integration of our products and services. Loan receivables and financed service contracts have terms of one year to three years on average.

Outstanding financing receivables that are aged 31 days or more from the contractual payment date are considered past due. We do not accrue interest on financing receivables that are considered impaired and more than 120 days past due unless either the receivable has not been collected due to administrative reasons or the receivable is well secured and in the process of collection. Financing receivables may be placed on nonaccrual status earlier if, in management's opinion, a timely collection of the full principal and interest becomes uncertain. After a financing receivable has been categorized as nonaccrual, interest will be recognized when cash is received. A financing receivable may be returned to accrual status after all of the customer's delinquent balances of principal and interest have been settled, and the customer remains current for an appropriate period.

We facilitate arrangements for third-party financing extended to channel partners, consisting of revolving short-term financing, generally with payment terms ranging from 60 to 90 days. In certain instances, these financing arrangements result in a transfer of our receivables to the third party. The receivables are derecognized upon transfer, as these transfers qualify as true sales, and we receive a payment for the receivables from the third party based on our standard payment terms. These financing arrangements facilitate the working capital requirements of the channel partners, and, in some cases, we guarantee a portion of these arrangements. We could be called upon to make payments under these guarantees in the event of nonpayment by the channel partners.

The following table summarizes our financing receivables (in millions):

	July 30, 2022	July 31, 2021	Increase (Decrease)
Lease receivables, net	$ 1,175	$ 1,697	$ (522)
Loan receivables, net	4,556	5,117	(561)
Financed service contracts, net	2,183	2,450	(267)
Total, net	$ 7,914	$ 9,264	$ (1,350)

Deferred revenue relating to these financing arrangements is recorded in accordance with revenue recognition policies or for the fair value of the financing guarantees.

The following table presents the breakdown of deferred revenue (in millions):

	July 30, 2022	July 31, 2021	Increase (Decrease)
Product	$ 10,427	$ 9,416	$ 1,011
Service	12,837	12,748	89
Total	$ 23,264	$ 22,164	$ 1,100
Reported as:			
Current	$ 12,784	$ 12,148	$ 636
Noncurrent	10,480	10,016	464
Total	$ 23,264	$ 22,164	$ 1,100

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Total deferred revenue increased 5% in fiscal 2022. The increase in deferred product revenue of 11% was primarily due to increased deferrals related to our recurring software offerings. The slight increase in deferred service revenue was driven by the impact of contract renewals, partially offset by amortization of deferred service revenue.

Financing Receivables

(a) Financing Receivables

Financing receivables primarily consist of lease receivables, loans receivables, and financed service contracts. Lease receivables represent sales-type leases resulting from the sale of Cisco's and complementary third-party products and are typically collateralized by a security interest in the underlying assets. Lease receivables consist of arrangements with terms of four years on average. Loan receivables represent financing arrangements related to the sale of our hardware, software, and services, which may include additional funding for other costs associated with network installation and integration of our products and services. Loan receivables have terms of three years on average. Financed service contracts include financing receivables related to technical support and advanced services. Revenue related to the technical support services is typically deferred and included in deferred service revenue and is recognized ratably over the period during which the related services are to be performed, which typically ranges from one year to three years.

A summary of the Company's financing receivables is presented as follows (in millions):

July 30, 2022	**Lease Receivables**	**Loan Receivables**	**Financed Service Contracts**	**Total**
Gross	**$ 1,176**	**$ 4,656**	**$ 2,186**	**$ 8,018**
Residual value	**76**	**—**	**—**	**76**
Unearned income	**(54)**	**—**	**—**	**(54)**
Allowance for credit loss	**(23)**	**(100)**	**(3)**	**(126)**
Total, net	**$ 1,175**	**$ 4,556**	**$ 2,183**	**$ 7,914**
Reported as:				
Current	**$ 578**	**$ 2,176**	**$ 1,151**	**$ 3,905**
Noncurrent	**597**	**2,380**	**1,032**	**4,009**
Total, net	**$ 1,175**	**$ 4,556**	**$ 2,183**	**$ 7,914**

July 31, 2021	Lease Receivables	Loan Receivables	Financed Service Contracts	Total
Gross	$ 1,710	$ 5,203	$ 2,453	$ 9,366
Residual value	103	—	—	103
Unearned income	(78)	—	—	(78)
Allowance for credit loss	(38)	(86)	(3)	(127)
Total, net	$ 1,697	$ 5,117	$ 2,450	$ 9,264
Reported as:				
Current	$ 780	$ 2,372	$ 1,228	$ 4,380
Noncurrent	917	2,745	1,222	4,884
Total, net	$ 1,697	$ 5,117	$ 2,450	$ 9,264

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(b) Credit Quality of Financing Receivables

The tables below present our gross financing receivables, excluding residual value, less unearned income, categorized by our internal credit risk rating by period of origination (in millions):

July 30, 2022 Internal Credit Risk Rating	Prior	Fiscal Year July 28, 2018	July 27, 2019	July 25, 2020	July 31, 2021	July 30, 2022	Total
Lease Receivables:							
1 to 4	$ 2	$ 25	$ 74	$ 124	$ 176	$ 152	$ 553
5 to 6	1	10	67	146	165	151	540
7 and Higher	—	1	4	12	2	10	29
Total Lease Receivables	$ 3	$ 36	$ 145	$ 282	$ 343	$ 313	$ 1,122
Loan Receivables:							
1 to 4	$ 1	$ 46	$ 136	$ 458	$ 896	$ 1,488	$ 3,025
5 to 6	1	10	71	242	465	733	1,522
7 and Higher	1	1	20	38	37	12	109
Total Loan Receivables	$ 3	$ 57	$ 227	$ 738	$ 1,398	$ 2,233	$ 4,656
Financed Service Contracts:							
1 to 4	$ 1	$ 3	$ 37	$ 78	$ 562	$ 799	$ 1,480
5 to 6	—	7	44	103	244	297	695
7 and Higher	—	—	2	7	2	—	11
Total Financed Service Contracts	$ 1	$ 10	$ 83	$ 188	$ 808	$ 1,096	$ 2,186
Total	$ 7	$ 103	$ 455	$ 1,208	$ 2,549	$ 3,642	$ 7,964

July 31, 2021 Internal Credit Risk Rating	Prior	Fiscal Year July 29, 2017	July 28, 2018	July 27, 2019	July 25, 2020	July 31, 2021	Total
Lease Receivables:							
1 to 4	$ 2	$ 20	$ 100	$ 168	$ 282	$ 227	$ 799
5 to 6	1	17	65	187	285	231	786
7 and Higher	—	2	6	12	23	4	47
Total Lease Receivables	$ 3	$ 39	$ 171	$ 367	$ 590	$ 462	$ 1,632
Loan Receivables:							
1 to 4	$ 4	$ 86	$ 134	$ 577	$ 990	$ 1,552	$ 3,343
5 to 6	—	19	75	202	505	925	1,726
7 and Higher	1	2	4	50	43	34	134
Total Loan Receivables	$ 5	$ 107	$ 213	$ 829	$ 1,538	$ 2,511	$ 5,203
Financed Service Contracts:							
1 to 4	$ —	$ 38	$ 26	$ 106	$ 252	$ 1,053	$ 1,475
5 to 6	—	6	26	105	302	520	959
7 and Higher	—	—	1	6	7	5	19
Total Financed Service Contracts	$ —	$ 44	$ 53	$ 217	$ 561	$ 1,578	$ 2,453
Total	$ 8	$ 190	$ 437	$ 1,413	$ 2,689	$ 4,551	$ 9,288

The following tables present the aging analysis of gross receivables as of July 30, 2022 and July 31, 2021 (in millions):

July 30, 2022	DAYS PAST DUE (INCLUDES BILLED AND UNBILLED) 31 - 60	61 - 90	91+	Total Past Due	Current	Total	120+ Still Accruing	Nonaccrual Financing Receivables	Impaired Financing Receivables
Lease receivables	$ 8	$ 6	$ 26	$ 40	$ 1,082	$ 1,122	$ 7	$ 11	$ 11
Loan receivables	72	36	48	156	4,500	4,656	8	58	58
Financed service contracts	26	26	81	133	2,053	2,186	6	2	2
Total	$ 106	$ 68	$ 155	$ 329	$ 7,635	$ 7,964	$ 21	$ 71	$ 71

July 31, 2021	DAYS PAST DUE (INCLUDES BILLED AND UNBILLED) 31 - 60	61 - 90	91+	Total Past Due	Current	Total	120+ Still Accruing	Nonaccrual Financing Receivables	Impaired Financing Receivables
Lease receivables	$ 21	$ 17	$ 29	$ 67	$ 1,565	$ 1,632	$ 1	$ 33	$ 26
Loan receivables	71	17	35	123	5,080	5,203	4	33	33
Financed service contracts	18	13	18	49	2,404	2,453	3	3	3
Total	$ 110	$ 47	$ 82	$ 239	$ 9,049	$ 9,288	$ 8	$ 69	$ 62

Past due financing receivables are those that are 31 days or more past due according to their contractual payment terms. The data in the preceding tables is presented by contract, and the aging classification of

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each contract is based on the oldest outstanding receivable, and therefore past due amounts also include unbilled and current receivables within the same contract.

(c)Allowance for Credit Loss Rollforward

The allowances for credit loss and the related financing receivables are summarized as follows (in millions):

	CREDIT LOSS ALLOWANCES			
	Lease Receivables	**Loan Receivables**	**Financed Service Contracts**	**Total**
Allowance for credit loss as of July 31, 2021	**$ 38**	**$ 86**	**$ 3**	**$ 127**
Provisions (benefits)	**(13)**	**4**	**—**	**(9)**
Recoveries (write-offs), net	**(2)**	**—**	**—**	**(2)**
Foreign exchange and other	**—**	**10**	**—**	**10**
Allowance for credit loss as of July 30, 2022	**$ 23**	**$ 100**	**$ 3**	**$ 126**

	CREDIT LOSS ALLOWANCES			
	Lease Receivables	Loan Receivables	Financed Service Contracts	Total
Allowance for credit loss as of July 25, 2020	$ 48	$ 81	$ 9	$ 138
Provisions (benefits)	(10)	(12)	(5)	(27)
Recoveries (write-offs), net	(1)	(1)	—	(2)
Foreign exchange and other	1	18	(1)	18
Allowance for credit loss as of July 31, 2021	$ 38	$ 86	$ 3	$ 127

	CREDIT LOSS ALLOWANCES			
	Lease Receivables	Loan Receivables	Financed Service Contracts	Total
Allowance for credit loss as of July 27, 2019	$ 46	$ 71	$ 9	$ 126
Provisions (benefits)	5	32	1	38
Recoveries (write-offs), net	(3)	(19)	—	(22)
Foreign exchange and other	—	(3)	(1)	(4)
Allowance for credit loss as of July 25, 2020	$ 48	$ 81	$ 9	$ 138

(d) Lessor Arrangements

Our leases primarily represent sales-type leases with terms of four years on average. We provide leasing of our equipment and complementary third-party products primarily through our channel partners and distributors, for which the income arising from these leases is recognized through interest income. Interest income for fiscal 2022 and 2021 was $54 million and $75 million, respectively, and was included in interest income in the Consolidated Statement of Operations. The net investment of our lease receivables is measured at the commencement date as the gross lease receivable, residual value less unearned income and allowance for credit loss. For additional information, see Note 9.

Future minimum lease payments on our lease receivables as of July 30, 2022 are summarized as follows (in millions):

Fiscal Year	Amount
2023	$ 582
2024	314
2025	171
2026	80
2027	28
Thereafter	1
Total	1,176
Less: Present value of lease payments	1,122
Unearned income	$ 54

Actual cash collections may differ from the contractual maturities due to early customer buyouts, refinancings, or defaults.

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We provide financing of certain equipment through operating leases, and the amounts are included in property and equipment in the Consolidated Balance Sheets. Amounts relating to equipment on operating lease assets held by us and the associated accumulated depreciation are summarized as follows (in millions):

	July 30, 2022		July 31, 2021	
Operating lease assets	$	185	$	273
Accumulated depreciation		(111)		(165)
Operating lease assets, net	$	74	$	108

Our operating lease income for fiscal 2022 and 2021 was $107 million and $151 million, respectively, and was included in product revenue in the Consolidated Statement of Operations. Minimum future rentals on noncancelable operating leases as of July 30, 2022 are summarized as follows (in millions)

Fiscal Year	Amount	
2023	$	33
2024		16
2025		4
2026		—
Total	$	53

Actual cash collections may differ from the contractual maturities due to early customer buyouts, refinancings, or defaults.

D. Inventory

Disclosures regarding inventory are straightforward and focus on the major classes of inventory and the basis for determining ending inventory values presented on the balance sheet. ASC 330, *Inventory*, provides the disclosure requirements for inventory as well as Rule 5-02.6 of the SEC's Regulation S-X.

According to ASC 330, the basis of stating inventories should be consistently applied and should be disclosed in the financial statements. Whenever a significant change in basis is made, there should be disclosure of the nature of the change and, if material, the effect on income. A change of such basis might have an important effect upon the interpretation of the financial statements both before and after that change, and hence, in the event of a change, a full disclosure of its nature and of its effect, if material, upon income should be made.

Similarly, when substantial and unusual losses result from the application of the lower of cost or market rule, it is typically desirable to disclose the amount of the loss in the income statement as a charge separately identified from the cost of goods sold.

Additional ASC 330 requirements and guidance include:

- When goods are stated above cost, this fact should be fully disclosed.
- When inventories are stated at sales prices, use of such basis should be fully disclosed.
- The amounts of net losses on firm purchase commitments accrued should be disclosed separately in the income statement.
- Significant estimates applicable to inventories should be disclosed.

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Rule 5-02.6 of the SEC's Regulation S-X requires registrants to separately disclose in the balance sheet or in the notes to the financial statements the amounts of major classes of inventory such as:

- Raw materials, work in process, and finished goods;
- Inventoried costs relating to long-term contracts or programs; and
- Supplies.

In addition, the basis of determining the inventory amounts should also be disclosed, as well as the method by which amounts are removed from inventory, for example, FIFO, LIFO, average cost, or estimated average cost per unit. If any general and administrative costs are charged to inventory, 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 should be disclosed in the notes to the financial statements. If the LIFO inventory method is used, the excess of replacement or current cost overstated LIFO value (if material) should be disclosed parenthetically or in the notes to the financial statements.

In July 2015, the FASB issued ASU No. 2015-11, *Inventory (Topic 330) – Simplifying the Measurement of Inventory*. While ASU No. 2015-11 primarily simplified the application of the lower of cost or market test for inventory valuation, ASU No. 2015-11 also made small modifications to the disclosure requirements for inventory. However, the FASB does not expect these changes to result in any changes in practice.

Note that while the following examples are from publicly traded entities, the disclosures for private entities would look very similar. However, the breakout of inventory into its components is presented in order to comply with SEC reporting requirements.

1. Disclosure example – Keurig Green Mountain, Inc.

INVENTORIES

Inventories consist primarily of green and roasted coffee, including coffee in pods, purchased finished goods such as coffee brewers, and packaging materials. Inventories are stated at the lower of cost or market. Cost is being measured using an adjusted standard cost method which approximates FIFO (first-in, first-out). The Company regularly reviews whether the net realizable value of its inventory is lower than its carrying value. If the valuation shows that the net realizable value is lower than the carrying value, the Company takes a charge to cost of sales and directly reduces the carrying value of the inventory.

The Company estimates any required write downs for inventory obsolescence by examining its inventories on a quarterly basis to determine if there are indicators that the carrying values exceed net realizable value. Indicators that could result in additional inventory write downs include age of inventory, damaged inventory, slow moving products and products at the end of their life cycles. While management believes that inventory is appropriately stated at the lower of cost or market, significant judgment is involved in determining the net realizable value of inventory.

Inventories consisted of the following (in thousands) as of:

	September 26, 2015	September 27, 2014
Raw materials and supplies	$227,529	$169,858
Finished goods	464,451	665,309
	$691,980	$835,167

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As of September 26, 2015, the Company had approximately $264.3 million in green coffee purchase commitments, of which approximately 90% had a fixed price. These commitments primarily extend through fiscal 2017. The value of the variable portion of these commitments was calculated using an average "C" price of coffee of $1.29 per pound at September 26, 2015. In addition to its green coffee commitments, the Company had approximately $313.6 million in fixed-price brewer and related accessory purchase commitments and $920.9 million in production raw materials commitments at September 26, 2015. The Company believes, based on relationships established with its suppliers, that the risk of non-delivery on such purchase commitments is remote.

As of September 26, 2015, minimum future inventory purchase commitments were as follows (in thousands):

	Inventory Fiscal Year	Purchase Obligations(1)
	2016	$574,636
	2017	490,538
	2018	258,140
	2019	109,805
	2020	65,762
Thereafter	--	$1,498,881

(1) Certain purchase obligations are determined based on a contractual percentage of forecasted volumes.

2. Disclosure example – General Dynamics Corporation

INVENTORIES

Our inventories represent primarily business-jet components and are stated at the lower of cost or net realizable value. Work in process represents largely labor, material and overhead costs associated with aircraft in the manufacturing process and is primarily based on the estimated average unit cost of the units in a production lot. Raw materials are valued primarily on the first-in, first-out method. We record pre-owned aircraft acquired in connection with the sale of new aircraft at the lower of the trade-in value or the estimated net realizable value.

Inventories consisted of the following:

December	2021	2020
Work in process	$1,889	$1,828
Raw materials	1,376	1,290
Finished goods	28	28
Pre-owned aircraft	73	75
	$3,366	$3,221

E. Property, plant, and equipment

Property, plant, and equipment (PP&E), also referred to as “fixed assets,” includes, for example, land, buildings, machinery, and vehicles that are used in the day-to-day operating activities of an entity. PP&E have two basic characteristics, they are held primarily for use in business operations and they have relatively long lives.

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PP&E is initially recorded at historical cost, which includes all necessary expenditures to get an asset ready for its intended use, for example, the cost of razing an old building in preparation for building a new factory. This cost, less any estimated residual (or salvage) value, is charged to expense over the asset's estimated useful life using one of several depreciation methods such as straight line, units of production, or double declining balance.

Recognition of the impairment of a long-lived asset is generally required when circumstances indicate that an entity will not be able to recover the carrying amount of the asset. The accounting for impaired assets differs depending on whether the entity intends to dispose of the asset or continue to use it.

Disclosures regarding PP&E are straightforward and focus on the major classes of assets and the depreciation methods and amounts surrounding them. ASC 360, *Property, Plant, and Equipment*, provides the disclosure requirements for PP&E.

1. Disclosure requirements

According to ASC 360, because of the significant effects on financial position and results of operations of the depreciation method (or methods) used, all of the following disclosures should be made in the financial statements themselves or in the notes to the financial statements:

a. Depreciation expense for the period.
b. Balances of major classes of depreciable assets, by nature or function, at the balance sheet date.
c. Accumulated depreciation, either by major classes of depreciable assets or in total, at the balance sheet date.
d. A general description of the method or methods used in computing depreciation with respect to major classes of depreciable assets.

If an entity recognizes an impairment loss on a long-lived asset, all of the following information should be disclosed in the notes to the financial statements for the period:

a. A description of the impaired long-lived asset (asset group) and the facts and circumstances leading to the impairment.
b. If not separately presented on the face of the statement, the amount of the impairment loss and the caption in the income statement or the statement of activities that includes that loss.
c. The method or methods for determining fair value (whether based on a quoted market price, prices for similar assets, or another valuation technique).
d. If applicable, the segment in which the impaired long-lived asset (asset group) is reported under ASC 280, *Segment Reporting*.

The following disclosure requirements in accordance with ASC 205, *Presentation of Financial Statements*, are also applicable to long-lived assets (disposal groups) within the scope of ASC 360.

According to ASC 205, the following should be disclosed in the notes to the financial statements that cover the period in which a long-lived asset (disposal group) has either been sold or is classified as held for sale under the requirements of ASC 360-10-45-9:

a. A description of the facts and circumstances leading to the expected disposal, the expected manner and timing of that disposal, and, if not separately presented on the face

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of the statement, the carrying amounts of the major classes of assets and liabilities included as part of a disposal group.

b. The gain or loss recognized in accordance with ASC 360-10-35-40 and 360-10-40-5 and if not separately presented on the face of the income statement, the caption in the income statement or the statement of activities that includes that gain or loss.

c. If applicable, amounts of revenue and pretax profit or loss reported in discontinued operations.

d. If applicable, the segment in which the long-lived asset (disposal group) is reported under ASC 280.

The following disclosure examples, while for publicly traded entities, are representative of the disclosures which private entities would make with regard to PP&E as well and serve as good examples of the disclosures required for both public and private entities.

2. Disclosure example – Sun Hydraulics Corporation

PROPERTY, PLANT, AND EQUIPMENT

Property, plant, and equipment is stated at cost. Expenditures for repairs and improvements that significantly add to the productive capacity or extend the useful life of an asset are capitalized. Repairs and maintenance are expensed as incurred. Depreciation is computed using the straight-line method over the following useful lives:

	Years
Computer Equipment	3 – 5
Machinery and equipment	4 - 12
Furniture and fixtures	4 - 10
Leasehold and land improvements	10 - 15
Buildings	25 - 40

Gains or losses on the retirement, sale, or disposition of property, plant, and equipment are reflected in the Consolidated Statement of Operations in the period in which the assets are taken out of service.

Impairment of Long-Lived Assets

Long-lived assets, such as property and equipment, and purchased intangibles subject to amortization, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of the asset is measured by comparison of its carrying amount to future net cash flows the asset is expected to generate. If such assets are considered impaired, the impairment to be recognized is measured as the amount by which the carrying amount of the asset exceeds its fair value.

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6. PROPERTY, PLANT, AND EQUIPMENT

	January 2, 2016	December 27, 2014
Machinery and equipment	$ 97,552	$ 94,702
Office furniture and equipment	9,983	9,417
Buildings	41,652	45,604
Leasehold and land improvements	5,666	2,664
Land	9,956	10,104
	$ 164,809	$ 162,491

Depreciation expense for the years ended January 2, 2016, December 27, 2014, and December 28, 2013, totaled $8,442, $7,717, and $6,511, respectively.

3. Disclosure example – FormFactor, Inc.

IMPAIRMENT OF LONG-LIVED ASSETS

We test long-lived assets or asset groups such as property, plant and equipment and intangibles for recoverability when events or changes in circumstances indicate that their carrying amounts may not be recoverable. Circumstances that could trigger a review include, but are not limited to: significant decreases in the market price of the asset; significant adverse changes in the business climate or legal factors; accumulation of costs significantly in excess of the amount originally expected for the acquisition or construction of the asset; current period cash flow or operating losses combined with a history of losses or a forecast of continuing losses associated with the use of the asset; and current expectation that the asset will more likely than not be sold or disposed of significantly before the end of its estimated useful life.

Recoverability is assessed based on the carrying amounts of the asset or asset group and the sum of the undiscounted cash flows expected to result from the use and the eventual disposal of the asset. An impairment loss is recognized when the carrying amount is not recoverable and exceeds fair value.

Significant judgments and assumptions are required in the forecast of future operating results used in the preparation of the estimated future cash flows, including profit margins, long-term forecasts of the amounts and timing of overall market growth and our percentage of that market, groupings of assets, discount rates and terminal growth rates. In addition, significant estimates and assumptions are required in the determination of the fair value of our intangible assets and tangible long-lived assets, including replacement cost, economic obsolescence, and the value that could be realized in an orderly liquidation. Changes in these estimates could have a material adverse effect on the assessment of our long-lived assets, thereby requiring us to write down the assets.

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Note 7 - Impairment of Long-lived Assets

The following table summarizes the components of the impairments that we recorded in fiscal 2014, 2013, and 2012 (in thousands):

	Fiscal Years Ended		
	December 27, 2014	December 28, 2013	December 29, 2012
Impairment of long-lived assets:			
Assets held for sale	$ 191	$ —	$ 168
Assets to be disposed of other than by sale	1,028	761	253
Total	$ 1,219	$ 761	$ 421

Assets held-for-sale
During fiscal 2014, we reclassified $0.6 million of building and $0.5 million of machinery and equipment from "Property, plant and equipment, net" to "Prepaid expenses and other current assets" in our balance sheet as these assets were identified as held for sale. In the same fiscal year, we recorded a gain of $0.2 million and $52.0 thousand on the sale of the building and machinery and equipment, respectively. In addition, we also recorded a $0.2 million impairment charge related to machinery and equipment which was held for sale. There were no long-lived assets classified as held for sale as of December 27, 2014. In fiscal 2013, we did not record any impairment charge on assets held for sale. In fiscal 2012, we recorded a $0.2 million charge related to certain assets which were previously held for sale that were determined to be no longer saleable and used for internal purposes. These impairments were included within "Impairment of long-lived assets" in the Consolidated Statement of Operations for their respective periods.

Assets to be disposed of other than by sale
In fiscal 2014 and 2013, we recorded impairment charges of $1.2 million and $0.8 million, respectively, for manufacturing assets and software that we no longer utilize. In fiscal 2012, we recorded $0.2 million of charges related to the termination of on-going construction-in-progress projects. All of these charges are included in "Impairment of long-lived assets" in the Consolidated Statements of Operations for their respective periods. Refer to Note 8 to the Notes to Consolidated Financial Statements—Goodwill and Intangible Assets for further details relating to our intangible long-lived assets.

Question to Ponder:

Given this review of balance sheet asset disclosures, what changes, if any, would you propose to make to the required disclosures discussed above?

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IV. Chapter summary

In this chapter, we reviewed the following disclosures related to several key balance sheet assets in accordance with U.S. generally accepted accounting principles:

- Cash and cash equivalents;
- Marketable securities;
- Receivables;
- Inventory; and
- Property, Plant, and Equipment.

Examples illustrating these disclosures included those from the published financial statements of:

- Cash and cash equivalents:
  - Generic cash equivalents disclosure.
  - Generic restricted cash disclosure example.
  - The Clorox Company.
- Marketable securities:
  - Sample disclosure – ASC 825 quantitative example.
  - Caterpillar Inc.
- Receivables:
  - Generic disclosure for trade receivables.
  - Cisco Systems, Inc.
- Inventory:
  - Keurig Green Mountain, Inc.
  - General Dynamics Corporation.
- Property, Plant, and Equipment:
  - Sun Hydraulics Corporation.
  - FormFactor, Inc.

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Balance Sheet Disclosures – Liabilities and Equity

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Balance Sheet Disclosures – Liabilities and Equity

Learning objective

After completing this chapter, you should be familiar with:
- Disclosures related to several key balance sheet liabilities and equity in accordance with U.S. GAAP.

I. Introduction

In this chapter we will review disclosures related to several key balance sheet liabilities and equity in accordance with U.S. generally accepted accounting principles (GAAP). To illustrate these disclosures, example excerpts from recently published financial statements will be presented for your review as well as some generic disclosures which have been adapted from private company financial statements. Once again, since there are literally thousands of such examples available, the examples included here are only meant as a sample of the many possible alternatives typically seen in practice today.

FASB Accounting Standards Codification (ASC) 405 through 480 provides the detail requirements and guidance relating to balance sheet disclosures surrounding liabilities. Disclosure requirements for various liabilities are also found in other ASC topic areas as well, for example, 505, *Equity*, for dividends payable; 740, *Income Taxes*, for income taxes payable; 842, *Leases*, for lease obligations; and 850, *Related Party Disclosures*, for payables to related parties. ASC 505, *Equity*, provides the detail requirements and guidance relating to balance sheet disclosures surrounding equity.

II. ASC 210, Balance Sheet

ASC 210, *Balance Sheet*, includes the following general guidance relating to presentation of current liabilities in the balance sheet:

> A total of current liabilities should be presented in classified balance sheets. This would include 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).

ASC 470, *Debt*, includes guidance on the following debt transactions that might result in current liability classification – due on demand loan agreements, callable debt agreements, and short-term obligations expected to be refinanced.

As a balance sheet category, current liabilities generally include obligations for items that have entered into the operating cycle, such as:
- 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.

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- Collections received in advance of the delivery of goods or performance of services (obligations representing long-term deferments of the delivery of goods or services would not be shown as current liabilities).
- 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.

Current liabilities would also include obligations whose regular and ordinary liquidation is expected to occur within a relatively short period of time, usually 12 months, for example:

- Short-term debts arising from the acquisition of capital assets.
- Serial maturities of long-term obligations.
- Amounts required to be expended within one year under sinking fund provisions.
- Agency obligations arising from the collection or acceptance of cash or other assets for the account of third persons, for example, 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 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.

III. Liability disclosures

A. Trade accounts payable

Trade accounts payable by definition are financial instruments, the disclosure requirements around which center on fair value measurement. However, ASC 825, *Financial Instruments*, states – "For trade receivables and payables, no disclosure is required under this Subtopic if the carrying amount approximates fair value." Since trade accounts payable generally do approximate fair value, we will move on with our discussion here.

B. Short-term obligations

The ASC defines short-term obligations as those that are scheduled to mature within one year after the date of an entity's balance sheet or, for those entities that use the operating cycle concept of working capital, within an entity's operating cycle that is longer than one year. Such obligations typically include short-term notes payable, loans payable, and commercial paper, which, like trade accounts payable, are by definition financial instruments. In this case, ASC 825 requires an entity to disclose the fair value and the basis (or bases) for estimating the fair value of these particular financial instruments, unless it is impractical to do so.

According to Rule 5-02.19 of Regulation S-X, an entity should separately state amounts payable to: (1) banks for borrowings; (2) factors or other financial institutions for borrowings; and (3) holders of commercial paper, in the balance sheet or in the notes to the financial statements. In addition, the amount and terms of unused lines of credit for short-term financing (including commitment fees and the conditions under which lines may be withdrawn) should also 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 should also be furnished in the notes to the financial statements. The

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amount of these lines of credit which support a commercial paper borrowing arrangement or similar arrangements should be separately identified.

For other current liabilities, any item in excess of five percent of total current liabilities should be stated separately in the balance sheet or in the notes to the financial statements. 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.

1. Sample disclosure example – Short-term debt

Short-term notes payable consist of the following at December 31, 2022:

Banks	$400,000
Vendor	175,000
Affiliate	125,000
	$700,000

Notes payable to banks bear interest at rates ranging from 4.25 to 4.75 percent and are secured by the company's accounts receivable. Notes due to a vendor relate to purchases of inventory and bear interest at 4.75 percent. The note is secured by the raw material inventory purchased by the note. The note due to affiliate is unsecured and bears interest at 3.5 percent. The proceeds of the note were used to fund operating cash flow needs for the company.

2. Disclosure example – Levi Strauss & Co.

SHORT-TERM BORROWINGS

Short-term borrowings consist of term loans and revolving credit facilities at various foreign subsidiaries which the Company expects to either pay over the next twelve months or refinance at the end of their applicable terms. Certain of these borrowings are guaranteed by stand-by letters of credit allocated under the Company's senior secured revolving credit facility.

Short-term borrowings of $31.5 million at various foreign subsidiaries were expected to be either paid over the next twelve months or refinanced at the end of their applicable terms.

Short-term debt	November 30, 2022	November 24, 2021
	(Dollars in thousands)	
Short-term borrowings	$31,524	$41,861

C. Asset retirement and environmental obligations

ASC 410, *Asset Retirement and Environmental Obligations*, provides the accounting guidance and disclosure requirements of a liability for an asset retirement (and the associated asset retirement cost) and an environmental remediation liability that results from the normal operation of a long-lived asset.

Oftentimes, an entity will have a legal obligation associated with the retirement of a tangible long-lived asset as a matter of law, statute, ordinance, or contract. In these situations, the entity should recognize the fair value of a liability for the obligation in the period in which it is incurred and can be reasonably estimated; capitalize as an asset the retirement cost by increasing the carrying amount of the related

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long-lived asset by the same amount as the liability; and subsequently charge the cost to expense using a systematic and rational method over the asset's useful life.

Environmental remediation liabilities should be based on:

- Enacted laws and existing regulations and policies;
- Remediation technology that is expected to be approved to complete the remediation effort; and
- The reporting entity's estimates of what it will cost to perform all elements of the remediation effort when they are expected to be performed.

The fair value measurement can be discounted to reflect the time value of money if the aggregate amount of the obligation and the amount and timing of cash payments for the obligation are fixed or reliably determinable.

1. Disclosure requirements for asset retirement obligations

According to ASC 410, an entity should disclose all of the following information about its asset retirement obligations:

a. A general description of the asset retirement obligations and the associated long-lived assets.
b. The fair value of assets that are legally restricted for purposes of settling asset retirement obligations.
c. A reconciliation of the beginning and ending aggregate carrying amount of asset retirement obligations showing separately the changes attributable to the following components, whenever there is a significant change in any of these components during the reporting period:
    1. Liabilities incurred in the current period;
    2. Liabilities settled in the current period;
    3. Accretion expense; and
    4. Revisions in estimated cash flows.

"Accretion expense" is an amount recognized as an expense classified as an operating item in the statement of income resulting from the increase in the carrying amount of the liability associated with the asset retirement obligation.

If the fair value of an asset retirement obligation cannot be reasonably estimated that fact and the reasons therefore should be disclosed.

Entities with significant asset retirement obligations tend to be larger, public companies. However, smaller entities can enter into agreements where they commit to restore facilities to a pre-existing condition. While the amounts involved are not nearly as significant as with some of the examples which we will review, the disclosures which these entities must make are identical to those which larger entities must make. In the following example, we will review a hypothetical disclosure which would be representative of a disclosure which a smaller or medium sized entity would make. Then we will look at a disclosure from a publicly traded entity as well.

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2. Disclosure example – Generic entity with asset retirement obligation

ASSET RETIREMENT OBLIGATIONS

Pursuant to the lease agreement for land and property where the company stores its building materials and other supplies, the company is obligated to restore the entire facility to the condition which it existed at the commencement of the lease agreement. The company accounts for this asset retirement obligation in accordance with ASC 410-20, *Asset Retirement Obligation*. The company periodically assesses the cost of this restoration effort and, in accordance with ASC 410-20, has recorded a liability of $125,000, which represents its best estimate of fulfilling its obligations. This liability is included in the Other Liabilities section of the balance sheet and is presented on an undiscounted basis.

Based on its most recent assessment, the company has not changed its estimate of the cost of restoration nor has it expended any amounts related to this obligation.

3. Disclosure example – Comcast Corporation

ASSET RETIREMENT OBLIGATIONS

Certain of our cable franchise agreements and lease agreements contain provisions requiring us to restore facilities or remove property in the event that the franchise or lease agreement is not renewed.

We expect to continually renew our cable franchise agreements and therefore cannot reasonably estimate any liabilities associated with such agreements. A remote possibility exists that franchise agreements could be terminated unexpectedly, which could result in us incurring significant expense in complying with restoration or removal provisions. The disposal obligations related to our properties are not material to our consolidated financial statements. We do not have any significant liabilities related to asset retirements recorded in our consolidated financial statements.

4. Disclosure requirements for environmental obligations

According to ASC 410, disclosure matters related to environmental obligations include:

a. Accounting principles;
b. Environmental remediation loss contingencies;
c. Environmental remediation costs recognized currently; and
d. Conclusions on loss contingencies and other matters.

The disclosures discussed in this context are two-tiered: (1) disclosures that are required; and (2) disclosures that are encouraged, but not required.

ASC 410 requires an entity to disclose whether the accrual for environmental remediation liabilities is measured on a discounted basis. If an entity utilizes present-value measurement techniques, disclosures should include if any portion of the accrued obligation is discounted, the undiscounted amount of the obligation, and the discount rate used in the present-value determinations.

The disclosure guidance in ASC 450, *Contingencies*, and ASC 275, *Risks and Uncertainties*, also apply to environmental remediation liabilities (discussed in previously in this course material).

ASC 410 encourages, but does not require, the following environmental remediation disclosures:

- Accrual benchmarks used in connection with remediation obligations;
- The event, situation, or set of circumstances that generally triggered the recognition of an environmental remediation-related loss contingency;

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- The entity's policy concerning the timing of recognition of recoveries;
- The estimated time frame of disbursements for recorded amounts if expenditures are expected to continue over the long-term;
- The estimated time frame for realization of recognized probable recoveries, if realization is not expected in the near-term;
- If an estimate of the probable or reasonably possible loss or range of loss cannot be made, the reasons why it cannot be made;
- If information about the reasonably possible loss or the recognized and additional reasonably possible loss for an environmental remediation obligation related to an individual site is relevant to an understanding of the financial position, cash flows, or results of operations of the entity, the following with respect to the site:
    1. The total amount accrued for the site;
    2. The nature of any reasonably possible loss contingency or additional loss, and an estimate of the possible loss or the fact that an estimate cannot be made and the reasons why it cannot be made;
    3. Whether other potentially responsible parties are involved and the entity's estimated share of the obligation;
    4. The status of regulatory proceedings; and
    5. The estimated time frame for resolution of the contingency.
- The estimated time frame for resolution of the uncertainty as to the amount of the loss;
- The amount of environmental remediation costs recognized in the income statement in the following detail:
    1. The amount recognized for environmental remediation loss contingencies in each period;
    2. The amount of any recovery from third parties that is credited to environmental remediation costs in each period; and
    3. The income statement caption in which environmental remediation costs and credits are included.
- Any additional specific disclosures with respect to environmental remediation loss contingencies that would be useful in furthering financial statement users' understanding of such matters.

Whether notification by regulatory authorities in relation to particular environmental laws and regulations constitutes the assertion of a claim is a matter of legal determination. If an entity concludes that it has no current legal obligation to remediate a situation of probable or possible environmental impact, then no disclosures are required. However, if an entity is required by existing laws and regulations to report the release of hazardous substances and to begin a remediation study or if assertion of a claim is deemed probable, the matter would represent a loss contingency subject to the disclosure provisions of ASC 450, regardless of a lack of involvement by a regulatory agency.

The notes to the financial statements might also include a contingency conclusion that addresses the estimated total unrecognized exposure to environmental remediation and other loss contingencies. Such contingency conclusions might state, for example, that "management believes that the outcome of these uncertainties should not have a material adverse effect on the financial condition, cash flows, or operating results of the entity." Such an assertion that an outcome should not have a material adverse effect must be supportable, and if the entity is unable to estimate the maximum end of the range of possible outcomes, it might be difficult to support an assertion that the outcome should not have a material adverse effect.

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Entities might also want to provide a description of the general applicability and impact of environmental laws and regulations upon their business and how the existence of such laws and regulations may give rise to loss contingencies for future environmental remediation. Such disclosures often acknowledge the uncertainty of the effect of possible future changes to environmental laws and their application, and they are frequently made on an aggregated basis, considering the entity's total exposures for all its environmental sites.

We reviewed a sample environmental liability contingency footnote disclosure that would be relevant to a smaller or medium-sized entity earlier in the course, when we reviewed sample commitment and contingency footnote disclosures.

Clearly, as the size and complexity of an entity's operations grows, the likelihood of incurring a significant environmental remediation liability grows as well. While dealing with very substantive environmental obligations, the following footnote provides a good example of the depth and complexity of such footnote disclosure related to complex environmental obligations.

5. Disclosure example – Dow Chemical Co.

COMMITMENTS AND CONTINGENT LIABILITIES

Environmental Matters

Introduction

Accruals for environmental matters are recorded when it is probable that a liability has been incurred and the amount of the liability can be reasonably estimated based on current law and existing technologies. At December 31, 2015, the Company had accrued obligations of $670 million for probable environmental remediation and restoration costs, including $74 million for the remediation of Superfund sites. These obligations are included in "Accrued and other current liabilities" and "Other noncurrent obligations" in the consolidated balance sheets. This is management's best estimate of the costs for remediation and restoration with respect to environmental matters for which the Company has accrued liabilities, although it is reasonably possible that the ultimate cost with respect to these particular matters could range up to approximately two and a half times that amount. Consequently, it is reasonably possible that environmental remediation and restoration costs in excess of amounts accrued could have a material impact on the Company's results of operations, financial condition, and cash flows. It is the opinion of the Company's management, however, that the possibility is remote that costs in excess of the range disclosed will have a material impact on the Company's results of operations, financial condition, or cash flows. Inherent uncertainties exist in these estimates primarily due to unknown conditions, changing governmental regulations and legal standards regarding liability, and emerging remediation technologies for handling site remediation and restoration.

At December 31, 2014, the Company had accrued obligations of $706 million for probable environmental remediation and restoration costs, including $78 million for the remediation of Superfund sites.

The following table summarizes the activity in the Company's accrued obligations for environmental matters for the years ended December 31, 2015 and 2014:

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Accrued Obligations for Environmental Matters				
In millions		2015		2014
Balance at January 1	$	706	$	722
Additional accruals		230		228
Charges against reserve		(233)		(219)
Foreign currency impact		(33)		(25)
Balance at December 31	$	670	$	706

The amounts charged to income on a pretax basis related to environmental remediation totaled $218 million in 2015, $227 million in 2014 and $203 million in 2013. Capital expenditures for environmental protection were $49 million in 2015, $78 million in 2014 and $102 million in 2013.

Midland Off-Site Environmental Matters

On June 12, 2003, the Michigan Department of Environmental Quality ("MDEQ") issued a Hazardous Waste Operating License (the "License") to the Company's Midland, Michigan manufacturing site (the "Midland site"), which was renewed and replaced by the MDEQ on September 25, 2015, and included provisions requiring the Company to conduct an investigation to determine the nature and extent of off-site contamination in the City of Midland soils, the Tittabawassee River and Saginaw River sediment and floodplain soils, and the Saginaw Bay, and, if necessary, undertake remedial action.

City of Midland

On March 6, 2012, the Company submitted an Interim Response Activity Plan Designed to Meet Criteria ("Work Plan") to the MDEQ that involved the sampling of soil at residential properties near the Midland site for the presence of dioxins to determine where clean-up may be required and then conducting remediation for properties that sample above the remediation criteria. The MDEQ approved the Work Plan on June 1, 2012, and implementation of the Work Plan began on June 4, 2012. The Company also submitted and had approved by the MDEQ, amendments to the Work Plan. As of December 31, 2014, remediation was completed on all 132 properties that tested above the remediation criteria, and this completion is noted in the License.

Tittabawassee and Saginaw Rivers, Saginaw Bay

The Company, the U.S. Environmental Protection Agency ("EPA") and the State of Michigan ("State") entered into an administrative order on consent ("AOC"), effective January 21, 2010, that requires the Company to conduct a remedial investigation, a feasibility study and a remedial design for the Tittabawassee River, the Saginaw River and the Saginaw Bay, and pay the oversight costs of the EPA and the State under the Comprehensive Environmental Response, Compensation, and Liability Act. These actions, to be conducted under the lead oversight of the EPA, will build upon the investigative work completed under the State Resource Conservation Recovery Act program from 2005 through 2009.

The Tittabawassee River, beginning at the Midland Site and extending down to the first six miles of the Saginaw River, are designated as the first Operable Unit for purposes of conducting the remedial investigation, feasibility study, and remedial design work. This work will be performed in a largely upriver to downriver sequence for eight geographic segments of the Tittabawassee and upper Saginaw Rivers. In the first quarter of 2012, the EPA requested the Company address the Tittabawassee River floodplain ("Floodplain") as an additional segment. In August 2014, the EPA proposed for public comment the

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techniques that can be used to remedy the Floodplain, including proposed site-specific clean-up criteria. In January 2015, the Company and the EPA entered into an order to address remediation of the Floodplain. The remedial work is expected to take place over the next six years. The remainder of the Saginaw River and the Saginaw Bay are designated as a second Operable Unit and the work associated with that unit may also be geographically segmented.

The AOC does not oblige the Company to perform removal or remedial action; that action can only be required by a separate order. The Company and the EPA will be negotiating orders separate from the AOC that will obligate the Company to perform remedial actions under the scope of work of the AOC. The Company and the EPA have entered into three separate orders to perform limited remedial actions to implement early actions -- two separate orders to address remedial actions in two of the nine geographic segments in the first Operable Unit and the order to address the Floodplain.

Alternative Dispute Resolution Process

The Company, the EPA, the U.S. Department of Justice, and the natural resource damage trustees (which include the Michigan Office of the Attorney General, the MDEQ, the U.S. Fish and Wildlife Service, the U.S. Bureau of Indian Affairs and the Saginaw-Chippewa tribe) have been engaged in negotiations to seek to resolve potential governmental claims against the Company related to historical off-site contamination associated with the City of Midland, the Tittabawassee and Saginaw Rivers and the Saginaw Bay. The Company and the governmental parties started meeting in the fall of 2005 and entered into a Confidentiality Agreement in December 2005. The Company continues to conduct negotiations under the Federal Alternative Dispute Resolution Act with all of the governmental parties, except the EPA which withdrew from the alternative dispute resolution process on September 12, 2007.

On September 28, 2007, the Company and the natural resource damage trustees entered into a Funding and Participation Agreement that addressed the Company's payment of past costs incurred by the natural resource damage trustees, payment of the costs of a trustee coordinator and a process to review additional cooperative studies that the Company might agree to fund or conduct with the natural resource damage trustees. On March 18, 2008, the Company and the natural resource damage trustees entered into a Memorandum of Understanding ("MOU") to provide a mechanism for the Company to fund cooperative studies related to the assessment of natural resource damages. This MOU was amended and funding of cooperative studies was extended until March 2014. All cooperative studies have been completed. On April 7, 2008, the natural resource damage trustees released their "Natural Resource Damage Assessment Plan for the Tittabawassee River System Assessment Area."

At December 31, 2015, the accrual for these off-site matters was $62 million (included in the total accrued obligation of $670 million). At December 31, 2014, the Company had an accrual for these off-site matters of $62 million (included in the total accrued obligation of $706 million).

Environmental Matters Summary

It is the opinion of the Company's management that the possibility is remote that costs in excess of those disclosed will have a material impact on the Company's results of operations, financial condition, or cash flows.

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D. Guarantees

ASC 460, *Guarantees*, establishes the accounting and disclosure requirements to be met by a guarantor for certain guarantees issued and outstanding. Guarantees are basically loss contingencies; however, in accordance with ASC 460, an entity should disclose certain loss contingencies even though the possibility of loss might be remote. The common characteristic of these is a guarantee that provides a right to proceed against an outside party in the event that the guarantor is called on to satisfy the guarantee, and include, for example:

- Guarantees and indirect guarantees of indebtedness of others.
- Obligations of commercial banks under standby letters of credit.
- Guarantees to repurchase receivables (or, in some cases, to repurchase the related property) that have been sold or otherwise assigned.
- Other agreements that in substance have the same guarantee characteristic.

According to ASC 460, a guarantor should disclose all of the following information about each guarantee, or each group of similar guarantees, even if the likelihood of the guarantor's having to make any payments under the guarantee is remote:

a. The nature of the guarantee, including all of the following:
    1. The approximate term of the guarantee;
    2. How the guarantee arose;
    3. The events or circumstances that would require the guarantor to perform under the guarantee;
    4. The current status (that is, as of the date of the statement of financial position) of the payment/performance risk of the guarantee (for example, the current status of the payment/performance risk of a credit-risk-related guarantee could be based on either recently issued external credit ratings or current internal groupings used by the guarantor to manage its risk); and
    5. If the entity uses internal groupings for purposes of item (a)(4), how those groupings are determined and used for managing risk.
b. All of the following information about the maximum potential amount of future payments under the guarantee:
    1. The maximum potential amount of future payments (undiscounted) that the guarantor could be required to make under the guarantee, which should not be reduced by the effect of any amounts that may possibly be recovered under recourse or collateralization provisions in the guarantee (which are addressed under (d) and (e));
    2. If the terms of the guarantee provide for no limitation to the maximum potential future payments under the guarantee, that fact;
    3. If the guarantor is unable to develop an estimate of the maximum potential amount of future payments under its guarantee, the reasons why it cannot estimate the maximum potential amount.
c. The current carrying amount of the liability, if any, for the guarantor's obligations under the guarantee (including the amount, if any, recognized under ASC 450, *Contingencies*), regardless of whether the guarantee is freestanding or embedded in another contract.
d. The nature of any recourse provisions that would enable the guarantor to recover from third parties any of the amounts paid under the guarantee.
e. The nature of any assets held either as collateral or by third parties that, upon the occurrence of any triggering event or condition under the guarantee, the guarantor can obtain and liquidate to recover all or a portion of the amounts paid under the guarantee.

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f. If estimable, the approximate extent to which the proceeds from liquidation of assets held either as collateral or by third parties would be expected to cover the maximum potential amount of future payments under the guarantee.

ASC 460 provides an exception for product warranties to the requirements of (b) above.

In the following examples, we will highlight an example from a publicly traded entity. Next, as many guarantees in private, smaller, or medium-sized entities occur due to agreements between shareholders and the entity, we will provide a generic footnote which describes an entity's guarantee of an affiliate's debt. This situation contemplates the circumstances of ASU No. 2014-07, which deals with the accounting for common control leasing arrangements.

1. Disclosure example – Harris Corporation

FINANCIAL GUARANTEES

Financial guarantees are contingent commitments issued to guarantee the performance of a customer to a third party in borrowing arrangements, such as commercial paper issuances, bond financings and similar transactions. As of July 3, 2015, there were no such contingent commitments accrued for in our Consolidated Balance Sheet.

We have entered into commercial commitments in the normal course of business including surety bonds, standby letter of credit agreements and other arrangements with financial institutions and customers primarily relating to the guarantee of future performance on certain contracts to provide products and services to customers and to obtain insurance policies with our insurance carriers. As of July 3, 2015, we had total commercial commitments, including performance guarantees, of $738 million.

2. Sample disclosure example – Guarantee of debt of a common control entity

COMMITMENTS AND CREDIT RISKS

The company leases its facility from another entity (lessor), both of which are 100 percent owned by the principal shareholder of the company (see Note 8, *Leases*). The lessor has outstanding installment bank debt of $525,000 related to the costs to construct the facility which it leases to the company. The company and the lessor have no other business transactions other than that related to the lease agreement.

When entering into the lease agreement with the lessor, the company agreed to fully guarantee the entire amount of the debt due by the lessor to the bank related to the construction of the leased facility. To date, the lessor has made all required payments on its debt and the lease payments in the agreement between the company and the lessor are structured such as to provide sufficient liquidity to the lessor for the express purposes of using the proceeds of the lease payments to repay its bank debt. The debt, which has principal payments of $52,500 per year and a 4.75 percent interest rate, will be fully repaid over its remaining 10-year term. As the lessor is presently current with its payments on the debt, the company has no amounts accrued related to this guarantee arrangement.

E. Long-term debt

ASC 470, *Debt*, includes extensive accounting and disclosure guidance surrounding debt (as you can imagine), including separate topic areas related to debt with conversion and other options, participating mortgage loans, product financing arrangements, modifications and extinguishments, and troubled debt

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restructurings by debtors. For our discussion, we will focus on the overall general disclosures relating to debt found in ASC 470.

General disclosures in the financial statements regarding debt focus on the significant categories of debt, for example, notes payable to banks, related-party notes, and lease obligations (including operating and financing leases with the adoption of ASC 842), and the terms, interest rates, maturity dates, and subordinate features of an entity's debt structure.

Rule 5-02.22 of the SEC's Regulation S-X includes the following requirements related to bonds, mortgages, and other long-term debt, including capitalized leases:

a. In the balance sheet or in the notes to the financial statements, separately state each issue or type of obligation and information indicating:
    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 2010 to 2020";
    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 of conversion.
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 should be disclosed in the notes to the financial statements if significant.

ASC 470 includes the following overall general disclosure requirements relating to debt:

a. The combined aggregate amount of maturities and sinking fund requirements for all long-term borrowings should be disclosed for each of the five years following the date of the latest balance sheet presented.
b. The circumstances related to long-term liabilities containing a grace period within which the debtor may cure the violation, if it is probable that the violation will be cured within that period, thus preventing the obligation from becoming callable.
c. In some cases, the existence of a subjective acceleration clause should be disclosed.
d. If a short-term obligation is excluded from current liabilities pursuant to the provisions of ASC 460, the notes to financial statements should include a general description of the financing agreement and the terms of any new obligation incurred or expected to be incurred or equity securities issued or expected to be issued as a result of a refinancing.

As mentioned previously, in January 2016, the FASB issued ASU No. 2016-01, dealing with financial instruments. One of the topics impacted by ASU No. 2016-01 was the treatment of changes in fair value by an entity electing the fair value option of a debt instrument due to changes in the instrument-specific credit risk. ASU No. 2016-01 requires such changes to be recorded as a change in Other Comprehensive Income. We will discuss the impact on financial statement disclosures in Chapter 6 of this course.

Other than the above noted additional disclosures required for SEC registrants, long-term debt disclosures are similar for both private and public entities, both large and small. A major difference for smaller and medium-sized entities is the number of credit arrangements which they have outstanding at one time. Larger corporations often have multiple issuances of long-term debt outstanding at one time.

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Additionally, they also frequently have credit facilities with one or multiple financial institutions. Smaller and medium-sized entities, especially non-public ones, usually have either one or a few credit facilities, often with just one financial institution.

In the following examples, we will look at a representative disclosure for a smaller, private entity's credit facility and, for comparison, also look at such a disclosure for a larger, publicly traded entity, with multiple debt issuances outstanding.

1. Sample disclosure example – Credit facility with financial institution

TERM LOAN

The company has a term loan outstanding as well as a revolving line of credit arrangement with a financial institution.

The term loan is for $1,000,000, payable over 10 years in annual installments of $100,000, plus interest. The fixed interest rate for the loan is 6.25% and the term loan has a current outstanding balance at December 31, 2022 and 2021 of $700,000 and $800,000, respectively. Amounts due within one year of the balance sheet date are classified as short-term debt.

The term loan contains several restrictive covenants by which the company must abide. Under the terms of the loan agreement, the loan is callable by the financial institution, with all amounts outstanding on the debt immediately due, in the event of an uncured or waived breach of any debt covenant.

First, it agrees to not enter into any other long-term debt arrangement without prior approval of the lender. We have obtained a verbal agreement with the lender that amounts recorded as lease obligations upon the adoption of ASC 842, *Leases*, and are classified as operating leases, will not be considered long-term debt obligations for purposes of applying this covenant.

Second, the debt contains various covenants related to the maintenance of working capital and dividend payments. The company is required to maintain an average annual working capital balance, computed at the end of each fiscal year, in an amount in excess of $250,000. As of December 31, 2022, our average annual working capital balance was $325,000. Additionally, amounts payable as dividends to shareholders, the principal one of which is the Chief Executive Officer of the company, are limited to 50% of the excess of average annual working capital over $250,000. No dividend payments have been declared nor paid by the company in either 2022 or 2021.

The company believes that it is in compliance with all of its restrictive covenants at December 31, 2022.

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As of December 31, 2022, the annual aggregate maturities of our loan during each of the next five fiscal years, and thereafter, are as follows (amounts in thousands):

	Amount
2023	$100,000
2024	100,000
2025	100,000
2026	100,000
2027	100,000
Thereafter	200,000

2. Disclosure example – Toll Brothers, Inc.

LOANS PAYABLE, SENIOR NOTES AND MORTGAGE COMPANY LOAN FACILITY

Loans Payable At October 31, 2022 and 2021, loans payable consisted of the following (amounts in thousands):

	2022	2021
Senior unsecured term loan	$ 650,000	$ 650,000
Loans payable – other	537,043	364,042
Deferred issuance costs	(1,768)	(2,508)
	$ 1,185,275	$ 1,011,534

Senior Unsecured Term Loan

We are party to a five-year $650.0 million senior unsecured term loan facility (the “Term Loan Facility”) with a syndicate of banks, most of which is scheduled to expire on November 1, 2026. In the first quarter of fiscal 2021, we voluntarily repaid $150.0 million of the then $800.0 million in principal amount that was outstanding. No prepayment charges were incurred in connection with the repayment. On October 31, 2021, we entered into term loan extension agreements to extend the maturity date of $548.4 million of outstanding term loans from November 1, 2025 to November 1, 2026, with the remainder of the term loans remaining due November 1, 2025. The Term Loan Facility provides an accordion feature under which we may, subject to certain conditions set forth in the agreement, increase the Term Loan Facility up to a maximum aggregate amount of $1.5 billion. Other than $101.6 million of term loans that are scheduled to mature on November 1, 2025, there are no payments required before the final maturity date on the Term Loan Facility.

Under the Term Loan Facility, as amended, we may select interest rates equal to (i) London Interbank Offered Rate (“LIBOR”) plus an applicable margin, (ii) the base rate (as defined in the agreement) plus an applicable margin, or (iii) the federal funds/Euro rate (as defined in the agreement) plus an applicable margin, in each case, based on our leverage ratio. At October 31, 2022, the interest rate on the Term Loan Facility was 4.81% per annum.

We and substantially all of our 100%-owned home building subsidiaries are guarantors under the Term Loan Facility. The Term Loan Facility contains substantially the same financial covenants as the Revolving Credit Facility, as described below.

In November 2020, we entered into five interest rate swap transactions to hedge $400.0 million of the Term Loan Facility through October 2025. The interest rate swaps effectively fix the interest cost on the $400.0 million at 0.369% plus the spread set forth in the pricing schedule in the Term Loan Facility, which was 1.05% as of October 31, 2022. These interest rate swaps were designated as cash flow hedges.

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Revolving Credit Facility

We are party to a $1.905 billion senior unsecured, five-year revolving credit facility (the "Revolving Credit Facility") with a syndicate of banks, substantially all of which is scheduled to expire on November 1, 2026. On October 31, 2021, we entered into extension letter agreements (the "Revolver Extension Agreements") to extend the maturity date of $1.78 billion of the revolving loans and commitments from November 1, 2025 to November 1, 2026, with the remainder of the revolving loans and commitments continuing to terminate on November 1, 2025.

Under the Revolving Credit Facility, up to 100% of the commitment is available for letters of credit. The Revolving Credit Facility has an accordion feature under which we may, subject to certain conditions set forth in the agreement, increase the Revolving Credit Facility up to a maximum aggregate amount of $2.50 billion. We may select interest rates for the Revolving Credit Facility equal to (i) LIBOR plus an applicable margin or (ii) the lenders' base rate plus an applicable margin, which in each case is based on our credit rating and leverage ratio. At October 31, 2022, the interest rate on outstanding borrowings under the Revolving Credit Facility would have been 4.95% per annum. We are obligated to pay an undrawn commitment fee that is based on the average daily unused amount of the Aggregate Credit Commitment and our credit ratings and leverage ratio. Any proceeds from borrowings under the Revolving Credit Facility may be used for general corporate purposes. We and substantially all of our 100%-owned home building subsidiaries are guarantors under the Revolving Credit Facility.

Under the terms of the Revolving Credit Facility, at October 31, 2022, our maximum leverage ratio (as defined in the credit agreement) may not exceed 1.75 to 1.00, and we are required to maintain a minimum tangible net worth (as defined in the credit agreement) of no less than approximately $2.23 billion. Under the terms of the Revolving Credit Facility, at October 31, 2022, our leverage ratio was approximately 0.30 to 1.00 and our tangible net worth was approximately $5.96 billion. Based upon the limitations related to our repurchase of common stock in the Revolving Credit Facility, our ability to repurchase our common stock was limited to approximately $4.47 billion as of October 31, 2022. In addition, under the provisions of the Revolving Credit Facility, our ability to pay cash dividends was limited to approximately $3.72 billion as of October 31, 2022.

At October 31, 2022, we had no outstanding borrowings under the Revolving Credit Facility and had outstanding letters of credit of $117.7 million.

Loans Payable – Other

"Loans payable – other" primarily represent purchase money mortgages on properties we acquired that the seller had financed, project-level financing, and various revenue bonds that were issued by government entities on our behalf to finance community infrastructure and our manufacturing facilities. Information regarding our loans payable at October 31, 2022 and 2021, is included in the table below ($ amounts in thousands):

	2022	2021
Aggregate loans payable at October 31	$ 537,043	$ 364,042
Weighted-average interest rate	4.14 %	4.33 %
Interest rate range	0.19% - 7.00%	0.14% - 10.0%
Loans secured by assets:		
Carrying value of loans secured by assets	$ 537,043	$ 364,042
Carrying value of assets securing loans	$ 1,327,683	$ 1,067,728

The contractual maturities of "Loans payable – other" as of October 31, 2022, ranged from one month to 29.5 years

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Senior Notes

At October 31, 2022 and 2021, senior notes consisted of the following (amounts in thousands):

	2022	2021
5.875% Senior Notes due February 15, 2022	$ —	$ 409,856
4.375% Senior Notes due April 15, 2023	400,000	400,000
4.875% Senior Notes due November 15, 2025	350,000	350,000
4.875% Senior Notes due March 15, 2027	450,000	450,000
4.35% Senior Notes due February 15, 2028	400,000	400,000
3.80% Senior Notes due November 1, 2029	400,000	400,000
Bond discounts, premiums, and deferred issuance costs - net	(4,729)	(5,867)
	$ 1,995,271	$ 2,403,989

The senior notes are the unsecured obligations of Toll Brothers Finance Corp., our 100%-owned subsidiary. The payment of principal and interest is fully and unconditionally guaranteed, jointly and severally, by us and substantially all of our 100%-owned home building subsidiaries (together with Toll Brothers Finance Corp., the "Senior Note Parties"). The senior notes rank equally in right of payment with all the Senior Note Parties' existing and future unsecured senior indebtedness, including the Revolving Credit Facility and the Term Loan Facility. The senior notes are structurally subordinated to the prior claims of creditors, including trade creditors, of our subsidiaries that are not guarantors of the senior notes. Each series of senior notes is redeemable in whole or in part at any time at our option, at prices that vary based upon the then-current rates of interest and the remaining original term of the senior notes to be redeemed.

In November 2021, we redeemed the remaining $409.9 million principal amount of 5.875% Senior Notes due February 15, 2022, at par, plus accrued interest.

In March 2021, we redeemed, prior to maturity, all $250.0 million aggregate principal amount of our then-outstanding 5.625% Senior Notes due 2024. In connection with this redemption, we incurred a pre-tax charge of $34.2 million, inclusive of the write-off of unamortized deferred financing costs, which is recorded in our Consolidated Statement of Operations and Comprehensive Income.

In the first quarter of fiscal 2021, we redeemed, prior to maturity, approximately $10.0 million of the $409.9 million then-outstanding principal amount of 5.875% Senior Notes due February 15, 2022, plus accrued interest.

Mortgage Company Loan Facility

Toll Brothers Mortgage Company ("TBMC"), our wholly owned mortgage subsidiary, has a mortgage warehousing agreement ("Warehousing Agreement") with a bank, which has been amended from time to time, to finance the origination of mortgage loans by TBMC. The Warehousing Agreement is accounted for as a secured borrowing under ASC 860, "Transfers and Servicing." The Warehousing Agreement provides for loan purchases up to $75.0 million, subject to certain sublimits. In addition, the Warehousing Agreement, provides for an accordion feature under which TBMC may request that the aggregate commitments under the Warehousing Agreement be increased to an amount up to $150.0 million for a short period of time. We are also subject to an under usage fee based on outstanding balances, as defined in the Warehousing Agreement. Before the amendment and restatement in April 2022, the Warehousing Agreement was set to expire on April 2, 2022, and borrowings thereunder bore interest at LIBOR plus 1.75% per annum. In April 2022, the Warehousing Agreement was amended and restated to extend the expiration date to March 31, 2023 and to cause borrowings thereunder to bear interest at the Bloomberg Short-Term Yield Index Rate ("BSBY") plus 1.75% per annum (with a BSBY floor of 0.50%). At

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October 31, 2022, the interest rate on the Warehousing Agreement was 5.38% per annum. Borrowings under this facility are included in the fiscal 2023 maturities in the table below.

At each of October 31, 2022 and 2021, there was $148.9 million and $147.5 million, respectively, outstanding under the Warehousing Agreement, which are included in liabilities in our Consolidated Balance Sheets. At October 31, 2022 and 2021, amounts outstanding under the agreement were collateralized by $187.2 million and $245.0 million, respectively, of mortgage loans held for sale, which are included in assets in our Consolidated Balance Sheets. As of October 31, 2022, there were no aggregate outstanding purchase price limitations reducing the amount available to TBMC. There are several restrictions on purchased loans under the agreement, including that they cannot be sold to others, they cannot be pledged to anyone other than the agent, and they cannot support any other borrowing or repurchase agreements.

General

As of October 31, 2022, the annual aggregate maturities of our loans and notes during each of the next five fiscal years are as follows (amounts in thousands):

	Amount
2023	$ 755,150
2024	$ 130,214
2025	$ 88,488
2026	$ 477,674
2027	$ 1,008,879

3. Presentation and disclosure considerations in light of COVID-19

The impact of the response to the COVID-19 pandemic is creating liquidity issues for many entities, often resulting in their inability to repay debt as per the contractual requirements and their renegotiation of the terms of the debt. Also, the impact of COVID-19 on entities' financial statements is also frequently resulting in the violation of debt covenants, which also creates significant presentation and disclosure issues.

The accounting for modifications under U.S. GAAP is very complicated, with the accounting treatment, and related disclosures, dictated by both the facts and circumstances surrounding the modification and the impact of the modification on the entity's expected cash flows. The three potential accounting outcomes are the following:

- Troubled debt restructuring;
- Debt modification; and
- Debt extinguishment.

The review of the accounting and disclosure requirements of these transactions is generally beyond the scope of this course. However, the accounting and disclosure guidance can be found in ASC Topic 470, *Debt*.

Similarly, other contractual arrangements, such as leases, may be modified in light of the significant liquidity issues which many lessees face as a result of COVID-19. Both ASC Topic 842 provides the accounting and related disclosure guidance related to accounting for lease modifications.

Additionally, an entity may be in violation of a debt covenant at the balance sheet date, which provides the lender with the opportunity to demand immediate repayment of the debt. In such instances, the debt

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would be classified as current, with the circumstances which resulted in the current classification being disclosed in the financial statements.

In order to prevent this financial statement outcome, and the related liquidity issues resulting from the accelerated repayment of the debt, borrowers in such situations negotiate waivers to the violated covenant in order to prevent the debt from being immediately callable. Such waivers may result in the debt remaining classified as non-current. However, there needs to be a careful analysis of the waiver provisions in order to determine the appropriate classification. The following is a summary of the relevant accounting considerations.

<u>Waiver of Debt Covenant Violations</u>
Debt agreements frequently contain provisions that allow the lender to demand repayment prior to maturity. Essentially, the debt is callable by the lender if certain events occur. Some of these provisions can be exercised at any time, while others are contingently exercisable upon the occurrence of specific events. Debt classification, and related disclosures, for these types of instruments requires consideration of the terms in the debt agreement.

Debt that is callable by the lender based on conditions that existed at the balance sheet date is considered a due-on-demand loan. Due-on-demand loan agreements provide the lender with a right to demand repayment at any time at its discretion. The due-on-demand language can vary by agreement.

Some typical examples include the following:

- The term note matures in monthly installments or on demand, whichever is earlier.
- Principal and interest are due on demand or annually.

Per ASC 470-10-45-10, obligations that, by their terms, are due on demand or will be due on demand within one year (or the operating cycle, if longer) from the balance sheet date—even if liquidation is not expected within that period—are required to be classified as current liabilities.

Long-term financing agreements may contain subjective acceleration clauses (SAC), in which the lender may refuse to continue to lend if the borrower experiences an adverse change. These clauses are typically referred to as material adverse change (MAC) or material adverse effect (MAE) clauses.

Unlike a demand provision, a SAC typically requires a covenant violation or default event to occur before it can be invoked.

The ASC Master Glossary defines a subjective acceleration clause as a provision in a debt agreement that states that the creditor may accelerate the scheduled maturities of the obligation under conditions that are not objectively determinable (for example, if the debtor fails to maintain satisfactory operations or if a material adverse change occurs).

Per ASC 470-10-45-2, the likelihood of the due date being accelerated determines the classification of debt with a SAC. If acceleration of the due date is probable, and likely to occur, (e.g., the reporting entity has recurring losses or liquidity problems), the long-term debt subject to a SAC should be classified as a current liability.

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However, if acceleration of the due date is judged reasonably possible, disclosure of the existence of a SAC clause is generally sufficient, with the debt classified as noncurrent. If the acceleration of the due date is deemed remote, neither reclassification nor disclosure is required.

Debt agreements may contain clauses that make the debt callable by the lender upon certain contingent events. At each reporting period, the reporting entity should assess whether a contingent event has occurred as of the balance sheet date that makes the debt obligation callable by the lender. If so, current classification is required. Entities should disclose any SACs in their general description of debt agreements.

Further, many debt agreements include covenants on the borrower for the life of the agreement. Breach of a covenant triggers an event of default, which may lead to an increase in the interest rate or a potential demand for repayment (i.e., the debt becomes due). The following table summarizes the impact on the presentation of debt in various debt covenant violation scenarios:

Covenant violation scenario		**Classification**
1. Violation; no waiver; no grace period.		Current
2. Violation; no waiver; grace period.		
	It is probable that the violation will be cured within the grace period.	Noncurrent
	It is not probable that the violation will be cured within the grace period.	Current
3. Violation; waiver or modification obtained after the balance sheet date.		
	Covenant not required to be met within one year from the balance sheet date.	Noncurrent
	It is reasonably possible the covenant will be met at subsequent testing dates within one year from the balance sheet date.	Noncurrent
	It is probable the covenant will not be met at subsequent testing dates within one year from the balance sheet date.	Current
4. Violation avoided through modification made before the balance sheet date.		
	It is reasonably possible the covenant will be met at subsequent testing dates within one year from the balance sheet date.	Noncurrent
	It is probable the covenant will not be met at subsequent testing dates within one year from the balance sheet date.	Current
5. Violation occurring or anticipated after the balance sheet date.		Noncurrent

Let us review some of this guidance in greater detail.

Scenarios 1 and 2 are pretty straightforward.

In scenario 3, a covenant violation has occurred, and a waiver or modification is obtained after the balance sheet date. In this scenario, the classification of debt depends on the manner in which the waiver or modification was provided.

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Frequently, a covenant violation occurs at the balance sheet date and the lender requires the borrower to meet the same covenant, or a more restrictive covenant, in the next 12 months. ASC 470-10-55-2 through ASC 470-10-55-6 indicates that the obligation should be classified as a noncurrent liability at the balance sheet date if a waiver is obtained, unless the borrower concludes that the chance of meeting the same or more restrictive covenants at subsequent compliance measurement dates within the next year is remote (i.e., it is probable the borrower will violate the future covenant). As long as the borrower can conclude that it is at least reasonably possible that it will be able to meet the covenant when required, the debt should remain classified as noncurrent.

The entity should disclose the existence of the covenant and its decision that supports its classification.

Though unusual, if a covenant violation has occurred at the balance sheet date, the lender may not require the borrower to meet the same covenant, or a more restrictive covenant, in the next 12 months.

In such scenarios, ASC 470-10-45-11(a) indicates that the associated obligations should be classified as current unless one of the following conditions exists:

- The lender has waived the right to demand repayment for more than a year (or an operating cycle, if longer) from the balance sheet date. If the obligation is callable by the lender because of violations of certain provisions of the debt agreement, the lender needs to waive its right with regard to only those specific violations.
- The lender has subsequently lost the right to demand repayment for more than a year (or an operating cycle, if longer) from the balance sheet date. For example, if the borrower has cured the violation after the balance sheet date and the obligation is not callable by the lender at the time the financial statements are issued, the lender has lost the right to demand repayment.

A borrower may determine in advance of the balance sheet date that it will not be able to meet certain covenants. The borrower may seek to modify the debt agreement in advance so it will be compliant at the balance sheet date. In this fact pattern, the modification is in substance a waiver, except that it is obtained prior to the actual violation (instead of after, as a waiver would be).

ASC 470-10-55-4(d) provides guidance for when a covenant would have been violated at the balance sheet date absent a modification of the debt agreement before the balance sheet date, and for which violation is probable at the subsequent compliance date after the balance sheet date. It requires current classification of the debt, unless the provisions of ASC 470-10-45-13 through ASC 470-10-45-20 for refinancing short-term debt are met, in which case the debt may be classified as noncurrent.

ASC 470-10-55-4(a) through ASC 470-10-55-4(c) address classification when a covenant violation is probable after the balance sheet date, but no violation existed at the balance sheet date. In those instances, noncurrent classification would be appropriate (assuming all other conditions for noncurrent classification have been met). This is true regardless of whether the violation occurs after the balance sheet date but before the financial statements are issued, or if the violation is anticipated to occur in the next year. This scenario is essentially treated as a Type 2, disclosure-only subsequent event.

Current classification of the debt in this scenario is permitted in limited circumstances when the reporting entity concluded this was a more appropriate presentation.

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Given the potentially significant impact on the presentation of the debt in the financial statements, entities should appropriately disclose the covenant violated, the resultant presentation of the debt and their justification for that presentation, given the above guidance.

The following are example disclosures related to several of these scenarios.

<u>Debt covenant violation has occurred, with no waiver but the violation is expected to be cured in the grace period.</u>
At December 31, 2021, the company was in violation of the debt covenant related to its $500,000 term note that is due on June 30, 2023. That covenant required a certain current ratio, as defined in the debt agreement, be achieved as of December 31, 2021. As of December 31, 2021, the required ratio was not met, thus allowing the borrower to demand immediate repayment of the term loan.

However, the covenant contained a 90-day grace period, whereby if the violated covenant were subsequently met at the end of the 90-day grace period, March 31, 2022, the violation would be deemed to be cured and the borrower could no longer require immediate payment of the term loan.

As the company deemed the covenant violation at December 31, 2021 to be due to a temporary liquidity situation that existed at that date and that was subsequently resolved shortly after year-end, the company believes that it is probable that it will meet the current ratio covenant at March 31, 2022 and has thereby presented the entire balance of the term loan as a non-current liability as of December 31, 2021.

<u>Debt covenant violation has occurred, with a waiver obtained after the balance sheet date.</u>
At December 31, 2021, the company was in violation of the debt covenant related to its $500,000 term note that is due on June 30, 2023. That covenant required a certain current ratio, as defined in the debt agreement, be achieved as of December 31, 2019. As of December 31, 2019, the required ratio was not met, thus allowing the borrower to demand immediate repayment of the term loan.

On February 15, 2022, the company obtained a waiver from the lender of this covenant. Per this waiver, the company does not need to meet the requirements of this covenant until December 31, 2022. Accordingly, the company has classified this term loan as non-current in its December 31, 2021 financial statements.

<u>Debt covenant violation has occurred, with a waiver obtained after the balance sheet date; interim assessment of covenant is required.</u>
At December 31, 2021, the company was in violation of the debt covenant related to its $500,000 term note that is due on June 30, 2023. That covenant required a certain current ratio, as defined in the debt agreement, be achieved as of December 31, 2021. As of December 31, 2021, the required ratio was not met, thus allowing the borrower to demand immediate repayment of the term loan.

On February 15, 2022, the company obtained a waiver from the lender of this covenant. Per this waiver, the lender agreed to not require immediate repayment of the loan. However, per the waiver, the lender requires the company to meet the current ratio covenant as of June 30, 2022.

Given the company's deteriorating financial condition due to the impact of COVID-19 mandated closure of its retail facilities, which the company expects to continue for the foreseeable future, the company

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believes that it is probable that it will not meet the current ratio covenant as of June 30, 2022 and will thereby be in violation of this covenant at that date, allowing the borrower to demand immediate repayment of the term loan. Accordingly, the company has classified the term loan as a current liability in its December 31, 2021 financial statements.

F. Leases

On February 25, 2016, ASU No. 2016-02, *Leases (Topic 842) was issued by FASB*. This guidance introduced required reporting of leases on the balance sheet and also enhances footnote disclosures. ASU 2016-02 codifies FASB *Accounting Standards Codification* (ASC) 842, *Leases*, and makes conforming amendments to other FASB ASC topics. FASB ASU No. 2016-02 was subsequently amended by the following updates:

- ASU No. 2018-01, *Leases (Topic 842): Land Easement Practical Expedient for Transition to Topic 842*
- ASU No. 2018-10, *Codification Improvements to Topic 842, Leases*
- ASU No. 2018-11, *Leases (Topic 842): Targeted Improvements*
- ASU No. 2018-20, *Leases (Topic 842): Narrow-Scope Improvements for Lessors*
- ASU No. 2019-01, *Leases (Topic 842): Codification Improvements*
- ASU No. 2019-10, *Financial Instruments—Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842): Effective Dates*
- ASU No. 2020-05, *Revenue from Contracts with Customers (Topic 606) and Leases (Topic 842) Effective Dates for Certain Entities*
- ASU No. 2021-05*, Leases (Topic 842): Lessors – Certain Leases with Variable Lease Payments*

ASC 842 is applicable to any entity that enters into a lease and applies to all leases and subleases of property, plant, and equipment. However, the following arrangements are excluded from the guidance and are accounted for under other ASC topics.

a. Leases of intangible assets
b. Leases to explore for or use nonregenerative resources such as minerals, oil, and natural gas
c. Leases of biological assets, such as timber
d. Leases of inventory
e. Leases of assets under construction

1. Disclosure Example – Intuit, Inc.

Lease Policy

Our leases are primarily operating leases for office facilities. We do not have significant finance leases. We determine if an arrangement is a lease and classify it as either a finance or operating lease at lease inception. Operating leases are included in operating lease right-of-use (ROU) assets, other current liabilities, and operating lease liabilities on our consolidated balance sheets. Operating lease liabilities are recognized at the lease commencement date based on the present value of the future minimum lease payments over the lease term. Our leases generally do not have a readily determinable implicit rate, therefore we use our incremental borrowing rate at the commencement date in determining the present value of future payments. Our incremental borrowing rate is determined based on a yield curve derived from publicly traded bond offerings for companies with similar credit ratings to us. Our lease terms may include options to purchase, extend or terminate the lease when it is reasonably certain that we will exercise that option. We account for the lease and non-lease components as a single lease component. We measure ROU assets based on the corresponding lease liabilities adjusted for any initial direct costs and prepaid lease payments made to the lessor before or at the commencement date, net of lease incentives. Lease expense for minimum lease payments is recognized on a straight-line basis over the lease term. Variable lease payments are not included in the calculation of the ROU asset and lease liability and are recognized as lease expense is incurred. Our variable lease payments generally relate to

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amounts paid to lessors for common area maintenance under our real estate leases. Our subleases generally do not relieve us of our primary obligations under the corresponding head lease. As a result, we account for the head lease based on the original assessment at inception. We determine if the sublease arrangement is either a sales-type, direct financing, or operating lease at inception. If the total remaining lease cost on the head lease for the term of the sublease is greater than the anticipated sublease income, the ROU asset is assessed for impairment. Our subleases are generally operating leases and we recognize sublease income on a straight-line basis over the sublease term.

Leases
We lease office facilities under non-cancellable operating lease arrangements. Our facility leases generally provide for periodic rent increases and may contain escalation clauses and renewal options. Our leases have remaining lease terms of up to 20 years, which include options to extend that are reasonably certain of being exercised. Some of our leases include one or more options to extend the leases for up to 10 years per option which we are not reasonably certain to exercise. The options to extend are generally at rates to be determined in accordance with the agreements. Options to extend the lease are included in the lease liability if they are reasonably certain of being exercised. We do not have significant finance leases.

We sublease certain office facilities to third parties. These subleases have remaining lease terms of up to 8 years, some of which include one or more options to extend the subleases for up to 5 years per option.

In March 2020, we entered into an agreement to terminate an office facility lease and related sublease, which were due to expire in 2025 and 2022, respectively. As a result, we reduced our operating lease right-of-use assets and lease liabilities by $61 million during the twelve months ended July 31, 2020.

The components of lease expense were as follows:

	Twelve Months Ended July 31,		
(In millions)	2022	2021	2020
Operating lease cost [1]	$ 105	$ 75	$ 69
Variable lease cost	15	11	13
Sublease income	(17)	(16)	(22)
Total net lease cost	$ 103	$ 70	$ 60

[1] Includes short-term leases, which are not significant for the twelve months ended July 31, 2022, 2021 or 2020.

Supplemental cash flow information related to operating leases was as follows:

	Twelve Months Ended July 31,		
(In millions)	2022	2021	2020
Cash paid for amounts included in the measurement of operating lease liabilities	$ 104	$ 76	$ 70
Right-of-use assets obtained in exchange for new operating lease liabilities [1]	$ 238	$ 60	$ 346

[1] For the twelve months ended July 31, 2020, this includes $319 million for operating leases existing on August 1, 2019 and $27 million for operating leases that commenced during fiscal 2020.

Other information related to operating leases was as follows at the dates indicated:

	July 31,		
	2022	2021	2020
Weighted-average remaining lease term for operating leases	8.1 years	6.8 years	5.5 years
Weighted-average discount rate for operating leases	2.9 %	2.3 %	3.1 %

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Future minimum lease payments under non-cancellable operating leases as of July 31, 2022 were as follows:

(In millions)	Operating Leases [1]
Fiscal year ending July 31,	
2023	$ 64
2024	105
2025	93
2026	76
2027	67
Thereafter	323
Total future minimum lease payments	728
Less imputed interest	(102)
Present value of lease liabilities	$ 626

[1] Non-cancellable sublease proceeds for the fiscal years ending July 31, 2023, 2024, 2025, 2026, 2027, and thereafter of $11 million, $10 million, $5 million, $1 million, $1 million, and $3 million, respectively, are not included in the table above.

Supplemental balance sheet information related to operating leases was as follows at the date indicated:

(In millions)	July 31, 2022	July 31, 2021
Operating lease right-of-use assets	$ 549	$ 380
Other current liabilities	$ 84	$ 66
Operating lease liabilities	542	380
Total operating lease liabilities	$ 626	$ 446

IV. ASC 740, Income Taxes disclosures

ASC 740, *Income Taxes*, provides guidance on both the balance sheet and income statement disclosure requirements relating to income taxes. In this chapter we will review all disclosures related to Income Taxes under ASC 740.

A. Balance sheet presentation

As a reminder, deferred tax assets represent future reductions in the payment of income taxes while deferred tax liabilities represent future tax payments of income taxes. They are separately classified on balance sheet from income taxes payable or receivable, which represent the amount owed or receivable based on the current year's income tax return.

B. Income statement presentation

The total income tax amount for an entity consists of two parts. First, the current portion is the amount of the total tax payable or receivable from the taxing jurisdiction; this is taken directly from the tax return.

The second component of income tax expense or benefit is the change between the beginning and end of the year deferred tax account balances which are found on the balance sheet. However, as we saw when we were discussing intra-period allocations, there are a few exceptions to this general rule. For example, certain changes to deferred taxes are recorded through OCI, such as balances related to pensions.

Further, an entity makes an election as to how it will classify interest and penalties due to taxing authorities. Interest can be classified as either a component of income tax expense or interest expense, while penalties can be classified as either income tax expense or another classification. Entities must disclose the policy and the amount of interest and penalties included in the income statement.

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Lastly, professional fees incurred as part of tax compliance or planning activities would not be included in income tax expense but rather as part of selling, general, and administrative expense (SG&A).

V. Financial statement disclosures

Given that a large amount of activity is summarized in two income statement accounts and, under ASU No. 2015-17, two balance sheet accounts, it is not surprising that the required disclosures related to income taxes are extensive, both for the balance sheet and income statement amounts. Let us start with the balance sheet disclosures.

A. Balance sheet disclosures

Entities are required to disclose the following in the notes to their financial statements with regard to balance sheet tax accounts for each period presented in the financial statements:

- Gross deferred tax assets and liabilities.
- Valuation allowance and its net change. In addition to these quantitative disclosures, entities should consider adding qualitative evidence concerning the positive and negative evidence it considered in arriving at these amounts.
- The tax effect of each type of temporary difference and carryforward that gives rise to deferred tax assets and liabilities. Public entities are required to provide this information in a quantitative format while a private company can provide the information in a qualitative format.
- The amounts and expiration dates of loss and tax credit carryforwards.
- Temporary differences for which a deferred tax liability has not been recognized. An example of this would be if an entity did not provide a deferred tax liability on the earnings of foreign subsidiaries due to its intent to permanently reinvest those earnings in the subsidiary. This disclosure should include the following:
  - A description of the temporary difference and the reasons which could make them taxable in the future;
  - Their cumulative amount; and
  - The amount of any unrecognized deferred tax liability.
- Other required disclosures, as applicable, include the following:
  - Nature and effect of any significant matters affecting the comparability of the information presented,
  - Any portion of the valuation allowance for which subsequently recognized tax benefits will be credited directly to contributed capital, and
  - The amount of income tax expense or benefit allocated to each component of OCI.

B. Income statement disclosures

An entity is required to disclose the amount of income tax expense or benefit allocated to continuing operations, as well as that allocated to other components, in accordance with the intra-period allocation provisions. Often, this disclosure, at least for continuing and discontinued operations, is on the face of the financial statements.

Entities are also required to reconcile income tax expense attributable to continuing operations to the statutory Federal income tax rate applied to book pre-tax income from continuing operations. For public companies, this reconciliation can be in a dollar or percentage format while, for private companies, the rate reconciliation can be of a qualitative nature only.

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The following are common items included in the rate reconciliation:

- Changes in the valuation allowance.
- Use of permanent differences or tax credits in determination of taxes payable or deferred taxes.
- Impact of changes in tax rates.
- Unremitted foreign earnings that are deemed permanently reinvested.
- Impact of tax holidays.
- Change in unrecognized tax benefits from uncertain tax positions.
- Stock-based compensation shortfalls (windfalls will also be included with the effective date of ASU No. 2016-09).
- Goodwill impairment or tax amortization.

Often the rate reconciliation is seen as a report card on the entity's ability to manage its tax liability. Many of the reconciling items can be seen as arising as the result of effective tax planning strategies.

Additionally, entities are required to discloses the significant components of income tax expense. These components should consist of the following:

- Current income tax expense or benefit.
- Deferred tax expense or benefit.
- Investment tax credits.
- Government grants.
- Benefits of operating loss carryforwards.
- Tax expense from the direct allocation of certain tax benefits directly to contributed capital.
- Adjustments to deferred taxes due to enacted changes in tax rates or laws.
- Changes in valuation allowance from the beginning of the year due to changes in assumptions about the realization of deferred tax assets.

Topic 740 also requires other disclosures with regard to uncertain tax positions. We will discuss the accounting for such positions, including required disclosures, later in the course. Additionally, extensive disclosures are required with regard to stock-based compensation, including amounts related to taxes on such transactions. We will also discuss this topic later in the course.

Generally, these disclosures are required for all entities, whether they be public or private, unless otherwise noted above. However, there are several other items of disclosure relief for non-public entities. They are not required to disclose the following:

- Tabular reconciliation of the total amount of unrecognized tax benefits at the beginning and end of the reporting date.
- Tax holidays granted by foreign jurisdictions.
- Net difference between the tax bases and the reported amount of assets and liabilities when they are structured as nontaxable entities.

Further, only SEC registrants are required to make the following disclosures, under the SEC S-X rules:

- In the rate reconciliation, individual reconciling items that are more than 5 percent of the amount computed by multiplying the pre-tax income by the statutory tax rate.
- The source of income/loss before taxes as either foreign or domestic.
- For each major component of income tax expense, the amounts applicable to U.S. Federal tax, foreign income taxes, or other income taxes.
- Tax holidays granted.

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As we wrap our discussion up, note that the FASB is reviewing the required disclosures in Topic 740 as part of its Disclosure Framework review project. This is part of a broader initiative to both review how the FASB develops its required disclosures for a topic and how entities apply that guidance. The review of Topic 740 disclosures has moved to the Exposure Draft stage as of March 2023 and the following high-level insight is now available:

- Public business entities would be required on an annual basis to (1) disclose specific categories in the rate reconciliation and (2) provide additional information for reconciling items that meet a quantitative threshold (if the effect of those reconciling items is equal to or greater than 5 percent of the amount computed by multiplying pretax income (loss) by the applicable statutory tax rate).
- All entities would disclose the following information about income taxes paid:
  1. The year-to-date amount of income taxes paid (net of refunds received) disaggregated by federal (national), state, and foreign taxes on both an interim and annual basis
  2. The amount of income taxes paid (net of refunds received) disaggregated by individual jurisdictions in which income taxes paid (net of refunds received) is equal to or greater than 5 percent of total income taxes paid (net of refunds received), on an annual basis.
- All entities would also have additional disclosures related to:
  1. Income (or loss) from continuing operations before income tax expense (or benefit) disaggregated between domestic and foreign
  2. Income tax expense (or benefit) from continuing operations disaggregated by federal (national), state, and foreign. The amendments in this proposed Update would eliminate the requirement for all entities to (1) disclose the nature and estimate of the range of the reasonably possible change in the unrecognized tax benefits balance in the next 12 months or (2) make a statement that an estimate of the range cannot be made.

The requirement to disclose the cumulative amount of each type of temporary difference when a deferred tax liability is not recognized because of the exceptions to comprehensive recognition of deferred taxes related to subsidiaries and corporate joint ventures would be removed by the proposed update.

C. Example of income tax disclosures – Microsoft

The following are sample disclosures of some of the required disclosures related to income taxes. The entities selected provide examples of the significantly different outcomes that may occur based on the operations of the entity. For instance, Microsoft derives a significant portion of its revenue from outside of the U.S. and it has a relatively small, fixed asset base.

1. Components of income and income tax expense

The following disclosure details the sources of Microsoft's taxable income by geography as well as the breakdown of its income tax expense both by its components and its geography. As we will see when we look at Microsoft's rate reconciliation, their foreign earnings are generally taxed at a lower rate than their U.S.-based earnings.

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The components of the provision for income taxes were as follows:

(In millions)

Year Ended June 30,		2021		2020		2019
Current Taxes						
U.S. federal	$	3,285	$	3,537	$	4,718
U.S. state and local		1,229		763		662
Foreign		5,467		4,444		5,531
Current taxes	$	9,981	$	8,744	$	10,911
Deferred Taxes						
U.S. federal	$	25	$	58	$	(5,647)
U.S. state and local		(204)		(6)		(1,010)
Foreign		29		(41)		194
Deferred taxes	$	(150)	$	11	$	(6,463)
Provision for income taxes	$	9,831	$	8,755	$	4,448

U.S. and foreign components of income before income taxes were as follows:

(In millions)

Year Ended June 30,		2021		2020		2019
U.S.	$	34,972	$	24,116	$	15,799
Foreign		36,130		28,920		27,889
Income before income taxes	$	71,102	$	53,036	$	43,688

2. Rate reconciliation

In Microsoft's rate reconciliation, we see that their effective tax rate of 13.8 percent is significantly lower than their U.S. Federal and State statutory rate of 22.4 percent. This is due to several reasons:

- Lower tax rate on foreign earnings than on U.S.-based earnings.
- Positive effect of the TCJA-added foreign-derived intangible income deduction, which creates a preferable U.S. federal income tax rate on income derived from sales of goods and services to foreign customers. This credit incentivizes the use of U.S.-based intellectual property, as opposed to foreign-based intellectual property, which generally drives the lower income tax rate on foreign-sourced income.
- Excess tax benefit over that recorded at the statutory rate from the exercise or vesting of share-based awards. Essentially, the actual deduction taken exceeded the expected tax benefit recorded when the expense for share-based payments recorded under ASC 718 was originally recorded.

Effective Tax Rate

The items accounting for the difference between income taxes computed at the U.S. federal statutory rate and our effective rate were as follows:

Year Ended June 30,	2021	2020	2019
Federal statutory rate	21.0%	21.0%	21.0%
Effect of:			
Foreign earnings taxed at lower rates	(2.7)%	(3.7)%	(4.1)%
Impact of the enactment of the TCJA	0%	0%	0.4%
Impact of intangible property transfers	0%	0%	(5.9)%
Foreign-derived intangible income deduction	(1.3)%	(1.1)%	(1.4)%
State income taxes, net of federal benefit	1.4%	1.3%	0.7%
Research and development credit	(0.9)%	(1.1)%	(1.1)%
Excess tax benefits relating to stock-based compensation	(2.4)%	(2.2)%	(2.2)%
Interest, net	0.5%	1.0%	1.0%
Other reconciling items, net	(1.8)%	1.3%	1.8%
Effective rate	13.8%	16.5%	10.2%

3. Components of its deferred tax assets and liabilities

Unlike many capital-intensive businesses, Microsoft is in a net deferred tax asset position. Its largest deferred tax asset relates to the future tax benefit to be derived from its recorded book amortization of intangible assets not yet recorded for tax purposes, deferred revenue for book purposes already taxed, and accruals, reserves, and other expenses recorded for book purposes not yet deducted for tax purposes.

Microsoft's deferred tax liabilities consist of the tax effect of unrealized gains on equity and debt investments as well as deferred taxes related to the GILTI tax on foreign-derived income.

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Lastly, note the deferred tax asset and liability related to leases are essentially offset and due to the recording of operating leases under ASC 842.

(In millions)				
June 30,		2021		2020
Deferred Income Tax Assets				
Stock-based compensation expense	$	**502**	$	461
Accruals, reserves, and other expenses		**2,960**		2,721
Loss and credit carryforwards		**1,090**		865
Amortization		**6,346**		6,737
Leasing liabilities		**4,060**		3,025
Unearned revenue		**2,659**		1,553
Other		**543**		354
Deferred income tax assets		**18,160**		15,716
Less valuation allowance		**(769)**		(755)
Deferred income tax assets, net of valuation allowance	$	**17,391**	$	14,961
Deferred Income Tax Liabilities				
Book/tax basis differences in investments and debt	$	**(2,605)**	$	(2,642)
Leasing assets		**(3,834)**		(2,817)
Depreciation		**(1,010)**		(376)
Deferred GILTI tax liabilities		**(2,815)**		(2,581)
Other		**(144)**		(344)
Deferred income tax liabilities	$	**(10,408)**	$	(8,760)
Net deferred income tax assets	$	**6,983**	$	6,201
Reported As				
Other long-term assets	$	**7,181**	$	6,405
Long-term deferred income tax liabilities		**(198)**		(204)
Net deferred income tax assets	$	**6,983**	$	6,201

4. Other required disclosures

This table represents the roll-forward of Microsoft's uncertain tax positions.

The aggregate changes in the gross unrecognized tax benefits related to uncertain tax positions were as follows:

(In millions)						
Year Ended June 30,		2021		2020		2019
Beginning unrecognized tax benefits	$	**13,792**	$	13,146	$	11,961
Decreases related to settlements		**(195)**		(31)		(316)
Increases for tax positions related to the current year		**790**		647		2,106
Increases for tax positions related to prior years		**461**		366		508
Decreases for tax positions related to prior years		**(297)**		(331)		(1,113)
Decreases due to lapsed statutes of limitations		**(1)**		(5)		0
Ending unrecognized tax benefits	$	**14,550**	$	13,792	$	13,146

VI. Equity

ASC 505, *Equity*, provides guidance on the disclosure requirements associated with the separate accounts comprising shareholders' equity and the specific outstanding securities issued by an entity.

According to ASC 505, if both financial position and results of operations are presented, disclosure of changes in the separate accounts comprising shareholders' equity (in addition to retained earnings) and of the changes in the number of shares of equity securities during at least the most recent annual fiscal period and any subsequent interim period presented is required to make the financial statements sufficiently informative. Disclosure of such changes can take the form of separate statements or may be made in the basic financial statements or in the notes to the financial statements. In addition, an entity should also explain, in summary form within its financial statements, the pertinent rights and privileges of the various securities outstanding. Examples of information that should be disclosed are dividend and liquidation preferences, participation rights, call prices and dates, conversion or exercise prices or rates and pertinent dates, sinking-fund requirements, unusual voting rights, and significant terms of contracts to issue additional shares. In this context, an entity should disclose within its financial statements the number of shares issued upon conversion, exercise, or satisfaction of required conditions during at least the most recent annual fiscal period and any subsequent interim period presented.

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A. Securities with preferences

ASC 505 requires an entity that issues preferred stock (or other senior stock) that has a preference in involuntary liquidation considerably in excess of the par or stated value of the shares should disclose the liquidation preference of the stock (the relationship between the preference in liquidation and the par or stated value of the shares). That disclosure should be made in the equity section of the statement of financial position in the aggregate, either parenthetically or in short, rather than on a per-share basis or through disclosure in the notes.

In addition, an entity should disclose both of the following within its financial statements (either on the face of the statement of financial position or in the notes to the financial statements):

1. The aggregate or per-share amounts at which preferred stock may be called or is subject to redemption through sinking-fund operations or otherwise; and
2. The aggregate and per-share amounts of arrearages in cumulative preferred dividends.

B. Contingently convertible securities

According to ASC 505, to comply with the general disclosure requirements above, the significant terms of the conversion features of the contingently convertible security should be disclosed to enable financial statement users to understand the circumstances of the contingency and the potential impact of conversion. Quantitative and qualitative terms of the contingently convertible security, disclosure of which would be helpful in understanding both the nature of the contingency and the potential impact of conversion, include all of the following:

a. Events or changes in circumstances that would cause the contingency to be met and any significant features necessary to understand the conversion rights and the timing of those rights, for example, the periods in which the contingency might be met and the securities may be converted if the contingency is met.
b. The conversion price and the number of shares into which a security is potentially convertible.
c. Events or changes in circumstances, if any, that could adjust or change the contingency, conversion price, or number of shares, including significant terms of those changes.
d. The manner of settlement upon conversion and any alternative settlement methods, for example, cash, shares, or a combination.

In order to meet these disclosure requirements, the possible conversion prices and dates as well as other significant terms for each convertible instrument should be disclosed.

Additionally, the issuer should disclose in the notes to the financial statements the terms of the transaction, including the excess of the aggregate fair value of the instruments that the holder would receive at conversion over the proceeds received and the period over which the discount is amortized.

Disclosures should indicate whether the shares that would be issued if the contingently convertible securities were converted are included in the calculation of diluted earnings per share (EPS) and the reasons why or why not.

C. Redeemable securities

ASC 505 also requires an entity that issues redeemable stock should disclose the amount of redemption requirements, separately by issue or combined, for all issues of capital stock that are redeemable at fixed

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or determinable prices on fixed or determinable dates in each of the five years following the date of the latest statement of financial position presented.

Disclosures related to equity is another area that will vary significantly, based on the complexity of the equity structure of the entity. Equity disclosures for entities with one class of common stock are frequently made just on the face of the financial statements, not even requiring footnote disclosure.

D. Disclosure example – Nike, Inc.

REDEEMABLE PREFERRED STOCK

	Common Stock				Capital in Excess of Stated Value	Accumulated Other Comprehensive Income	Retained Earnings	Total
	Class A		Class B					
(In millions, except per share data)	Shares	Amount	Shares	Amount				

Note 10 – Redeemable Preferred Stock

Sojitz America is the sole owner of the Company's authorized redeemable preferred stock, $1 par value, which is redeemable at the option of Sojitz America or the Company at par value aggregating $0.3 million. A cumulative dividend of $0.10 per share is payable annually on May 31 and no dividends may be declared or paid on the common stock of the Company unless dividends on the redeemable preferred stock have been declared and paid in full. There have been no changes in the redeemable preferred stock in the three years ended May 31, 2015, 2014, and 2013. As the holder of the redeemable preferred stock, Sojitz America does not have general voting rights but does have the right to vote as a separate class on the sale of all or substantially all of the assets of the Company and its subsidiaries, on merger, consolidation, liquidation or dissolution of the Company or on the sale or assignment of the NIKE trademark for athletic footwear sold in the United States. The redeemable preferred stock has been fully issued to Sojitz America and is not blank check preferred stock. The Company's articles of incorporation do not permit the issuance of additional preferred stock.

E. Disclosure example – Sungard Data Systems

PREFERRED STOCK WITH LIQUIDATION PREFERENCE

1. Preferred Stock

SCCII

SCCII has preferred and common stock outstanding at December 31, 2013 and 2014. The preferred stock is non-voting and ranks senior in right of payment to the common stock. Each share of preferred stock has a liquidation preference of $100 (the initial Class P liquidation preference) plus an amount equal to the accrued and unpaid dividends accruing at a rate of 11.5% per year of the initial Class P liquidation preference ($100 per share), compounded quarterly. Holders of preferred stock are entitled to receive cumulative preferential dividends to the extent a dividend is declared by the Board of Directors of SCCII at a rate of 11.5% per year of the initial Class P liquidation preference ($100 per share) payable quarterly in arrears. The aggregate amount of cumulative but undeclared preferred stock dividends at December 31, 2013 and 2014 was $764 million and $744 million, respectively ($77.35 and $98.64 per share, respectively).

Preferred shares and stock awards which include preferred shares are held by certain members of management. In the case of termination resulting from disability or death, an employee or his/her estate may exercise a put option which would require the Company to repurchase vested shares at the current

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fair market value. Accordingly, these shares of preferred stock must be classified as temporary equity (between liabilities and stockholder's equity) on the balance sheet of SCCII.

COMMON STOCK WITH CONVERSION AND LIQUIDATION PREFERENCE

2. Common Stock

SCC has nine classes of common stock, Class L and Class A-1 through A-8. Class L common stock has identical terms as Class A common stock except as follows:

- Class L common stock has a liquidation preference: distributions by SCC are first allocated to Class L common stock up to its $81 per share liquidation preference plus an amount sufficient to generate a rate of return of 13.5% per annum, compounded quarterly ("Class L Liquidation Preference"). All holders of Common stock, as a single class, share in any remaining distributions pro rata based on the number of outstanding shares of Common stock; and
- Each share of Class L common stock automatically converts into Class A common stock upon an initial public offering or other registration of the Class A common stock and is convertible into Class A common stock upon a majority vote of the holders of the outstanding Class L common stock upon a change in control or other realization events. If converted, each share of Class L common stock is convertible into one share of Class A common stock plus an additional number of shares of Class A common stock determined by dividing the Class L Liquidation Preference at the date of conversion by the adjusted market value of one share of Class A common stock as set forth in the certificate of incorporation of SCC.

In the case of termination resulting from disability or death, an employee or his/her estate may exercise a put option which would require the Company to repurchase vested shares at the current fair market value. Accordingly, these common shares must be classified as temporary equity (between liabilities and equity) on the balance sheet of SCC.

F. Proposed ASC updates

In April 2022, the FASB removed from its agenda a project to simplify how to distinguish certain liabilities, such as convertible debt, from equity based upon feedback it was receiving.

VII. Chapter summary

In this chapter, we reviewed the following disclosures related to several key balance sheet liabilities in accordance with U.S. generally accepted accounting principles:

- Trade accounts payable;
- Short-term obligations;
- Asset retirement and environmental obligations;
- Guarantees;
- Long-term debt; and
- Income taxes payable.

Examples illustrating these disclosures included those from the published financial statements of:

- Short-term obligations
  - Sample disclosure example
  - Levi Strauss & Co.

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- Asset retirement and environmental obligations
  - Generic disclosure example
  - Comcast Corporation
  - Dow Chemical Company
- Guarantees
  - Harris Corporation
  - Sample disclosure example
- Long-term debt
  - Sample disclosure example
  - Toll Brothers, Inc.
- Income taxes payable
  - Sample disclosure example
  - MicroSoft Corporation

We also reviewed disclosures related to equity in accordance with U.S. generally accepted accounting principles. An example illustrating these disclosures included those from the published financial statements of Nike, Inc., and Sungard Data Systems.

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Income Statement and Statement of Cash Flows Disclosures

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Income Statement and Statement of Cash Flows Disclosures

Learning objective

After completing this chapter, you should be familiar with:

- Disclosures related to several key income statement and statement of cash flows items in accordance with U.S. GAAP.

I. Introduction

In this chapter we will review disclosures related to several key income statement and statement of cash flows items. To illustrate these disclosures, example excerpts from recently published financial statements will be presented for your review. Once again, since there are literally thousands of such examples available, the examples included here are only meant as a sample of the many possible alternatives typically seen in practice today.

The disclosure guidance related to income statement items is included throughout the FASB Accounting Standards Codification™ (ASC). We will focus our attention here on some of those key disclosure matters relating to revenue recognition and certain expense items, including compensation/retirement benefits, and income taxes.

We will then conclude the chapter by reviewing the disclosure guidance related to the statement of cash flows.

II. Revenue recognition

A. ASC Topic 606: *Revenue from Contracts with Customers*

With the adoption of ASC 606 disclosure requirements increased significantly beyond the disclosured required under ASC 605, even for SEC registrants. Non-PBEs receive significant disclosure relief in several areas from these requirements, particularly in the area of many of the quantitative disclosures that are required under ASC 606.

While public business entity disclosures were aided by early adopters and the SEC's comments on the disclosures, unfortunately, non-PBEs did not have the same benefit with regard to access to examples from early adopters. While non-PBE's could undoubtedly use the examples of the disclosures of PBEs, the non-PBEs would need to both tailor the disclosures to their individual facts and circumstances as well as "peel back" the disclosures that are optional for them.

So, what does it all mean? As we stated in the last chapter, it is likely that SEC registrants' disclosures will evolve over time, as best practices emerge, and registrants respond to SEC comments for additional or changed information. The same thing is likely to happen, but on a larger scale, for non-PBEs. While not as publicly accessible as the financial statements of PBEs, examples of disclosures from the financial statements of non-PBEs are sure to emerge.

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Further, scrutiny from accounting firms, as well as from the peer-review process in which most accounting firms engaged in attestation work are enrolled, will also, over time, foster consistency in disclosures. However, this process will likely take longer than the process for PBEs. In the meantime, all entities, but especially non-PBEs, should continue to review examples from both public and private companies in order to obtain fresh ideas on how to improve their disclosures. They should engage in dialogue with both industry peers, as well as their accountants, in order to access other examples they can leverage to improve their own disclosures.

Lastly, they should also acknowledge that less disclosure doesn't always equal better disclosure. The disclosure reliefs in ASC 606 for non-PBEs are meant to ease their implementation burden. However, the revenue disclosures in ASC 606 are meant to provide useful information concerning the nature, timing, and uncertainty of revenue and cash flows arising from revenue contracts with customers. As the burden of initial implementation eases, entities may find that the effort to accumulate the quantitative and other information which is not required for non-PBEs is not as significant of a task as originally seen and may also provide stakeholders such as banks, other creditors, current and potential customers, and others with the type of information that advances the interests of the entity. While there is a clear trade-off between more disclosure information and the cost of accumulating it, entities shouldn't dismiss out of hand the prospects of electing not to use some of the disclosure reliefs provided for non-PBEs.

III. Enhanced disclosures

,Prior to the issuance of ASC 606 revenue has been one account in the financial statements where the required disclosures have been relatively scant. Other than those entities that utilize industry-specific guidance, disclosures tended to be little more than the entity's revenue recognition policy.

However, that has changed with ASC 606. Required disclosures include the following:

ASC	**Required Disclosure**
Disaggregation of revenue	• Disaggregation of revenue into categories that show how economic factors affect the nature, amount, timing, and uncertainty of revenue and cash flows.
Reconciliation of contract balances	• Opening and closing balances and revenue recognized during the period from changes in contract balances and quantitative and qualitative information about the significant changes in contract balances. • The amount of revenue recognized that was included in the contract liability balance at the beginning of the period. • The amount of revenue recognized in the current period relating to performance obligations satisfied in a prior period (such as from contracts with variable consideration). • How the timing of the satisfaction of a performance obligation relates to the timing of payments. Discussion of the effect on the contract asset and liability balances related to any timing differences.
Performance obligations	• When performance obligations are typically satisfied. • Significant payment terms. • Nature of the goods or services promised to be transferred. • Obligations for returns, refunds, or other similar obligations. • Types of warranties and related obligations.
Remaining performance obligations	• The amount of the transaction price allocated to any remaining performance obligations not subject to significant revenue reversal. • When the entity expects to recognize revenue associated with the transaction price allocated to the remaining performance obligations.

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ASC	Required Disclosure
	• Qualitative description of any significant contract renewal and variable consideration not included within the transaction price.
Costs to obtain or fulfill contracts	• Disclosure of the closing balances, by main category of asset, of capitalized costs to obtain and fulfill a contract and the amount of amortization in the period. • Disclosure of the method used to determine the amount of costs incurred and the amortization for each reporting period.
Other qualitative disclosures	• Significant judgments and changes in judgments that affect the amount and timing of revenue, including: ○ Timing of satisfaction of performance obligations; and ○ Transaction price and amount allocated to performance obligations. • For performance obligations satisfied over time, disclose: ○ Method used to recognize revenue (output or input method used and how applied); and ○ Why method used faithfully depicts the transfer of goods or services. • For performance obligations satisfied at a point in time, disclose significant judgments made in evaluating when customer obtains control. • Disclose information about the input, methods, and assumptions used to determine the transaction price, assess whether variable consideration is constrained, allocate transaction price, and determine the standalone selling price. • Disclose how management determines the minimum amount of revenue not subject to the variable consideration constraint. • Describe the practical expedients, including those for transition, used in an entity's revenue accounting policies.
Interim disclosures	• Disaggregation of revenue disclosure. • Contract balances disclosure. • Revenue recognized in the reporting period that was included in the contract liability balance at the beginning of the period. • Remaining performance obligation disclosures. • Information about the entity's remaining performance obligations as of the end of the reporting period.

As you can see, these are pretty voluminous. Here are a few points and then on to some sample disclosures from ASC 606.

First, the above disclosure requirements are for public companies. Private companies have either reduced or modified disclosures, as follows:

ASC	Required Disclosure
Disaggregation of revenue	• Nonpublic entities may elect to not apply the quantitative disaggregation or revenue disclosure guidance discussed above. If this election is made, an entity still must disclose: ○ Revenue disaggregated according to the timing of transfer of goods or services (at a point in time or over time); and ○ Qualitative information about how economic factors (i.e., type of customer, geographical location, and type of contract) affect the amount, nature, timing, and uncertainty of revenue and cash flows.
Reconciliation of contract balances	• Nonpublic entities can elect to disclose only the opening and closing balances of contract assets, contract liabilities, and receivables from contracts with its customers. The other disclosures described above are optional.

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ASC	Required Disclosure
Performance obligations	• Descriptive disclosures of an entity's performance obligations are required. However, disclosures regarding remaining unsatisfied or partially satisfied performance obligations are optional.
Significant judgments	• For performance obligations satisfied over time, disclose: ○ Method used to recognize revenue (output or input method used and how applied). • Disclose information about the input, methods, and assumptions used to determine the transaction price; assess whether variable consideration is constrained. • All other above disclosures under other qualitative disclosures are optional.
Practical expedients	• Above noted disclosures are optional.
Interim disclosures	• Above noted disclosures are optional.

Let us explore the content of some of these disclosures in a bit more detail, realizing that they will be tailored to the facts and circumstances of each entity's revenue recognition polices and customer base. No two sets of disclosures will be alike.

A. Disaggregated revenue

ASC 606 does not prescribe the categories for disaggregation but instead gives examples of categories that may be appropriate. These include:

- Disclosures presented outside of the financial statements, including earnings releases, annual reports, or investor presentations;
- Information regularly reviewed by the Chief Operating Decision Maker for evaluating financial performance of operating segments; and
- Other information, as applicable.

Examples of categories that may be appropriate include:

- Type of good or service;
- Geographical region;
- Market or type of customer;
- Type of contract;
- Contract duration;
- Timing of transfer of good or service; and
- Sales channels.

While there is a clear relationship between these categories to segment reporting, the disaggregation does not need to follow the categories used for segment reporting, especially as segment reporting is not required for private companies.

As you can see, this disclosure is more detailed than that which would be presented for segments. As the complexity and diversity of an entity's operations increase, the format of this disclosure should reflect this complexity.

The following are several examples of SEC registrants' disaggregation of revenue disclosures:

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Apple's disaggregated revenue disclosure is below:

Note 2 – Revenue

Net sales disaggregated by significant products and services for 2022, 2021 and 2020 were as follows (in millions):

	2022	2021	2020
iPhone (1)	$ 205,489	$ 191,973	$ 137,781
Mac (1)	40,177	35,190	28,622
iPad (1)	29,292	31,862	23,724
Wearables, Home and Accessories (1)(2)	41,241	38,367	30,620
Services (3)	78,129	68,425	53,768
Total net sales (4)	$ 394,328	$ 365,817	$ 274,515

(1) Products net sales include amortization of the deferred value of unspecified software upgrade rights, which are bundled in the sales price of the respective product.

(2) Wearables, Home and Accessories net sales include sales of AirPods, Apple TV, Apple Watch, Beats products, HomePod mini and accessories.

(3) Services net sales include sales from the Company's advertising, AppleCare, cloud, digital content, payment and other services. Services net sales also include amortization of the deferred value of services bundled in the sales price of certain products.

(4) Includes $7.5 billion of revenue recognized in 2022 that was included in deferred revenue as of September 25, 2021, $6.7 billion of revenue recognized in 2021 that was included in deferred revenue as of September 26, 2020, and $5.0 billion of revenue recognized in 2020 that was included in deferred revenue as of September 28, 2019.

Note 2 – Revenue

Net sales disaggregated by significant products and services for 2022, 2021 and 2020 were as follows (in millions):

	2022	2021	2020
iPhone (1)	$ 205,489	$ 191,973	$ 137,781
Mac (1)	40,177	35,190	28,622
iPad (1)	29,292	31,862	23,724
Wearables, Home and Accessories (1)(2)	41,241	38,367	30,620
Services (3)	78,129	68,425	53,768
Total net sales (4)	$ 394,328	$ 365,817	$ 274,515

(1) Products net sales include amortization of the deferred value of unspecified software upgrade rights, which are bundled in the sales price of the respective product.

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(3) Services net sales include sales from the Company's advertising, AppleCare, cloud, digital content, payment and other services. Services net sales also include amortization of the deferred value of services bundled in the sales price of certain products.

(4) Includes $7.5 billion of revenue recognized in 2022 that was included in deferred revenue as of September 25, 2021, $6.7 billion of revenue recognized in 2021 that was included in deferred revenue as of September 26, 2020, and $5.0 billion of revenue recognized in 2020 that was included in deferred revenue as of September 28, 2019.

The Company's proportion of net sales by disaggregated revenue source was generally consistent for each reportable segment in Note 11, "Segment Information and Geographic Data" for 2022, 2021 and 2020, except in Greater China, where iPhone revenue represented a moderately higher proportion of net sales in 2022 and 2021.

Note 11 – Segment Information and Geographic Data

The following table shows information by reportable segment for 2022, 2021 and 2020 (in millions):

	2022	2021	2020
Americas:			
Net sales	$ 169,658	$ 153,306	$ 124,556
Operating income	$ 62,683	$ 53,382	$ 37,722
Europe:			
Net sales	$ 95,118	$ 89,307	$ 68,640
Operating income	$ 35,233	$ 32,505	$ 22,170
Greater China:			
Net sales	$ 74,200	$ 68,366	$ 40,308
Operating income	$ 31,153	$ 28,504	$ 15,261
Japan:			
Net sales	$ 25,977	$ 28,482	$ 21,418
Operating income	$ 12,257	$ 12,798	$ 9,279
Rest of Asia Pacific:			
Net sales	$ 29,375	$ 26,356	$ 19,593
Operating income	$ 11,569	$ 9,817	$ 6,808

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The disaggregated revenue disclosures for The Boeing Company follow:

While our principal operations are in the United States, Canada and Australia, some key suppliers and subcontractors are located in Europe and Japan. Revenues, including foreign military sales, are reported by customer location and consisted of the following:

Years ended December 31,	2021	2020	2019
Europe	**$8,967**	$7,961	$10,366
Asia	**5,845**	5,931	16,346
Middle East	**4,653**	5,308	9,272
Canada	**969**	1,302	2,019
Oceania	**1,147**	832	2,006
Africa	**239**	114	1,113
Latin America, Caribbean and other	**1,376**	229	1,015
Total non-U.S. revenues	**23,196**	21,677	42,137
United States	**39,076**	36,979	42,681
Estimated potential concessions and other considerations to 737 MAX customers, net(1)	**14**	(498)	(8,259)
Total revenues	**$62,286**	$58,158	$76,559

(1) Net of insurance recoveries

BCA revenues by customer location consisted of the following:

Years ended December 31,	2021	2020	2019
Revenue from contracts with customers:			
Europe	**$4,334**	$3,872	$5,829
Middle East	**1,098**	1,647	5,761
Asia	**2,792**	2,679	12,446
Other	**1,681**	513	3,450
Total non-U.S. revenues	**9,905**	8,711	27,486
United States	**9,472**	7,899	12,676
Estimated potential concessions and other considerations to 737 MAX customers, net(1)	**14**	(498)	(8,259)
Total revenues from contracts with customers	**19,391**	16,112	31,903
Intersegment revenues, eliminated on consolidation	**102**	50	352
Total segment revenues	**$19,493**	$16,162	$32,255
Revenue recognized on fixed-price contracts	**100 %**	100 %	100 %
Revenue recognized at a point in time	**100 %**	100 %	100 %

(1) Net of insurance recoveries

BDS revenues on contracts with customers, based on the customer's location, consisted of the following:

Years ended December 31,	2021	2020	2019
Revenue from contracts with customers:			
U.S. customers	**$19,869**	$19,662	$19,465
Non-U.S. customers(1)	**6,671**	6,595	6,630
Total segment revenue from contracts with customers	**$26,540**	$26,257	$26,095
Revenue recognized over time	**99 %**	98 %	98 %
Revenue recognized on fixed-price contracts	**68 %**	69 %	70 %
Revenue from the U.S. government(1)	**89 %**	89 %	89 %

(1) Includes revenues earned from foreign military sales through the U.S. government.

BGS revenues consisted of the following:

Years ended December 31,	2021	2020	2019
Revenue from contracts with customers:			
Commercial	**$7,527**	$6,936	$10,167
Government	**8,553**	8,368	8,107
Total revenues from contracts with customers	**16,080**	15,304	18,274
Intersegment revenues eliminated on consolidation	**248**	239	194
Total segment revenues	**$16,328**	$15,543	$18,468
Revenue recognized at a point in time	**45 %**	47 %	55 %
Revenue recognized on fixed-price contracts	**86 %**	87 %	90 %
Revenue from the U.S. government(1)	**40 %**	41 %	34 %

(1) Includes revenues earned from foreign military sales through the U.S. government.

Note that Boeing, with three large and relatively independent product lines, commercial aviation, defense, and parts presented their disaggregated information in three separate tables (as well as a combined table). They further disaggregated this information in each table, using the relevant categories for each segment.

Further, the disaggregated categories for each segment were different.

Its disclosures demonstrated an entity not just employing a “cookie-cutter” approach but focusing its disclosures on the categories that are relevant to stakeholders in each segment.

B. Reconciliation of contract balances

The objective of this disclosure is to inform the reader of how much revenue was recognized in the current year that did not result from current-year activity. While the format for providing this information is flexible, the following information must be provided nonetheless:

- Opening and closing balances of the following accounts:
    - Receivables;
    - Contract assets; and
    - Contract liabilities.
- Revenue recognized in the reporting period that was included as a contract liability at the beginning of the period; and
- Revenue recognized in the current period from performance obligations that were satisfied or partially satisfied in the period, from such items as changes in transaction price.

Also, the entity should provide both qualitative and quantitative explanations for changes in the contract asset and liability account balances during the year. Examples of such explanations could be:

- Changes due to business combinations;
- Cumulative catch ups to revenue due to a change in estimate or contract modification; and
- Impairment of a contract asset.

Lastly, an entity should disclose how the timing of satisfaction of its performance obligations compares to the typical timing of payments and how this payment timing impacts contract asset and liability balances.

While this disclosure can be very complex, it also needs to be tailored to the specific fact pattern of the entity. Clearly, an entity with long-term production or manufacturing contracts, particularly if it recognizes revenue over time, will generate much larger contract asset and liability balances than an entity with a traditional, point in time revenue recognition approach. Entities with such complex operations probably already provide some of this information already.

In practice, entities will most likely present a rollforward of such contract asset and liability balances, with appropriate captions that capture the information that is required to be disclosed. They will most likely provide qualitative commentary on each element of the change in the account balances.

The following is an example of an SEC registrant’s disclosure of its account balances and rollforward disclosures:

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The following table provides information about receivables, contract assets and contract liabilities from contracts with customers (in thousands):

		As of March 31, 2017
Receivables	$	15,751
Short-term contract assets		883
Long-term contract assets		31
Short-term contract liabilities (deferred revenue)		1,908
Long-term contract liabilities (deferred revenue)		115

Significant changes in the contract assets and the contract liabilities balances during the period are as follows (in thousands):

	Three Months Ended March 31, 2017			
		Contract Assets		Contract Liabilities*
Revenue recognized that was included in the contract liability (def. revenue) balance at Jan. 1, 2017	$	—	$	2,627
Increases due to cash received, excluding amounts recognized as revenue during the period		—		929
Transferred to receivables from contract assets recognized at January 1, 2017		752		—
Performance obligations satisfied in previous periods		—		—

* Comprised of Deferred Revenue

Remember that non-PBEs only need to disclose the beginning and ending balances of their accounts receivable, contract asset, and contract liability balances.

C. Disclosure of performance obligations

ASC 606 requires disclosures about performance obligations that will supplement the entity's revenue recognition policy. This description should include information such as when and how the entity satisfies performance obligations, significant payment terms, the nature of the goods or services being promised, and information on items such as warranties, returns, refunds, and other obligations.

Entities are also required to disclose their remaining performance obligations and when they expect to recognize revenue related to them. This disclosure includes:

- The aggregate amount of the transaction price allocated to the performance obligations that are not satisfied as of the end of the reporting period; and
- An explanation of when the entity expects to recognize as revenue the amount disclosed above, either in a qualitative or quantitative manner.

Note that several practical expedients are applicable with this disclosure. First, the disclosure is not required for contracts that are less than one year in duration. Second, it is not required when an entity recognizes revenue equal to what it has a right to invoice when that amount corresponds directly with the value to the customer of the entity's performance to date. Also, these disclosures are required only for material performance obligations and the entity must disclose that they are using these practical expedients. Additionally, entities taking advantage of these exceptions must also disclose, in sufficient detail to allow the reader to understand, the nature of the performance obligations, the remaining duration, and a description of the variable consideration that has been excluded from the disclosure.
Let us review again the impact of ASU No. 2016-20 on these disclosures. ASU No. 2016-20 added the following two situations when an entity may elect to not disclose the above information:

1. The variable consideration is a sales- and usage-based royalty promised in exchange for a license of intellectual property; or
2. The variable consideration is allocated entirely to a wholly unsatisfied performance obligation or a wholly unsatisfied promise to transfer a distinct good or service that forms that part of a single performance obligation (a performance obligation consisting of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer) and meets the criteria for allocating variable consideration entirely to a single performance obligation or to a distinct good or service that forms part of a single performance obligation.

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The standard provides sample quantitative and qualitative disclosures related to performance obligations.

Cisco's performance obligation disclosure follows:

Remaining Performance Obligations The following table presents the breakdown of remaining performance obligations (in millions):

	July 30, 2022	July 31, 2021	Increase (Decrease)
Product	**$ 14,090**	$ 13,270	$ 820
Service	**17,449**	17,623	(174)
Total	**$ 31,539**	$ 30,893	$ 646
Short-term RPO	**$ 16,936**	$ 16,289	$ 647
Long-term RPO	**14,603**	14,604	(1)
Total	**$ 31,539**	$ 30,893	$ 646

Total remaining performance obligations increased 2% in fiscal 2022. Remaining performance obligations for product increased 6% and remaining product obligations for service decreased 1%, compared to fiscal 2021. We expect approximately 54% of total remaining performance obligations to be recognized as revenue over the next 12 months.

Non-PBE disclosure relief in this area is large, as they do not need to disclose the transaction price allocated to unfulfilled performance obligations. However, as we stated, generating such information on a consistent and regular basis can also be used for budgeting and cash flow projection purposes.

1. Significant judgments and other disclosures

Lastly, note that an entity must disclose its significant judgments that impact the amount and timing of revenue from its contracts with customers. Again, these will vary in complexity based on the operations of the entity's business.

In wrapping up our discussion on disclosures, here are a few takeaways:

- Disclosures relating to ASC 606 will continue to emerge. Entities should continue to benchmark their disclosures against both public and private peers;
- Consider where the necessary information will come from and develop policies and procedures to obtain it on a timely basis, if they do not already exist;
- Consider the proprietary nature of information being disclosed, including its sensitivity to competitors; and
- Get the input of a wide range of resources from both within the organization and outside of the organization.

IV. Disclosure examples

Let us look at a couple of examples of applying the above guidance for several hypothetical companies.

A. Example one

The company in example one is a retailer and installer of cabinetry products, InstallCo, or the Company. The company InstallCo purchases its inventory from its suppliers and sells its inventory, as is, to both contractors and individual customers. Most of the Company's sales are paid for at the time of sale, but the Company does offer 30-day credit terms to certain contractors with whom it engages in a large volume of sales. The credit terms essentially allow for the contractor to get paid by the residential customer before needing to remit payment to the Company. The Company will ship its product via common carrier, for a shipping and handling fee. Per the terms of its shipping contracts, title passes when the goods are placed on the common carrier, who assumes all responsibilities for any damaged goods.

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InstallCo will also install the cabinetry which its customers purchase from it. It employs three teams of installers and schedules the installation as close to the purchase of the cabinetry as possible. The Company bills on a time-and-materials basis for installation services.

The following is a representative footnote for InstallCo, describing its revenue recognition policies under ASC 606:

Revenue recognition policy
The Company derives its revenues primarily from the sale and installation of cabinetry products to both contractors and individual customers. Revenues are recognized when control of these products or services is transferred to its customers in an amount that reflects the consideration the Company expects to be entitled to in exchange for those products and services. Sales and other taxes the Company collects concurrent with revenue-producing activities are excluded from revenue. Shipping and handling fees charged to customers are reported within revenue. The Company does not have any significant financing components as payment is received at or shortly after the point of sale.

Revenue from performance obligations satisfied at a point in time consists of sales of cabinetry products from the Company's inventory. These goods are sold to homeowners and commercial designers and builders.

Revenue from performance obligations satisfied over time consists of the sale of installation services of the Company's cabinetry products. These services are generally provided to homeowners.

Disaggregation of revenue from contracts with customers
The following table disaggregates the Company's revenue based on the satisfaction of its performance obligations for the years ended December 31:

	2020	**2019**
Performance obligations satisfied at a point in time	$1,950,000	$1,790,000
Performance obligations satisfied over time	1,050,000	925,000
Total Net Sales	$3,000,000	$2,715,000

Performance obligations
For performance obligations related to the sale of cabinetry, control transfers to the customer at a point in time. The Company's principal terms of sale are FOB shipping point. The Company transfers control and records revenue for product sales either at the point of sale, when the customer takes possession of the goods, the title passes, and the Company has a right to payment, or upon placement of the goods on a common carrier, which assumes responsibility for shipment and delivery to the customer.
For performance obligations related to cabinetry installation services, control transfers to the customer over time. These services are sold under time-and-materials contracts. Revenue under time-and-materials contracts is recognized on the basis of actual time incurred multiplied by the billable hourly rate stated in the contract, plus materials expense incurred and billed when installation is complete.

Variable consideration and product warranties
The nature of the Company's business gives rise to variable consideration, typically including just returns that generally decrease the transaction price, which reduces revenue. These variable amounts are generally credited to the customer based on the product returns or price concessions. Variable consideration is estimated at the most likely amount that is expected to be earned.

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Estimated amounts are included in the transaction price to the extent it is probable that a significant reversal of cumulative revenue recognized will not occur when the uncertainty associated with the variable consideration is resolved. Estimates of variable consideration are estimated based upon historical experience and known trends.

The Company offers its customers the standard manufacturer's warranty on the performance of the cabinets. Under these warranty provisions, the customer may make a claim against the cabinet manufacturer, who is responsible for any repair to the products. The Company has no responsibility in such instances.

The Company does offer a one-year warranty of its installation services. The Company accrues the cost of the warranty claims which it expects to receive on its installation services as a component of its cost of sales. The cost is estimated based upon historical experience and known trends.

Contract balances

Contract assets include unbilled amounts typically resulting from sales under contracts when installation has begun but has not yet been completed and thereby billed. Contract assets were as follows for the years ended December 31:

	2020	**2019**	**2018**
Contract assets	$45,000	$39,000	$27,000

The Company had no contract liabilities at those dates.

B. Example two

The company in example two is a manufacturer of custom tools, BuildCo, or the Company. The Company fabricates custom specialty tools which are used by various manufacturers. BuildCo receives customer orders, along with any tool specifications and a 25-percent non-refundable deposit, which it uses to finance the purchase of the raw materials used in the fabrication process. Most contracts are completed within two to three weeks from the commencement of the fabrication process. The 25-percent deposit is forfeited if the order is cancelled, except in the case of a product which is appropriately not accepted by the customer due to nonconformity.

Completed tools are either shipped directly by common carrier to the customer, via FOB shipping point terms, or obtained directly by the buyer. The balance due, net of the 25-percent deposit, is billed when the customer has accepted the product and due within 30 days of invoicing.

The customer has three days to review and accept the equipment from the date of its receipt. As many of the Company's products are manufactured to specification, this acceptance process is a key quality check to assure that the product works as desired. Products which are not approved by the customer can be returned for credit or be reworked, if possible, by the Company. The Company warranties its equipment for defects for three years.

The following is a representative footnote describing its revenue recognition policies under ASC 606:

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Revenue recognition policy

The Company derives all of its revenues under fixed-price contracts primarily from the sale of custom fabricated and machined tools which are used by product manufacturers.

Revenues are recognized when control of these products is transferred by the Company to its customers, in an amount that reflects the consideration the Company expects to be entitled to in exchange for those products. Sales and other taxes the Company collects concurrent with revenue-producing activities are excluded from revenue. Shipping and handling fees charged to customers are reported within revenue. The Company does not have any significant financing components as shipment of its products generally occurs within several weeks of the receipt of the customer's non-refundable 25-percent deposit.

The Company records losses on its fixed-price contracts in the amount of and in the period when estimated contract costs exceed the contract price. The Company had no contracts in a loss position at December 31, 2020 and 2019.

Performance obligations

The Company's performance obligations under its contracts with customers are to manufacture and deliver custom tools.

The tools are shipped via common carrier, with FOB shipping point terms of sale. Title to the tools passes at that time.

However, due to the substantive nature and significance of the customer acceptance process, control is deemed to pass from the Company to its customer, and revenue subsequently recognized, at the earlier point in time that the Company receives notice that the product has been accepted by the customer, or three days from the receipt of the product by the customer via common carrier.

Variable consideration and product warranties

As the Company only has fixed-price contracts and its products cannot be returned after being accepted by the customer, the Company has no variable consideration.

The Company offers its customers a three-year warranty on its products. The Company accrues the cost of the warranty claims which it expects to receive on its products over the warranty period as a component of its cost of sales. The cost is estimated based upon historical experience and known trends.

Contract balances

Contract liabilities represent the 25-percent deposits which the Company receives upon receipt of an order from its customers which are refundable if the product is not accepted by the customer.

Contract liabilities were as follows for the years ended December 31:

	2020	2019	2018
Contract liabilities	$74,000	$49,000	$35,000

Question to Ponder:

Given the volume of required disclosures under ASC 606, how challenging is it for your clients/company to maintain the disclosures that are required under ASC 606?

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C. Nonmonetary transactions

Although most transactions involve the exchange of cash for goods or services, some transactions are nonmonetary in nature.

Reciprocal transfers involve the exchange of nonmonetary assets or liabilities with another entity, while nonreciprocal transfers involve the transfer of assets or services in one direction, such as from the entity to its owners.

Nonmonetary transactions include, for example:

- Exchanges of inventory for other property as a means of selling a product to a customer;
- Exchanges of productive assets, such as the trade of player contracts by professional sports organizations; or
- Exchanges of real estate for real estate.

According to ASC 845, *Nonmonetary Transactions*, an entity that engages in nonmonetary transactions during a period should disclose the nature of the transactions, the basis of accounting for the assets transferred, and any gains or losses recognized on the transfers.

In addition, the entity should also disclose the amount of gross operating revenue recognized as a result of nonmonetary transactions, and the amount of revenue and costs (or gains and losses) associated with inventory exchanges recognized at fair value.

1. Disclosure example – Sample stock dividend

STOCK DIVIDEND
On October 1, 2016, the company distributed 250,000 shares of common stock in connection with a 5-percent stock dividend. As a result of the stock dividend, common stock was increased by $250,000, additional paid-in capital was increased by $2,250,000, and retained earnings was decreased by $2,500,000. All references in the accompanying financial statements to the number of common shares and per-share amounts for 2014, 2015, and 2016 have been restated to reflect the stock dividend.

V. Expenses

FASB *Accounting Standards Codification* (ASC) 705 through 740 provides the detail accounting and disclosure guidance relating to various income statement expense items. Topics covered include the cost of sales and services, compensation, other expenses, research and development, and income taxes.

According to FASB Concepts Statement No. 6, *Elements of Financial Statements*, an expense is an outflow or other using up of assets or incurrences of liabilities (or a combination of both) from delivering or producing goods, rendering services, or carrying out other activities that constitute the entity's ongoing major or central operations.

Expenses represent actual or expected cash outflows (or the equivalent) that have occurred or will eventuate as a result of the entity's ongoing major or central operations. The assets that flow out or are used or the liabilities that are incurred may be of various kinds, for example, units of product delivered or produced, employees' services used, kilowatt hours of electricity used to light an office building, or taxes on current income.

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Similarly, the transactions and events from which expenses arise and the expenses themselves are in many forms and are called by various names, for example, cost of goods sold, cost of services provided, depreciation, interest, rent, and salaries and wages, depending on the kinds of operations involved and the way expenses are recognized. In concept, most expenses decrease assets rather than increase liabilities. They involve using (sacrificing) goods or services, not acquiring them.

However, acquisition and use of many goods or services may occur simultaneously or during the same period, and a convenient shortcut is often to record directly increases of liabilities. Taxes and other expenses resulting from nonreciprocal transfers to other entities commonly do result directly from incurring liabilities.

Losses are decreases in equity from peripheral or incidental transactions of an entity and from all other transactions and other events and circumstances affecting the entity except those that result from expenses or distributions to owners.

A. Cost of sales and services

ASC 705, *Cost of Sales and Services*, only provides links to guidance on accounting and disclosures for the cost of sales and services in other applicable ASC subtopics as the asset and liability model used in the ASC generally results in the inclusion of that guidance in other topics. For example, as assets are sold or remeasured (or liabilities incurred), the guidance related to the transactions is included in applicable sections of ASC 330, *Inventory*, and ASC 360, *Property, Plant, and Equipment*, rather than in this topic.

1. Disclosure example – Kohl's Corporation

COST OF MERCHANDISE SOLD
The following table illustrates the primary costs classified in Cost of Merchandise Sold.

Cost of Merchandise Sold
• Total cost of products sold including product development costs, net of vendor payments other than reimbursement of specific, incremental and identifiable costs
• Inventory shrink
• Markdowns
• Freight expenses associated with moving merchandise from our vendors to our distribution centers
• Shipping and handling expenses of sales generated on-line
• Terms cash discount

The classification of these expenses varies across the retail industry.

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2. Disclosure example – Catasys, Inc.

COST OF SERVICES

Healthcare Services

Cost of healthcare services consists primarily of salaries related to our care coaches, healthcare provider claims payments, and fees charged by our third-party administrators for processing these claims. Healthcare services cost of services is recognized in the period in which an eligible member receives services. We contract with doctors and licensed behavioral healthcare professionals, on a fee-for-service basis. We determine that a member has received services when we receive a claim or in the absence of a claim, by utilizing member data recorded in the eOnTrak database within the contracted timeframe, with all required billing elements correctly completed by the service provider.

B. Compensation – General

ASC 710, *Compensation–General*, provides guidance on compensated absences, deferred compensation arrangements, lump-sum payments under union contracts, and rabbi trusts.

The compensated absences guidance addresses accruing a liability for employees' rights to receive compensation for future absences when certain conditions are met, for example, vacation benefits, future sick pay benefits, holidays, certain sabbatical leaves and similar compensated absences.

The deferred compensation arrangements guidance addresses deferred compensation arrangements that are individual employment contracts and are not in substance a pension or other postretirement benefit plan.

The lump-sum payments under union contracts guidance addresses lump-sum payments received by union employees upon signing new union contracts.

The only disclosure requirement included in ASC 710 is for an employer to disclose the fact that a liability for employees' compensation for future absences was not accrued because the amount could not be reasonably estimated, for example:

> Employees of the Company are entitled to paid vacation and paid sick days depending on job classification, length of service, and other factors. It is not practicable for the Company to estimate the amount of compensation for future absences; accordingly, no liability for compensated absences has been recorded in the accompanying financial statements. The Company's policy is to recognize the costs of compensated absences when actually paid to employees.

1. Disclosure example – The Phoenix Companies, Inc.

RESTATEMENT OF PRIOR YEAR

During the fourth quarter of 2011, the Company determined that its historical methodology for accruing for compensated absences related to vacation did not properly reflect a liability for vacation partially earned during the fiscal year and anticipated to be utilized by the employee in the subsequent year. The Company determined that the balances should be corrected in the earliest period presented by correcting any individual amounts in the financial statements. The periods impacted by this correction commence with periods earlier than any periods presented in this annual report. Therefore, the Company will correct this by recording a cumulative effect of this amount in the earliest period presented as a decrease in retained earnings of $328,000 and an increase in accrued expenses in the amount of $547,000 and an

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increase in deferred tax assets of $219,000. This adjustment did not have a material impact on net income for any period presented in this annual report. Accordingly, the Consolidated Financial Statements for periods ended October 31, 2007, through October 31, 2010, have been restated to reflect this adjustment. In accordance with ASC Topic 250, *Accounting Changes and Error Corrections*, we evaluated the materiality of the error from a qualitative and quantitative perspective and concluded that the error was not material to any prior period. Further, we evaluated the materiality of the error on the results of operations for the fiscal years end October 31, 2007, through October 31, 2010, and concluded that the error was not material for the year or the trend of financial results for any period presented.

C. Compensation – Nonretirement postemployment benefits

ASC 712, *Compensation–Nonretirement Postemployment Benefits*, provides guidance on nonretirement postemployment benefits, including termination benefits and other postemployment benefits provided to former and inactive employees.

The only disclosure requirement included in ASC 712 is for an employer to disclose the fact that a liability for other postemployment benefits was not accrued because the amount could not be reasonably estimated, for example:

> The Company provides the following postemployment benefits to former and inactive employees: supplemental unemployment benefits, disability-related benefits, and job training and counseling. It is not practicable for the Company to reasonably estimate the amount of its obligation for postemployment benefits; accordingly, no liability for postemployment benefits has been recorded in the accompanying financial statements. The Company's policy is to recognize the costs of such postemployment benefits when actually paid.

1. Disclosure example – Dialogic, Inc.

POST-EMPLOYMENT COMPENSATION
We have entered into employment agreements with our Named Executive Officers that require us to make payments upon termination or constructive termination either before or after a change of control of the Company. These arrangements are discussed below.

In general, in order to be eligible for any benefits, our executives must be terminated without "cause" or voluntarily terminate their employment for "good reason" and will be required to sign a standard release agreement releasing claims against us and agreeing to the continued applicability of confidentiality and intellectual property agreements. We have selected this trigger as we feel it is a customary term of executive employment at comparable companies in our peer group. Additionally, we have provided enhanced benefits in the event that certain of our Named Executive Officers are terminated within 12 months following a "change of control." We believe that the enhanced benefits provided following a change of control are necessary to ensure that we can secure the service of our executives up to and through any potential change of control transaction.

Kevin Cook. In the event we terminate Mr. Cook's employment without Cause or Mr. Cook resigns for Good Reason, Mr. Cook will be entitled to receive (i) cash payments equal to 18 months of his then-current base salary, (ii) a cash payment equal to the annual bonus Mr. Cook would have received if he remained employed through the payment date, based on the actual achievement of the performance goals as determined by the Board and pro-rated based on the number of days Mr. Cook served as an active employee and (iii) cash payments made over time in an amount equal to the cost of continuing

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health insurance benefits for up to 18 months upon Mr. Cook's timely election of COBRA continuation coverage, or, collectively, the Cook Severance Benefits. In each case, receipt of the Cook Severance Benefits by Mr. Cook is subject to (i) his continued compliance with the obligations under his Non-disclosure, Confidentiality and Non-Solicitation Agreement, Invention and Secrecy Agreement, and Non-Competition and Non-Solicitation Agreement with the Company while receiving such Severance Benefits, (ii) the execution of a general release in favor of the Company, and (iii) his resignation from the Board of Directors if he is a member at the time of termination.

Nick Jensen. On August 9, 2012, we entered into a letter agreement with Mr. Jensen, or the Jensen Letter Agreement, pursuant to which Mr. Jensen resigned as our Chief Executive Officer effective August 9, 2012. Mr. Jensen continued to serve as a member of our Board until February 7, 2013. The Jensen Letter Agreement also set forth Mr. Jensen's role as a consultant to the Company for a period beginning August 9, 2012 and ending March 31, 2013. Under the terms of the Jensen Letter Agreement, Mr. Jensen is entitled to consulting fees at the rate of CAD $41,666 per month between September 2012 and December 2012 and CAD $33,333 per month between January 2013 and March 2013.

John Hanson. Under the Hanson Agreement, if we terminate Mr. Hanson's employment without Cause or Mr. Hanson resigns for Good Reason, Mr. Hanson will be entitled to receive (i) a cash payment equal to 12 months of his then-current base salary, (ii) any guaranteed bonus amount described above or, if such termination occurs in a period for which there is no guaranteed bonus, his target bonus for such period, and (iii) cash payments made over time in an amount equal to the cost of continuing health insurance benefits for up to 12 months upon Mr. Hanson's timely election of COBRA continuation coverage (collectively, the "Hanson Severance Benefits"). In each case, receipt of the Severance Benefits by Mr. Hanson is subject to (x) his continued compliance with the obligations under his proprietary information and invention agreement with us while receiving such Hanson Severance Benefits, (y) the execution of a general release in our favor, and (z) his resignation from the Board if he is a member at the time of termination. If we terminate Mr. Hanson's employment without Cause or Mr. Hanson resigns for Good Reason within 12 months of a Change of Control (as defined in the Hanson Agreement), Mr. Hanson will receive full vesting of his compensatory stock grants, including any outstanding stock option and restricted stock unit grants, on the effective date of such termination in addition to the Hanson Severance Benefits described above.

Anthony Housefather. In the event we terminate Mr. Housefather's employment without Cause or Mr. Housefather resigns for Good Reason, Mr. Housefather will be entitled to receive (i) cash payments equal to 15 months of his then-current base salary, (ii) a cash payment equal to the annual bonus Mr. Housefather would have received if he remained employed through the payment date, based on the actual achievement of the performance goals as determined by the Board and pro-rated based on the number of days Mr. Housefather served as an active employee (iii) cash payments made over time in an amount equal to the cost of continuing health insurance benefits from the date of his separation from service, until the earliest of (i) 15 months following Mr. Housefather's separation of service or (ii) the date when he becomes eligible for substantially equivalent health insurance coverage in connection with new employment (collectively, the "Housefather Severance Benefits"). In each case, receipt of the Housefather Severance Benefits by Mr. Housefather is subject to (i) his continued compliance with the obligations under his Non-Disclosure, Confidentiality and Non-Solicitation Agreement, Invention and Secrecy Agreement, and Non-Competition and Non-Solicitation Agreement with the Company while receiving such Housefather Severance Benefits, (ii) the execution of a general release in favor of the Company, and (iii) his resignation from the Board if he is a member at the time of termination.

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If we terminate Mr. Housefather's employment without Cause or Mr. Housefather resigns for Good Reason within 12 months of a Change of Control (as defined in the Housefather Agreement), Mr. Housefather will receive full vesting of his compensatory stock grants, including any outstanding stock option and restricted stock unit grants, on the effective date of such termination in addition to the Housefather Severance Benefits described above.

Each of the Hanson Agreement and Cook Agreement provides that, in the event that any benefits provided in connection with a change of control (or a related termination of employment) would be (i) considered a "parachute payment" within the meaning of Section 280G of the Code or (ii) subject to the excise tax imposed by Section 4999 of the Code, the executive officer will receive the greater, on an after-tax basis (taking account of all federal, state and local taxes and excise taxes), of the largest portion of such benefits that results in the executive's receipt of the greatest economic benefit (notwithstanding that all or some portion of the benefits may be subject to the excise tax) or such lesser amount of benefits as would result in no portion of the benefits being subject to the excise tax.

D. Compensation – Retirement benefits

ASC 715, *Compensation–Retirement Benefits*, establishes the accounting and reporting standards for an employer that offers pension, other postretirement, and certain special or contractual termination benefits to its employees. ASC 715 includes guidance covering defined benefit plans, defined contribution plans, and multiemployer plans.

Disclosure requirements related to retirement benefits are found in:

- ASC 715-20, *Defined Benefit Plans–General* (for defined benefit pension and other postretirement benefit plans);
- ASC 715-20, *Defined Contribution Plans*; and
- ASC 715-80, *Multiemployer Plans*.

According to ASC 715, the guidance in this topic is derived from the basic idea that a benefit plan is an exchange between the employer and the employee. In exchange for services provided by the employee, the employer promises to provide, in addition to current wages and other benefits, an amount of retirement income or benefit. It follows from that basic view that benefits are not gratuities but instead are part of an employee's compensation, and because payment is deferred, the benefit plan is a type of deferred compensation. It also follows that the employer's obligation for that compensation is incurred when the services are rendered.

Pension benefits are ordinarily in the form of periodic payments to retired employees or their survivors but might also include benefits payable as a single lump sum and other types of benefits, such as death benefits provided through a pension plan. Other postretirement benefits are ordinarily in the form of a reimbursement to plan participants or direct payment to providers for the cost of specified services, but they may also include benefits payable as a lump sum, such as death benefits.

Because the obligation to provide benefits arises as employees render the services necessary to earn the benefits pursuant to the terms of the plan, ASC 715 provides guidance regarding when the cost of providing the benefits should be recognized over those employee service periods.

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E. Defined benefit plans

ASC 715-20, *Defined Benefit Plans–General*, includes the disclosure requirements for defined benefit pension and other postretirement benefit plans. The requirements are quite extensive and generally split up between those required for public entities and those required for nonpublic entities, the difference being that nonpublic entities are not required to disclose the information listed below in items (a) through (c), (h), (m), (o) through (r).

1. Disclosure requirements (public entities)

According to ASC 715-20, an employer that sponsors one or more defined benefit pension plans or one or more defined benefit other postretirement plans should provide information separately for pension plans and other postretirement benefit plans.

Amounts related to the employer's results of operations should be disclosed for each period for which a statement of income is presented and amounts related to the employer's statement of financial position should be disclosed as of the date of each statement of financial position presented.

All of the following information should be disclosed:

a. A reconciliation of beginning and ending balances of the benefit obligation showing separately, if applicable, the effects during the period attributable to each of the following:
   1. Service cost.
   2. Interest cost.
   3. Contributions by plan participants.
   4. Actuarial gains and losses.
   5. Foreign currency exchange rate changes.
   6. Benefits paid.
   7. Plan amendments.
   8. Business combinations.
   9. Divestitures.
   10. Curtailments, settlements, and special and contractual termination benefits.

   For defined benefit pension plans, the benefit obligation is the projected benefit obligation. For defined benefit other postretirement plans, the benefit obligation is the accumulated postretirement benefit obligation.
b. A reconciliation of beginning and ending balances of the fair value of plan assets showing separately, if applicable, the effects during the period attributable to each of the following:
   1. Actual return on plan assets.
   2. Foreign currency exchange rate changes.
   3. Contributions by the employer.
   4. Contributions by plan participants.
   5. Benefits paid.
   6. Business combinations.
   7. Divestitures.
   8. Settlements.
c. The funded status of the plans and the amounts recognized in the statement of financial position, showing separately the assets and current and noncurrent liabilities recognized.
d. The objectives of the disclosures about postretirement benefit plan assets are to provide users of financial statements with an understanding of:

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1. How investment allocation decisions are made, including the factors that are pertinent to an understanding of investment policies and strategies.
2. The classes of plan assets.
3. The inputs and valuation techniques used to measure the fair value of plan assets.
4. The effect of fair value measurements using significant unobservable inputs (Level 3) on changes in plan assets for the period.
5. Significant concentrations of risk within plan assets. An employer should consider those overall objectives in providing the following information about plan assets:
    i. A narrative description of investment policies and strategies, including target allocation percentages or range of percentages considering the classes of plan assets disclosed pursuant to (ii) below, as of the latest statement of financial position presented (on a weighted-average basis for employers with more than one plan), and other factors that are pertinent to an understanding of those policies and strategies such as investment goals, risk management practices, permitted and prohibited investments including the use of derivatives, diversification, and the relationship between plan assets and benefit obligations. For investment funds disclosed as classes as described in (ii) below, a description of the significant investment strategies of those funds shall be provided.
    ii. The fair value of each class of plan assets as of each date for which a statement of financial position is presented. For additional guidance on determining appropriate classes of plan assets, see ASC 820-10-50-2B. Examples of classes of assets could include, but are not limited to, the following: cash and cash equivalents; equity securities (segregated by industry type, company size, or investment objective); debt securities issued by national, state, and local governments; corporate debt securities; asset-backed securities; structured debt; derivatives on a gross basis (segregated by type of underlying risk in the contract, for example, interest rate contracts, foreign exchange contracts, equity contracts, commodity contracts, credit contracts, and other contracts); investment funds (segregated by type of fund); and real estate. Those examples are not meant to be all inclusive. An employer should consider the overall objectives in ASC 715-20-50-1(d)(1) through (5) in determining whether additional classes of plan assets or further disaggregation of classes should be disclosed.
    iii. A narrative description of the basis used to determine the overall expected long-term rate-of-return-on-assets assumption, such as the general approach used, the extent to which the overall rate-of-return-on-assets assumption was based on historical returns, the extent to which adjustments were made to those historical returns in order to reflect expectations of future returns, and how those adjustments were determined. The description should consider the classes of assets as described in (ii) above, as appropriate.
    iv. Information that enables users of financial statements to assess the inputs and valuation techniques used to develop fair value measurements of plan assets at the reporting date. For fair value measurements using significant unobservable inputs, an employer shall disclose the effect of the measurements on changes in plan assets for the period. To meet those objectives, the employer shall disclose the following information for each class of plan assets disclosed pursuant to (ii) above for each annual period:
        1. The level of the fair value hierarchy within which the fair value measurements are categorized in their entirety, segregating fair value measurements using quoted prices in active markets for identical assets or liabilities (Level 1), significant other

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observable inputs (Level 2), and significant unobservable inputs (Level 3). The guidance in FASBA ASC 820-10-35-37 through 35-37A is applicable.

2. For fair value measurements of plan assets using significant unobservable inputs (Level 3), a reconciliation from the opening balances to the closing balances, disclosing separately changes during the period attributable to the following:
   A. Actual Return on Plan Assets (Component of Net Periodic Postretirement Benefit Cost) or Actual Return on Plan Assets (Component of Net Periodic Pension Cost), separately identifying the amount related to assets still held at the reporting date and the amount related to assets sold during the period.
   B. Purchases, sales, and settlements, net.
   C. The amounts of any transfers into or out of Level 3 (for example, transfers due to changes in the observability of significant inputs).
3. Information about the valuation technique(s) and inputs used to measure fair value and a discussion of changes in valuation techniques and inputs, if any, during the period.

e. For defined benefit pension plans, the accumulated benefit obligation.
f. The benefits (as of the date of the latest statement of financial position presented) expected to be paid in each of the next five fiscal years, and in the aggregate for the five fiscal years thereafter. The expected benefits should be estimated based on the same assumptions used to measure the entity's benefit obligation at the end of the year and should include benefits attributable to estimated future employee service.
g. The employer's best estimate, as soon as it can reasonably be determined, of contributions expected to be paid to the plan during the next fiscal year beginning after the date of the latest statement of financial position presented. Estimated contributions may be presented in the aggregate combining all of the following:
   1. Contributions required by funding regulations or laws.
   2. Discretionary contributions.
   3. Noncash contributions.
h. The amount of net benefit cost recognized, showing separately all of the following:
   1. The service cost component.
   2. The interest cost component.
   3. The expected return on plan assets for the period.
   4. The gain or loss component.
   5. The prior service cost or credit component.
   6. The transition asset or obligation component.
   7. The gain or loss recognized due to settlements or curtailments.
i. Separately the net gain or loss and net prior service cost or credit recognized in other comprehensive income for the period pursuant to ASC 715-30-35-11, 715-30-35-21, 715-60-35-16, and 715-60-35-25, and reclassification adjustments of other comprehensive income for the period, as those amounts, including amortization of the net transition asset or obligation, are recognized as components of net periodic benefit cost.
j. The amounts in accumulated other comprehensive income that have not yet been recognized as components of net periodic benefit cost, showing separately the net gain or loss, net prior service cost or credit, and net transition asset or obligation.
k. On a weighted-average basis, all of the following assumptions used in the accounting for the plans, specifying in a tabular format, the assumptions used to determine the benefit obligation and the assumptions used to determine net benefit cost:

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1. Assumed discount rates (see ASC 715-30-35-45 for a discussion of representationally faithful disclosure).
2. Rates of compensation increase (for pay-related plans).
3. Expected long-term rates of return on plan assets.

l. The assumed health care cost trend rate(s) for the next year used to measure the expected cost of benefits covered by the plan (gross eligible charges), and a general description of the direction and pattern of change in the assumed trend rates thereafter, together with the ultimate trend rate(s) and when that rate is expected to be achieved.

m. The effect of a one-percentage-point increase and the effect of a one-percentage-point decrease in the assumed health care cost trend rates on the aggregate of the service and interest cost components of net periodic postretirement health care benefit costs and the accumulated postretirement benefit obligation for health care benefits. Measuring the sensitivity of the accumulated postretirement benefit obligation and the combined service and interest cost components to a change in the assumed health care cost trend rates requires remeasuring the accumulated postretirement benefit obligation as of the beginning and end of the year. (For purposes of this disclosure, all other assumptions should be held constant, and the effects shall be measured based on the substantive plan that is the basis for the accounting.)

n. If applicable, the amounts and types of securities of the employer and related parties included in plan assets, the approximate amount of future annual benefits of plan participants covered by insurance contracts, including annuity contracts issued by the employer or related parties, and any significant transactions between the employer or related parties and the plan during the period.

o. If applicable, any alternative method used to amortize prior service amounts or net gains and losses pursuant to ASC 715-30-35-13 and 715-30-35-25 or 715-60-35-18 and 715-60-35-31.

p. If applicable, any substantive commitment, such as past practice or a history of regular benefit increases, used as the basis for accounting for the benefit obligation.

q. If applicable, the cost of providing special or contractual termination benefits recognized during the period and a description of the nature of the event.

r. An explanation of any significant change in the benefit obligation or plan assets not otherwise apparent in the other disclosures required by this subtopic.

s. The amounts in accumulated other comprehensive income expected to be recognized as components of net periodic benefit cost over the fiscal year that follows the most recent annual statement of financial position presented, showing separately the net gain or loss, net prior service cost or credit, and net transition asset or obligation.

t. The amount and timing of any plan assets expected to be returned to the employer during the 12-month period, or operating cycle if longer, that follows the most recent annual statement of financial position presented.

Again, nonpublic entities are not required to disclose the information listed above in items (a) through (c), (h), (m), (o) through (r).

Many smaller and medium-sized entities do not offer defined benefit pension plans. Accordingly, most sample disclosures for such plans are larger, publicly traded entities.

2. Disclosure example – Whirlpool Corporation

PENSION AND OTHER POSTRETIREMENT BENEFIT PLANS

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We have funded and unfunded defined benefit pension plans that cover certain employees in North America, Europe, Asia and Brazil. The United States plans comprise the majority of our obligation. All but one of these plans are frozen for all participants. The primary formula for United States salaried employees covered under the qualified defined benefit plan and the unfunded, nonqualified Retirement Benefits Restoration Plan was based on years of service and final average salary, while the primary formula for United States hourly employees covered under the defined benefit plans was based on specific dollar amounts for each year of service. There were multiple formulas for employees covered under the qualified and nonqualified defined benefit plans that were sponsored by Maytag, including a cash balance formula. We have foreign pension plans that accrue benefits. The plans generally provide benefit payments using a formula that is based upon employee compensation and length of service.
In addition, we sponsor an unfunded Supplemental Executive Retirement Plan that remains open to new participants and additional benefit accruals. This plan is nonqualified and provides certain key employees with additional defined pension benefits that supplement those provided by the Company's other retirement plans.

We provide postretirement health care benefits for eligible retired employees in the United States, Canada and Brazil. For our United States plan, which comprises the majority of our obligation, eligible retirees include those who were full-time employees with 10 years of service who attained age 55 while in service with us and those union retirees who met the eligibility requirements of their collective bargaining agreements. In general, the postretirement health and welfare benefit plans include cost-sharing provisions that limit our exposure for recent and future retirees and are contributory, with participants' contributions adjusted annually. In the United States, benefits for certain retiree populations follow a defined contribution model that allocates certain monthly or annual amounts to a retiree's account under the plan.

Pension assets and liabilities related to the European major domestic appliance business have been classified as held for sale in the fourth quarter of 2022.

The postretirement medical benefit programs are unfunded. We reserve the right to modify these benefits in the future.

Defined Benefit - Pensions and Other Postretirement Benefit Plans

Obligations and Funded Status at End of Year

	United States Pension Benefits		Foreign Pension Benefits		Other Postretirement Benefits	
Millions of dollars	2022	2021	2022	2021	2022	2021
Funded status						
Fair value of plan assets	**$ 2,072**	$ 2,904	**$ 30**	$ 665	**$ —**	$ —
Benefit obligations	**2,211**	2,968	**60**	924	**121**	166
Funded status	**$ (139)**	$ (64)	**$ (30)**	$ (259)	**$ (121)**	$ (166)
Amounts recognized in the consolidated balance sheets						
Noncurrent asset	**$ 21**	$ 56	**$ 7**	$ 20	**$ —**	$ —
Current liability	**(9)**	(9)	**(4)**	(12)	**(25)**	(24)
Noncurrent liability	**(151)**	(111)	**(33)**	(267)	**(96)**	(142)
Amount recognized	**$ (139)**	$ (64)	**$ (30)**	$ (259)	**$ (121)**	$ (166)
Amounts recognized in accumulated other comprehensive loss (pre-tax)						
Net actuarial loss	**$ 1,266**	$ 1,180	**$ 111**	$ 184	**$ (15)**	$ 14
Prior service (credit) cost	**1**	1	**3**	3	**(52)**	(93)
Amount recognized	**$ 1,267**	$ 1,181	**$ 114**	$ 187	**$ (67)**	$ (79)

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Change in Benefit Obligation

Millions of dollars	United States Pension Benefits 2022	United States Pension Benefits 2021	Foreign Pension Benefits 2022	Foreign Pension Benefits 2021	Other Postretirement Benefits 2022	Other Postretirement Benefits 2021
Benefit obligation, beginning of year	**$ 2,968**	$ 3,237	**$ 924**	$ 1,029	**$ 166**	$ 191
Service cost	**3**	3	**4**	5	**—**	—
Interest cost	**82**	77	**15**	14	**5**	5
Plan participants' contributions	**—**	—	**—**	1	**—**	—
Actuarial (gain) loss	**(606)**	(99)	**(262)**	(45)	**(28)**	(8)
Benefits paid	**(230)**	(234)	**(28)**	(29)	**(18)**	(21)
Plan amendments	**—**	—	**—**	—	**(5)**	—
Transfer of liabilities	**—**	—	**—**	(23)	**—**	—
Other adjustments	**—**	—	**11**	—	**—**	—
Settlements / curtailment (gain)	**(6)**	(16)	**(7)**	(18)	**—**	—
Foreign currency exchange rates	**—**	—	**(82)**	(10)	**1**	(1)
Reclassification of obligation to held for sale	**—**	—	**(515)**	—	**—**	—
Benefit obligation, end of year	**$ 2,211**	$ 2,968	**$ 60**	$ 924	**$ 121**	$ 166
Accumulated benefit obligation, end of year	**$ 2,205**	$ 2,955	**$ 52**	$ 891	**N/A**	N/A

The actuarial (gain) loss for all pension and other postretirement benefit plans in 2022 and 2021 was primarily related to a change in the discount rate used to measure the benefit obligation of those plans.

Change in Plan Assets

Millions of dollars	United States Pension Benefits 2022	United States Pension Benefits 2021	Foreign Pension Benefits 2022	Foreign Pension Benefits 2021	Other Postretirement Benefits 2022	Other Postretirement Benefits 2021
Fair value of plan assets, beginning of year	**$ 2,904**	$ 3,103	**$ 665**	$ 632	**$ —**	$ —
Actual return on plan assets	**(605)**	31	**(181)**	56	**—**	—
Employer contribution	**9**	20	**30**	30	**18**	21
Plan participants' contributions	**—**	—	**—**	1	**—**	—
Benefits paid	**(230)**	(234)	**(28)**	(29)	**(18)**	(21)
Transfer of plan assets	**—**	—	**—**	—	**—**	—
Settlements	**(6)**	(16)	**(7)**	(17)	**—**	—
Foreign currency exchange rates	**—**	—	**(70)**	(8)	**—**	—
Reclassification of plan assets to held for sale	**—**	—	**(379)**	—	**—**	—
Fair value of plan assets, end of year [(1)]	**$ 2,072**	$ 2,904	**$ 30**	$ 665	**$ —**	$ —

(1) Decrease in fair value of plan assets was primarily driven by market fluctuations during the current period.

Components of Net Periodic Benefit Cost

Millions of dollars	United States Pension Benefits 2022	United States Pension Benefits 2021	United States Pension Benefits 2020	Foreign Pension Benefits 2022	Foreign Pension Benefits 2021	Foreign Pension Benefits 2020	Other Postretirement Benefits 2022	Other Postretirement Benefits 2021	Other Postretirement Benefits 2020
Service cost	**$ 3**	$ 3	$ 3	**$ 4**	$ 5	$ 6	**$ —**	$ —	$ 4
Interest cost	**82**	77	94	**15**	14	17	**5**	5	8
Expected return on plan assets	**(144)**	(158)	(165)	**(31)**	(34)	(30)	**—**	—	—
Amortization:									
Actuarial loss	**57**	69	62	**9**	19	12	**—**	—	—
Prior service cost (credit)	**—**	—	—	**—**	—	—	**(46)**	(46)	(28)
Curtailment (gain) / loss	**—**	—	—	**(1)**	—	—	**—**	—	(3)
Settlement loss	**1**	5	39	**2**	2	11	**—**	—	—
Net periodic benefit cost	**$ (1)**	$ (4)	$ 33	**$ (2)**	$ 6	$ 16	**$ (41)**	$ (41)	$ (19)

The following table summarizes the net periodic cost recognized in operating profit and interest and sundry (income) expense for the years ended December 31, 2022, 2021 and 2020:

Millions of dollars	United States Pension Benefits 2022	United States Pension Benefits 2021	United States Pension Benefits 2020	Foreign Pension Benefits 2022	Foreign Pension Benefits 2021	Foreign Pension Benefits 2020	Other Postretirement Benefits 2022	Other Postretirement Benefits 2021	Other Postretirement Benefits 2020
Operating profit (loss)	**$ 3**	$ 3	$ 3	**$ 4**	$ 5	$ 6	**$ —**	$ —	$ 4
Interest and sundry (income) expense	**(4)**	(7)	30	**(6)**	1	10	**(41)**	(41)	(23)
Net periodic benefit cost	**$ (1)**	$ (4)	$ 33	**$ (2)**	$ 6	$ 16	**$ (41)**	$ (41)	$ (19)

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Other Changes in Plan Assets and Benefit Obligations Recognized in Other Comprehensive Income (Loss) (Pre-Tax) in 2022

Millions of dollars	United States Pension Benefits	Foreign Pension Benefits	Other Postretirement Benefits
Current year actuarial loss / (gain)	$ 145	$ (63)	$ (28)
Actuarial (loss) recognized during the year	(58)	(10)	—
Current year prior service cost (credit)	—	—	(5)
Prior service credit (cost) recognized during the year	—	—	46
Total recognized in other comprehensive income (loss) (pre-tax)	$ 87	$ (73)	$ 13
Total recognized in net periodic benefit costs and other comprehensive income (loss) (pre-tax)	$ 86	$ (75)	$ (27)

We amortize actuarial losses and prior service costs (credits) over a period of up to 20 years and 13 years, respectively.

Assumptions

Weighted-Average Assumptions used to Determine Benefit Obligation at End of Year

	United States Pension Benefits		Foreign Pension Benefits (1)		Other Postretirement Benefits	
	2022	2021	2022	2021	2022	2021
Discount rate	**5.55 %**	2.85 %	**4.72 %**	1.89 %	**6.05 %**	3.41 %
Rate of compensation increase	**4.50 %**	4.50 %	**3.52 %**	3.59 %	**N/A**	N/A
Interest crediting rate for cash balance plans	**4.30 %**	1.60 %	**2.85 %**	2.36 %	**N/A**	N/A

(1) Weighted-average assumptions include assumptions related to pension plans classified as held for sale during the fourth quarter of 2022.

Weighted-Average Assumptions used to Determine Net Periodic Cost

	United States Pension Benefits			Foreign Pension Benefits (1)			Other Postretirement Benefits		
	2022	2021	2020	2022	2021	2020	2022	2021	2020
Discount rate	**2.85%**	2.50%	3.13%	**1.89%**	1.55%	2.04%	**4.27%**	3.66%	3.35%
Expected long-term rate of return on plan assets	**5.50%**	6.00%	6.25%	**5.23%**	5.48%	5.39%	**N/A**	N/A	N/A
Rate of compensation increase	**4.50%**	4.50%	4.50%	**3.59%**	3.47%	3.10%	**N/A**	N/A	N/A
Interest crediting rate for cash balance plans	**1.60%**	1.25%	2.05%	**2.36%**	1.99%	1.80%	**N/A**	N/A	N/A
Health care cost trend rate									
Initial rate	**N/A**	N/A	N/A	**N/A**	N/A	N/A	**5.75%**	6.00%	6.25%
Ultimate rate	**N/A**	N/A	N/A	**N/A**	N/A	N/A	**5.00%**	5.00%	5.00%
Year that ultimate rate will be reached	**N/A**	N/A	N/A	**N/A**	N/A	N/A	**2025**	2025	2025

(1) Weighted-average assumptions include assumptions related to pension plans classified as held for sale during the fourth quarter of 2022.

Discount Rate

For our United States pension and postretirement benefit plans, the discount rate was selected using a hypothetical portfolio of high quality bonds outstanding at December 31 that would provide the necessary cash flows to match our projected benefit payments. For our foreign pension and postretirement benefit plans, the discount rate was primarily selected using high quality bond yields for the respective country or region covered by the plan.

Expected Return on Plan Assets

In the United States, the expected return on plan assets is developed considering asset mix, historical asset class data and long-term expectations. The resulting weighted-average return was rounded to the nearest quarter of one percent and applied to the fair value of plan assets at December 31, 2022.

For foreign pension plans, the expected rate of return on plan assets was primarily determined by observing historical returns in the local fixed income and equity markets and computing the weighted average returns with the weights being the asset allocation of each plan.

Funding Policy

Our funding policy is to contribute to our qualified United States pension plans amounts sufficient to meet the minimum funding requirement as defined by employee benefit and tax laws, plus additional amounts which we may determine to be appropriate. In certain countries other than the United States, the funding of pension plans is not common practice. Contributions to our United States pension plans may be made

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in the form of cash or, in the case of our defined contribution plan in our discretion, company stock. We pay for retiree medical benefits as they are incurred.

There have been no contributions to the pension trust for our U.S. defined benefit plans during the twelve months ended December 31, 2022 and 2021.

Expected Employer Contributions to Funded Plans

Millions of dollars	United States Pension Benefits	Foreign Pension Benefits
2023	$ —	$ 18

Expected Benefit Payments

Expected benefit payments related to the European major domestic appliance business classified as held for sale are excluded beyond 2023.

Millions of dollars	United States Pension Benefits	Foreign Pension Benefits	Other Postretirement Benefits
2023	$ 274	$ 34	$ 25
2024	218	6	12
2025	211	8	11
2026	206	6	9
2027	200	9	9
2028-2032	$ 873	$ 26	$ 40

<u>Plan Assets</u>

Our overall investment strategy is to achieve an appropriate mix of investments for long-term growth and for near-term benefit payments with a wide diversification of asset types, fund strategies, and investment fund managers. The target allocation for our plans is approximately 20% in growth assets and 80% in immunizing fixed income securities, with exceptions for foreign pension plans. The fixed income securities duration is intended to match that of our United States pension liabilities.

Plan assets are reported at fair value based on an exit price, representing the amount that would be received to sell an asset in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset. As a basis for considering such assumptions, a three-tiered fair value hierarchy is established, which prioritizes the inputs used in measuring fair value as follows: (Level 1) observable inputs such as quoted prices in active markets; (Level 2) inputs, other than the quoted prices in active markets that are observable, either directly or indirectly; and (Level 3) unobservable inputs in which there is little or no market data, which require the reporting entity to develop its own assumptions. Certain investments are valued based on net asset value (NAV), which approximates fair value. Such basis is determined by referencing the respective fund's underlying assets. There are no unfunded commitments or other restrictions associated with these investments. We manage the process and approve the results of a third-party pricing service to value the majority of our securities and to determine the appropriate level in the fair value hierarchy.

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The fair values of our pension plan assets at December 31, 2022 and 2021, by asset category were as follows:

	December 31,									
	Quoted prices (Level 1)		Other significant observable inputs (Level 2)		Significant unobservable inputs (Level 3)		Net Asset Value		Total	
Millions of dollars	2022	2021	2022	2021	2022	2021	2022	2021	2022	2021
Cash and cash equivalents	$ —	$ —	$ 159	$ 162	$ —	$ —	$ —	$ —	$ 159	$ 162
Government and government agency securities [1]										
U.S. securities	—	—	82	264	—	—	—	—	82	264
International securities	—	—	42	92	—	—	—	—	42	92
Corporate bonds and notes [1]										
U.S. companies	—	—	1,194	1,585	—	—	—	—	1,194	1,585
International companies	—	—	187	286	—	—	—	—	187	286
Equity securities [2]										
U.S. companies	—	—	—	—	—	—	—	—	—	—
International companies	11	36	—	—	—	—	—	—	11	36
Mutual funds [3]	—	—	73	103	—	—	—	—	73	103
Investments at net asset value										
U.S. equity securities [4]	—	—	—	—	—	—	166	308	166	308
International equity securities [4]	—	—	—	—	—	—	123	177	123	177
Short-term investment fund [4]	—	—	—	—	—	—	—	43	—	43
International debt securities [5]	—	—	—	—	—	—	—	178	—	178
International equity securities [5]	—	—	—	—	—	—	—	62	—	62
Real estate [6]	—	—	—	—	—	—	—	55	—	55
Limited partnerships [7]										
U.S. private equity investments	—	—	—	—	17	26	—	—	17	26
Diversified fund of funds	—	—	—	—	1	3	—	—	1	3
Emerging growth	—	—	—	—	2	3	—	—	2	3
All other investments	—	—	45	29	—	—	—	157	45	186
	$ 11	$ 36	$ 1,782	$ 2,521	$ 20	$ 32	$ 289	$ 980	$ 2,102	$ 3,569

(1) Valued using pricing vendors who use proprietary models to estimate the price a dealer would pay to buy a security using significant observable inputs, such as interest rates, yield curves, and credit risk.

(2) Valued using the closing stock price on a national securities exchange, which reflects the last reported sales price on the last business day of the year.

(3) Valued using the net asset value (NAV) of the fund, which is based on the fair value of underlying securities. The fund primarily invests in a diversified portfolio of equity securities, fixed income debt securities and real estate issued by non-U.S. companies.

(4) Common and collective trust funds valued using the NAV of the fund, which is based on the fair value of underlying securities.

(5) Fund of funds valued using the NAV of the fund, which is based on the fair value of underlying securities. International debt securities includes corporate bonds and notes and government and government agency securities.

(6) Valued using the NAV of the fund, which is based on the fair value of underlying assets.

(7) Valued at estimated fair value based on the proportionate share of the limited partnership's fair value, as determined by the general partner.

Fair Value Measurements Using Significant Unobservable Inputs (Level 3)

Millions of dollars	Limited Partnerships
Balance, December 31, 2021	$ 32
Realized gain / (loss) (net)	2
Unrealized gain / (loss) (net)	(6)
Purchases	—
Settlements	(8)
Balance, December 31, 2022	$ 20

Additional Information

The projected benefit obligation and fair value of plan assets for pension plans with a projected benefit obligation in excess of plan assets at December 31, 2022 and 2021 were as follows:

	United States Pension Benefits		Foreign Pension Benefits	
Millions of dollars	2022	2021	2022	2021
Projected benefit obligation	$ 1,866	$ 2,507	$ 37	$ 851
Fair value of plan assets	$ 1,706	$ 2,386	$ (1)	$ 578

The projected benefit obligation, accumulated benefit obligation and fair value of plan assets for pension plans with an accumulated benefit obligation in excess of plan assets at December 31, 2022 and 2021 were as follows:

	United States Pension Benefits		Foreign Pension Benefits	
Millions of dollars	2022	2021	2022	2021
Projected benefit obligation	$ 1,866	$ 2,507	$ 37	$ 851
Accumulated benefit obligation	1,860	2,494	34	831
Fair value of plan assets	$ 1,706	$ 2,386	$ (1)	$ 578

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F. Defined contribution plans

ASC 715-70, *Defined Contribution Plans*, provides guidance on the accounting and reporting of defined contribution plans. An employer's present obligation under the terms of a plan is fully satisfied when the contribution for the period is made, provided that costs (defined contributions) are not being deferred and recognized in periods after the related service period of the individual to whose account the contributions are to be made. In a postretirement health plan, an employer might establish individual postretirement health care accounts for each employee, each year contributing a specified amount to each active employee's account. The balance in each employee's account may be used by that employee after the employee's retirement to purchase health care insurance or for other health care benefits. Rather than providing for defined health care benefits, the employer is providing a defined amount of money that may be used by retirees toward the payment of their health care costs.

1. Disclosure requirements

According to ASC 715-70, an employer should disclose the amount of cost recognized for defined contribution pension plans and for other defined contribution postretirement benefit plans for all periods presented separately from the amount of cost recognized for defined benefit plans. The disclosures should include a description of the nature and effect of any significant changes during the period affecting comparability, such as a change in the rate of employer contributions, a business combination, or a divestiture.

2. Disclosure example – Whirlpool Corporation

DEFINED CONTRIBUTION PLAN – Included as a component of its PENSION AND OTHER POSTRETIREMENT BENEFIT PLANS disclosure.

A defined contribution plan is provided to all United States employees and is not classified within the net periodic benefit cost. The Company provides annual match and automatic company contributions, in cash or Company stock, of up to 7% of employees' eligible pay. Our contributions during 2022, 2021 and 2020 were $90 million, $91 million and $83 million, respectively.

G. Income taxes

ASC 740, *Income Taxes*, addresses financial accounting and reporting for the effects of income taxes that result from an entity's activities during the current and preceding years, including income statement related disclosures, which we review here.

1. Disclosure requirements

According to ASC 740, an entity should disclose the significant components of income tax expense attributable to continuing operations for each year presented, including, for example:

a. Current tax expense or benefit.
b. Deferred tax expense or benefit (exclusive of the effects of other components listed below).
c. Investment tax credits.
d. Government grants (to the extent recognized as a reduction of income tax expense).
e. The benefits of operating loss carryforwards.
f. Tax expense that results from allocating certain tax benefits directly to contributed capital.
g. Adjustments of a deferred tax liability or asset for enacted changes in tax laws or rates or a change in the tax status of the entity.

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h. Adjustments of the beginning-of-the-year balance of a valuation allowance because of a change in circumstances that causes a change in judgment about the realizability of the related deferred tax asset in future years. For example, any acquisition-date income tax benefits or expenses recognized from changes in the acquirer's valuation allowance for its previously existing deferred tax assets as a result of a business combination.

Additional disclosure requirements include:

- The amount of income tax expense or benefit allocated to continuing operations and the amounts separately allocated to other items (in accordance with the intraperiod tax allocation provisions of FABS ASC 740 and ASC 852, *Reorganizations*).
- For unrecognized tax benefits, at the end of each annual reporting period presented:
  a. The total amounts of interest and penalties recognized in the statement of operations and the total amounts of interest and penalties recognized in the statement of financial position.
  b. For positions for which it is reasonably possible that the total amounts of unrecognized tax benefits will significantly increase or decrease within 12 months of the reporting date:
     1. The nature of the uncertainty.
     2. The nature of the event that could occur in the next 12 months that would cause the change.
     3. An estimate of the range of the reasonably possible change or a statement that an estimate of the range cannot be made.
  c. A description of tax years that remain subject to examination by major tax jurisdictions.
  d. In addition, public entities should also disclose both of the following:
     1. A tabular reconciliation of the total amounts of unrecognized tax benefits at the beginning and end of the period, which should include at a minimum:
        - The gross amounts of the increases and decreases in unrecognized tax benefits as a result of tax positions taken during a prior period.
        - The gross amounts of increases and decreases in unrecognized tax benefits as a result of tax positions taken during the current period.
        - The amounts of decreases in the unrecognized tax benefits relating to settlements with taxing authorities.
        - Reductions to unrecognized tax benefits as a result of a lapse of the applicable statute of limitations.
     2. The total amount of unrecognized tax benefits that, if recognized, would affect the effective tax rate.
- A public entity that is not subject to income taxes because its income is taxed directly to its owners should disclose that fact and the net difference between the tax bases and the reported amounts of the entity's assets and liabilities.
- An entity that is a member of a group that files a consolidated tax return should disclose in its separately issued financial statements:
  a. The aggregate amount of current and deferred tax expense for each statement of earnings presented and the amount of any tax-related balances due to or from affiliates as of the date of each statement of financial position presented.
  b. The principal provisions of the method by which the consolidated amount of current and deferred tax expense is allocated to members of the group and the nature and effect of any changes in that method (and in determining related balances to or from affiliates) during the years for which the above disclosures are presented.
- Alternative acceptable policy choices available to an entity require disclosure as follows:

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a. An entity should disclose its policy on classification of interest and penalties in accordance with the alternatives permitted in ASC 740-10-45-25 in the notes to the financial statements.
b. ASC 740-10-25-46 identifies the deferral method and the flow-through method as acceptable methods of accounting for investment tax credits. Whichever method of accounting for the investment credit is adopted, it is essential that full disclosure be made of the method followed and amounts involved, when material.

- In addition to the above, disclosures regarding estimates meeting certain criteria are established in ASC 275, *Risks and Uncertainties*, for nongovernmental entities.

In Chapter 4, we reviewed examples of both income statement and balance sheet related disclosures related to income taxes which incorporated the impact of accounting for the impact of the TCJA. We will not review an additional example in this chapter of the course.

VI. Statement of cash flows

ASC 230, *Statement of Cash Flows*, only includes the following three disclosure requirements for the statement of cash flows:

- Cash equivalents policy;
- Interest and income taxes paid; and
- Noncash investing and financing activities.

A. Cash equivalents policy

An entity should disclose its policy for determining which items are treated as cash equivalents. (Any change to that policy is a change in accounting principle that should be effected by restating financial statements for earlier years presented for comparative purposes.) While we reviewed examples of a cash equivalents policy earlier in the course, here is an additional sample disclosure.

1. Disclosure example – The Home Depot, Inc.

CASH EQUIVALENTS
The Company considers all highly liquid investments purchased with original maturities of three months or less to be cash equivalents. The Company's cash equivalents are carried at fair market value and consist primarily of money market funds.

B. Interest and income taxes paid

If the indirect method is used, the amounts of interest paid (net of amounts capitalized) and income taxes paid during the period should be disclosed. Often, income taxes paid is disclosed in the income tax footnote, as we saw in our tax examples from Chapter 4.

However, other companies combine the supplemental cash flow information immediately following the statement of cash flow or in a separate footnote. For example:

1. Disclosure example – Exelon Corporation

SUPPLEMENTAL CASH FLOW INFORMATION
The following tables provide additional information regarding the Registrants' Consolidated Statements of Cash Flows for the years ended December 31, 2015, 2014, and 2013.

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For the year ended December 31, 2015	Exelon	Generation	ComEd	PECO	BGE
Cash paid (refunded) during the year:					
Interest (net of amount capitalized)	$ 930	$ 348	$ 308	$ 94	$ 120
Income taxes (net of refunds)	342	476	(265)	64	73

C. Noncash investing and financing activities

Information about all investing and financing activities of an entity during a period that affect recognized assets or liabilities but do not result in cash receipts or cash payments in the period should be disclosed.

Those disclosures may be either narrative or summarized in a schedule, and they should clearly relate the cash and noncash aspects of transactions involving similar items. Typical noncash investing and financing transactions include, for example:

- Converting debt to equity.
- Acquiring assets by assuming directly related liabilities, such as purchasing a building by incurring a mortgage to the seller.
- Obtaining an asset by entering into a capital lease.
- Obtaining a building or investment asset by receiving a gift.
- Exchanging noncash assets or liabilities for other noncash assets or liabilities.

For those transactions that are part cash and part noncash, only the cash portion should be reported in the statement of cash flows.

If there are only a few noncash transactions, it may be convenient to include them on the same page as the statement of cash flows. Otherwise, the transactions can be reported in the notes to the financial statements, using a table format or a narrative presentation.

1. Disclosure example – Union Pacific Corporation

NON-CASH INVESTING AND FINANCING ACTIVITIES

Supplemental Cash Flow Information			
Non-cash investing and financing activities:			
Capital investments accrued but not yet paid	**$ 100**	$ 174	$ 133
Capital lease financings	**13**	-	39
Cash dividends declared but not yet paid (Note 13)	**-**	438	356

D. Additional disclosures

Many entities also provide additional disclosures with respect to the statement of cash flows in order to help readers better understand various aspects of the reporting entity's operating environment, for example, cash flow information related to a change in presentation.

1. Disclosure example (Created)

In the first quarter of 20X3, ABC changed the presentation in its statement of cash flows for the issuance of certain equity shares related to employee stock compensation plans. Previously, such issuances were shown in the statement of cash flows as a reduction of cash from operating activities and a source of cash from financing activities. In 20X3, ABC determined that these issuances should be presented as non-cash items and that the presentation in the prior periods was not correct. The presentation in the statement of cash flows for the first quarter of 20X2 has been corrected to conform with the current presentation, resulting in a decrease in cash used for operations and a decrease in cash used for financing activities of $48 million. With respect to the periods previously reported, but not contained

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herein, the corresponding correction in the statement of cash flows results in an increase in cash generated from operations (or a decrease in cash used by operations in periods where there is a net cash use) and a decrease in cash used for financing activities compared with the information presented previously as follows: six months ended June 30, 20X2 - $62 million; nine months ended September 30, 20X2 - $103 million; year ended December 31, 20X2 - $103 million; year ended December 31, 20X1 - $82 million; and year ended December 31, 20X0 - $59 million.

VII. Chapter summary

In this chapter, we reviewed the following disclosures related to several key income statement and statement of cash flows items in accordance with U.S. generally accepted accounting principles:

- Revenue recognition under Topic 606;
- Nonmonetary transactions;
- Cost of sales and services;
- Compensation – general;
- Compensation – nonretirement postemployment benefits;
- Defined benefit plans;
- Defined contribution plans;
- Income taxes;
- Cash equivalents policy;
- Interest and income taxes paid;
- Noncash investing and financing activities; and
- Additional statement of cash flows disclosures.

Examples illustrating these disclosures included those from the published financial statements of:

- General revenue recognition:
  - Apple
  - The Boeing Company
- Nonmonetary transactions:
  - Sample stock dividend disclosure.
- Cost of sales and services:
  - Kohl's Corporation.
  - Catasys, Inc.
- Compensation – general:
  - The Phoenix Companies, Inc.
- Compensation – nonretirement postemployment benefits:
  - Dialogic, Inc.
- Defined benefit plans:
  - Whirlpool Corporation.
- Defined contribution plans:
  - Whirlpool Corporation.
- Income taxes:
  - See examples in Chapter 4.
- Cash equivalents policy:
  - The Home Depot, Inc.
- Interest and income taxes paid:
  - Exelon Corp.
- Noncash investing and financing activities:

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    - Union Pacific Corporation.
- Additional statement of cash flows disclosures:
    - Created.

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Disclosures Update

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Disclosures Update

Learning objective

After completing this chapter, you should be familiar with:
- Disclosure-related aspects of recently issued FASB *Accounting Standards Updates* (ASUs) and developing disclosure issues that will affect both public and nonpublic entities, business owners, management, preparers, and accountants and auditors.

I. Introduction

Our course to date has focused on some of the key disclosures required by current accounting standards. As we know, the FASB is constantly updating the ASC. While not all Updates will have a significant impact on an entity's financial reporting and disclosure, each of these is likely to change current disclosure requirements, to some extent, as will other standards that have already been issued but are not yet effective. In this chapter of the course, we will review some of the new disclosure requirements from new ASUs that have the greatest applicability to smaller and medium-sized entities that are on the horizon so you can get a feel for how some of the examples we discussed earlier are likely to change.

With Topic 606 now applicable for all entities, we reviewed its disclosure requirements in Chapter 5 of the course. We will now focus on the disclosure requirements related to leases as well as disclosures related to new updates that have the most applicability to small and medium sized entities.

II. ASU No. 2016-02: Leases

In 2016, the FASB issued ASU No. 2016-02, *Leases*, which added Topic 842 to the codification, which replaced the current guidance for lease accounting found in Topic 840. This update is effective now for public companies and non-public companies.

This is a far-reaching standard that significantly changes the balance sheet recognition for lessees of a right of use (ROU) asset and a lease liability. Other, though fewer major changes were also made to the guidance for lessee accounting of capital leases, to be known as finance leases under Topic 842 and to the lessor accounting for leases.

As the impact of this update will be greatest for lessees with operating leases, our discussion will focus on the disclosure requirements for those leasing arrangements known as operating leases under Topic 842.

The update states that the objective of the disclosure requirements is to enable users of financial statements to assess the amount, timing, and uncertainty of cash flows arising from leases. To achieve that objective, a **lessee** shall disclose qualitative and quantitative information about all of the following:

a. Its leases [as described in paragraphs 842-20-50-3(a) through (b) and 842-20-50-7 through 50-8].
b. The significant judgments made in applying the requirements in this Topic to those leases [as described in paragraph 842-20-50-3(c)].
c. The amounts recognized in the financial statements relating to those leases (as described in paragraphs 842-20-50-4 and 842-20-50-6).

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Further, a lessee should consider the level of detail necessary to satisfy the disclosure objective and how much emphasis to place on each of the various requirements. This includes aggregating or disaggregating disclosures as necessary to assure information is useful but not overwhelming.

A lessee shall disclose all of the following:

a. Information about the nature of its leases, including:
   1. A general description of those leases.
   2. The basis and terms and conditions on which variable lease payments are determined.
   3. The existence and terms and conditions of options to extend or terminate the lease. A lessee should provide narrative disclosure about the options that are recognized as part of its right-of-use assets and lease liabilities and those that are not.
   4. The existence and terms and conditions of residual value guarantees provided by the lessee.
   5. The restrictions or covenants imposed by leases, for example, those relating to dividends or incurring additional financial obligations.

   A lessee should identify the information relating to subleases included in the disclosures provided in (1) through (5), as applicable.
b. Information about leases that have not yet commenced but that create significant rights and obligations for the lessee, including the nature of any involvement with the construction or design of the **underlying asset**.
c. Information about significant assumptions and judgments made in applying the requirements of this Topic, which may include the following:
   1. The determination of whether a **contract** contains a lease (as described in paragraphs 842-10-15-2 through 15-27).
   2. The allocation of the consideration in a contract between lease and nonlease components (as described in paragraphs 842-10-15-28 through 15-32).
   3. The determination of the **discount rate for the lease** (as described in paragraphs 842-20-30-2 through 30-4).

For each period presented in the financial statements, a lessee should disclose the following amounts relating to a lessee's total lease cost, which includes both amounts recognized in profit or loss during the period and any amounts capitalized as part of the cost of another asset in accordance with other Topics, and the cash flows arising from lease transactions:

a. Finance lease cost segregated between the amortization of the right-of use assets and interest on the lease liabilities.
b. Operating lease cost determined in accordance with paragraphs 842-20-25-6(a) and 842-20-25-7.
c. Short-term lease cost, excluding expenses relating to leases with a lease term of one month or less, determined in accordance with paragraph 842-20-25-2.
d. Variable lease cost determined in accordance with paragraphs 842-20-25-5(b) and 842-20-25-6(b).
e. Sublease income, disclosed on a gross basis, separate from the finance or operating lease expense.
f. Net gain or loss recognized from sale and leaseback transactions in accordance with paragraph 842-40-25-4.

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g. Amounts segregated between those for finance and operating leases for the following items:
   1. Cash paid for amounts included in the measurement of lease liabilities, segregated between operating and financing cash flows.
   2. Supplemental noncash information on lease liabilities arising from obtaining right-of-use assets.
   3. Weighted-average remaining lease term.
   4. Weighted-average discount rate.

A lessee shall disclose a maturity analysis of its finance lease liabilities and its operating lease liabilities separately, showing the undiscounted cash flows on an annual basis for a minimum of each of the first five years and a total of the amounts for the remaining years. A lessee shall disclose a reconciliation of the undiscounted cash flows to the finance lease liabilities and operating lease liabilities recognized in the statement of financial position.

A lessee shall disclose lease transactions between related parties in accordance with paragraphs 850-10-50-1 through 50-6. Additionally, a lessee that accounts for short-term leases in accordance with paragraph 842-20-25-2 shall disclose that fact. If the short-term lease expense for the period does not reasonably reflect the lessee's short-term lease commitments, a lessee shall disclose that fact and the amount of its short-term lease commitments.

Lastly, a lessee that elects the practical expedient on not separating lease components from nonlease components in paragraph 842-10-15-37 shall disclose its accounting policy election and which class or classes of underlying assets it has elected to apply the practical expedient.

Per the standard, the following is an example of a disclosure that achieves the quantitative requirements of the Topic:

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	Year Ending December 31,	
	20X2	20X1
Lease cost		
Finance lease cost:	$XXX	$XXX
Amortization of right-of-use assets	XXX	XXX
Interest on lease liabilities	XXX	XXX
Operating lease cost	XXX	XXX
Short-term lease cost	XXX	XXX
Variable lease cost	XXX	XXX
Sublease income	(XXX)	(XXX)
Total lease cost	$XXX	$XXX
Other information		
(Gains) and losses on sale and leaseback transactions, net	$(XXX)	$XXX
Cash paid for amounts included in the measurement of lease liabilities	XXX	XXX
Operating cash flows from finance leases	XXX	XXX
Operating cash flows from operating leases	XXX	XXX
Financing cash flows from finance leases	XXX	XXX
Right-of-use assets obtained in exchange for new finance lease liabilities	XXX	XXX
Right-of-use assets obtained in exchange for new operating lease liabilities	XXX	XXX
Weighted-average remaining lease term—finance leases	X.X years	X.X years
Weighted-average remaining lease term—operating leases	X.X years	X.X years
Weighted-average discount rate—finance leases	X.X%	X.X%
Weighted-average discount rate—operating	X.X%	X.X%

The following is a representative disclosure from a public entity.

We have operating and finance leases for datacenters, corporate offices, research and development facilities, retail stores, and certain equipment. Our leases have remaining lease terms of 1 year to 20 years, some of which may include options to extend the leases for up to 5 years, and some of which may include options to terminate the leases within 1 year. As of September 30, 2017 and June 30, 2017, assets recorded under finance leases were $3.4 billion and $2.7 billion, respectively, and accumulated depreciation associated with finance leases was $209 million and $161 million, respectively.

The components of lease expense were as follows:

(In millions)

Three Months Ended September 30,	**2017**	**2016**
Operating lease cost	$ 388	$ 260
Finance lease cost		
Amortization of right-of-use assets	$ 48	$ 15
Interest on lease liabilities	30	12
Total finance lease cost	$ 78	$ 27

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Other information related to leases was as follows:

(In millions, except lease term and discount rate)

Three Months Ended September 30,	**2017**	**2016**
Supplemental Cash Flows Information		
Cash paid for amounts included in the measurement of lease liabilities:		
Operating cash flows from operating leases	$ 369	$ 267
Operating cash flows from finance leases	30	12
Financing cash flows from finance leases	25	6
Right-of-use assets obtained in exchange for lease obligations:		
Operating leases	391	55
Finance leases	728	267
Weighted Average Remaining Lease Term		
Operating leases	7 years	5 years
Finance leases	14 years	12 years
Weighted Average Discount Rate		
Operating leases	2.5%	2.3%
Finance leases	4.7%	5.1%

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Future minimum lease payments under non-cancellable leases as of September 30, 2017 were as follows:

(In millions)

Year Ending June 30,		Operating Leases		Finance Leases
2018 (excluding the three months ended September 30, 2017)	$	1,110	$	205
2019		1,385		281
2020		1,267		287
2021		1,022		293
2022		833		299
Thereafter		2,333		3,133
Total future minimum lease payments		7,950		4,498
Less imputed interest		(930)		(1,225)
Total	$	7,020	$	3,273
Reported as of September 30, 2017				
Other current liabilities	$	1,252	$	146
Operating lease liabilities		5,768		0
Other long-term liabilities		0		3,127
Total	$	7,020	$	3,273

As of September 30, 2017, we have additional operating and finance leases, primarily for datacenters, that have not yet commenced of $219 million and $2.3 billion, respectively. These operating and finance leases will commence between fiscal year 2018 and fiscal year 2019 with lease terms of 1 year to 20 years.

The following is an example of the ASC 842 disclosures of Tenet Healthcare, a for-profit operator of hospitals. Though it is from a for-profit entity, this disclosure example would serve as a good example for a not-for-profit entity as well, as the disclosure requirements are identical for both for and non-for-profit entities.

Example 2 – Tenet Healthcare Corp.

LEASES

The following table presents the components of our right-of-use assets and liabilities related to leases and their classification in our Condensed Consolidated Balance Sheet at March 31, 2019:

Component of Lease Balances	Classification in Condensed Consolidated Balance Sheet		March 31, 2019
Assets:			
Operating lease assets	Investments and other assets	$	799
Finance lease assets	Property and equipment, at cost, less accumulated depreciation and amortization		441
Total leased assets		**$**	**1,240**
Liabilities:			
Operating lease liabilities:			
Current	Other current liabilities	$	146
Long-term	Other long-term liabilities		714
Total operating lease liabilities			860
Finance lease liabilities:			
Current	Current portion of long-term debt		141
Long-term	Long-term debt, net of current portion		224
Total finance lease liabilities			365
Total lease liabilities		**$**	**1,225**

We determine if an arrangement is a lease at inception of the contract. Our right-of-use assets represent our right to use the underlying assets for the lease term and our lease liabilities represent our obligation to make lease payments arising from the leases. Right-of-use assets and lease liabilities are recognized at commencement date based on the present value of lease payments over the lease term. We use our estimated incremental borrowing rate, which is derived from information available at the lease commencement date, in determining the present value of lease payments. For our Hospital Operations and other Conifer segments, we estimate our incremental borrowing rates for our portfolio of leases using documented rates included in our recent equipment finance leases or, if applicable, recent secured debt issuances that correspond to various lease terms. We also give consideration to information obtained from our bankers, our secured debt fair value, and publicly available data for instruments with similar characteristics. For our Ambulatory Care segment, we estimate an incremental borrowing rate for each center by utilizing historical and projected financial data, estimating a hypothetical credit rating using publicly available market data and adjusting the market data to reflect the effects of collateralization.

Our operating leases are primarily for real estate, including off-campus outpatient facilities, medical office buildings, and corporate and other administrative offices, as well as medical and office equipment. Our

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finance leases are primarily for medical equipment and information technology and telecommunications assets. Our real estate lease agreements typically have initial terms of five to 10 years, and our equipment lease agreements typically have initial terms of three years. We do not record leases with an initial term of 12 months or less ("short-term leases") in our consolidated balance sheets.

Our real estate leases may include one or more options to renew, with renewals that can extend the lease term from five to 10 years. The exercise of lease renewal options is at our sole discretion. In general, we do not consider renewal options to be reasonably likely to be exercised, therefore renewal options are generally not recognized as part of our right-of-use assets and lease liabilities. Certain leases also include options to purchase the leased property. The useful life of assets and leasehold improvements is limited by the expected lease term unless there is a transfer of title or purchase option reasonably certain of exercise. The majority of our medical equipment leases have terms of three years with a bargain purchase option that is reasonably certain of exercise, so these assets are depreciated over their useful life, typically ranging from five to seven years. Similarly, some of our leases of information technology and telecommunications assets include a transfer of title and, therefore, have useful lives of 15 years. Certain of our lease agreements for real estate include payments based on actual common area maintenance expenses and others include rental payments adjusted periodically for inflation. These variable lease payments are recognized in other operating expenses, net, but are not included in the right-of-use asset or liability balances. Our lease agreements do not contain any material residual value guarantees, restrictions, or covenants.

We have elected the practical expedient that allows lessees to choose to not separate lease and non-lease components by class of underlying asset and are applying this expedient to all relevant asset classes. We have also elected the practical expedient package to not reassess at adoption (i) expired or existing contracts for whether they are or contain a lease, (ii) the lease classification of any existing leases, or (iii) initial indirect costs for existing leases.

The following table presents the components of our lease expense and their classification in our Condensed Consolidated Statement of Operations for the three months ended March 31, 2019:

Component of Lease Expense	Classification on Condensed Consolidated Statements of Operations	Three Months Ended March 31, 2019
Operating lease expense	Other operating expenses, net	$ 50
Finance lease expense:		
Amortization of leased assets	Depreciation and amortization	18
Interest on lease liabilities	Interest expense	5
Total finance lease expense		23
Variable and short term-lease expense	Other operating expenses, net	34
Total lease expense		**$ 107**

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The weighted-average lease terms and discount rates for operating and finance leases are presented in the following table:

	March 31, 2019
Weighted-average remaining lease term (years)	
Operating leases	6.7
Finance leases	6.1
Weighted-average discount rate	
Operating leases	5.2%
Finance leases	5.5%

Cash flow and other information related to leases is included in the following table:

	Three Months Ended March 31, 2019
Cash paid for amounts included in the measurement of lease liabilities:	
Operating cash outflows from operating leases	$ 47
Operating cash outflows from finance leases	$ 5
Financing cash outflows from finance leases	$ 36
Right-of-use assets obtained in exchange for lease obligations:	
Operating leases	$ 28
Finance leases	$ 36

Future maturities of lease liabilities at March 31, 2019 are presented in the following table:

	Operating Leases	Finance Leases	Total
2019	$ 144	$ 120	$ 264
2020	171	122	293
2021	152	64	216
2022	132	16	148
2023	110	13	123
Later years	339	123	462
Total lease payments	1,048	458	1,506
Less: Imputed interest	188	93	281
Total lease obligations	860	365	1,225
Less: Current obligations	146	141	287
Long-term lease obligations	**$ 714**	**$ 224**	**$ 938**

Future maturities of lease liabilities at December 31, 2018, prior to our adoption of ASU 2016-02, are presented in the following table:

		Years Ending December 31,					
	Total	2019	2020	2021	2022	2023	Later Years
Capital lease obligations	$ 425	$ 140	$ 95	$ 57	$ 37	$ 21	$ 75
Long-term non-cancelable operating leases	$ 932	$ 171	$ 151	$ 133	$ 113	$ 92	$ 272

Nonpublic Business Entity Considerations

The FASB decided **NOT** to provide any specified reliefs from the disclosure requirements for nonpublic business entities. Therefore, the lessee disclosure package is equally applicable to both public and nonpublic business entities.

III. ASU No. 2023-02, Investments - Equity Method and Joint Ventures (Topic 323): Accounting for Investments in Tax Credit Structures Using the Proportional Amortization Method

The ASU allows a reporting entity to use the proportional amortization method for tax equity investments if the conditions below are met:

1. It is probable that the income tax credits will be available to the equity investor.
2. The equity investor lacks significant influence over operations and financial policies of the investment entity.
3. Substantially all benefits are from income tax credits and other income tax benefits.
4. The yield is projected to be positive.

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5. The tax equity investor is a limited liability investor in the limited liability entity for legal and tax purposes, liability is limited to its capital investment.

The election to use the proportional amortization method is made on a tax-credit-program-by-tax-credit-program basis, and receipt of the investment tax credits are accounted for using the flow-through method under ASC 740, Income Taxes, even if the entity applies the deferral method for other investment tax credits received.

This ASU requires the delayed equity contribution guidance in paragraph 323-740-25-3 (which requires that a liability be recognized for delayed equity contributions that are unconditional and legally binding or for equity contributions that are contingent upon a future event when that contingent event becomes probable) to be used for tax equity investments accounted for using the proportional amortization method.

LIHTC investments that do not use the proportional amortization method will no longer use the delayed equity contribution guidance in ASC 323 and will account for the investment using other relevant GAAP depending upon the facts and circumstances related to the investment.

The amendments in this ASU require specific disclosures for an entity that has elected to apply the proportional amortization method. This ASU requires that a reporting entity disclose certain information in annual and interim reporting periods that enable investors to understand the following information about its investments that generate income tax credits and other income tax benefits from a tax credit program:

1. The nature of its tax equity investments
2. The financial statement effect of tax equity investments, related income tax credits and other income tax benefits.

To meet the aforementioned objectives, a reporting entity should disclose the following about investments that generate income tax credits and other income tax benefits from a tax credit program for which it has elected on a tax-credit-program-by-tax-credit-program basis to apply the proportional amortization method, including investments within that elected tax credit program that do not meet the requirements to use the proportional amortization method:

a. The amount of income tax credits and other income tax benefits recognized during the period, and the line item in the statement of operations (income statement) and statement of cash flows in which it has been recognized.
b. The amount of investments and the line item in which the investments are recognized in the statement of financial position (balance sheet).
c. For investments accounted for using the proportional amortization method, the amount of investment amortization recognized as a component of income tax expense (benefit).
d. For investments accounted for using the proportional amortization method, the amount of non-income-tax-related activity and other returns received that is recognized outside of income tax expense (benefit) and the line item in the statement of operations (income statement) and statement of cash flows in which it has been recognized.
e. For investments accounted for using the proportional amortization method, significant modifications or events that resulted in a change in the nature of the investment or a change in the relationship with the underlying project.

For public business entities, this ASU is effective for fiscal years beginning after December 15, 2023, including interim periods within those fiscal years. For all other entities, the ASU is effective for fiscal

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years beginning after December 15, 2024, including interim periods within those fiscal years. Early adoption is permitted for all entities in any interim period. If an entity adopts the amendments in an interim period, it should adopt them as of the beginning of the fiscal year that includes that interim period.

The ASU, except for LIHTC investments not utilizing the proportional amortization method, must be applied on either a modified retrospective basis or a retrospective transition basis. A reporting entity that has LIHTC investments that are no longer permitted to use (1) the cost method guidance, (2) the equity method, or (3) the delayed equity contribution method must either use the modified retrospective, retrospective, or apply a prospective approach. The election may be made separately for each of the three transition adjustment types; however, an entity must apply a consistent transition method for each transition adjustment type.

IV. ASU No. 2022-04, Liabilities, Supplier Finance Programs (Subtopic 405-50) – Disclosure of Supplier Finance Program Obligations

The FASB issued this ASU to address concerns regarding the transparency of supplier finance programs in buyer party financial statements. Buyers utilize supplier finance programs to allow an intermediary or third-party finance provider to pay approved supplier invoices, oftentimes in advance of the invoice due date, for purchased goods and services. Reverse factoring, payables finance, or structured payables arrangements are common examples of supplier finance programs.

This update includes amendments that improve disclosures to address financial statement user concerns regarding supplier finance programs and their impact on the reporting entity's working capital, liquidity, and cash flows. The ASU addresses the aforementioned concerns by requiring the following disclosure in each annual reporting period:

1. Key terms in the supplier finance program such as:
    a. Payment terms.
    b. Description of the assets pledged as security.
    c. Other guarantees related to the committed payments to the third-party finance provider or intermediary.
2. For buyer confirmed obligations to the third-party finance provider or intermediary the following should be disclosed:
    a. Outstanding unpaid amount by the buyer at the end of the annual period.
    b. Description of where in the balance sheet obligations are presented.
    c. A roll forward of the obligations for the annual period, including confirmed obligations and those subsequently paid.

For interim reporting periods the amount of confirmed valid obligations outstanding to the third-party finance provider or intermediary as of the end of the reporting period should be disclosed.

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Below are examples of the disclosures and roll forward provided in this ASU.

Example 1

Entity A enters into a supplier finance program with Intermediary B in which Entity A agrees to pay Intermediary B on the invoice maturity dates the stated amount of invoices that Entity A has confirmed on Intermediary B's supplier finance platform. Entity A pays Intermediary B an annual subscription fee for the supplier finance platform and a service fee for related support. Entity A or Intermediary B may terminate the agreement upon at least 90 days' notice. The agreement with Intermediary B does not require that Entity A provide assets pledged as security or other forms of guarantees for the supplier finance program. Intermediary B does not advise Entity A of the maximum size of the program. Intermediary B also enters into a separate arrangement with Entity A's suppliers and provides them with the option to request early payment from Intermediary B for invoices confirmed by Entity A. Entity A does not determine the terms or conditions of the arrangement between Intermediary B and Entity A's suppliers. Entity A does not participate in the transactions between its suppliers and Intermediary B. The supplier invoices that have been confirmed as valid under the program require payment in full within 90 days of the invoice date.

Entity A discloses the following information on the key terms of its supplier finance program:

Under a supplier finance program, Entity A agrees to pay an intermediary the stated amount of confirmed invoices from its designated suppliers on the original maturity dates of the invoices, an annual subscription fee for the supplier finance platform, and service fees for related support. Entity A or the intermediary may terminate the agreement upon at least 90 days' notice. The supplier invoices that have been confirmed as valid under the program require payment in full within 90 days of the invoice date.

Example 2

This Example provides an illustration of the guidance in subtopic ASC 405-50 based on the assumptions that Entity A provides one comparative balance sheet and that its supplier finance program is denominated in Entity A's reporting currency.

The roll forwards of Entity A's outstanding obligations confirmed as valid under its supplier finance program for years ended December 31, 20X2, and 20X1, are as follows (in thousands):

	20X2	20X1
Confirmed obligations outstanding at the beginning of the year	$ 730.00	$ 710.00
Invoices confirmed during the year	2,430.00	2,280.00
Confirmed invoices paid during the year	(2,310.00)	(2,260.00)
Confirmed obligations outstanding at the end of the year	$ 850.00	$ 730.00

The ASU is effective for fiscal years beginning after December 15, 2023. Early adoption is permitted. In the year of adoption, the key terms of the program and where in the balance sheet obligations are presented should be disclosed in annual and interim reporting periods. The requirements of the ASU, except for the roll forward, should be applied retrospectively to all periods in which a balance sheet is presented. The roll forward of information should be applied prospectively.

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V. ASU No. 2022-03, Fair Value Measurement (Topic 820): Fair Value Measurement of Equity Securities Subject to Contractual Sale Restrictions

This ASU was issued to clarify the guidance in Topic 820, *Fair Value Measurement* when measuring the fair value of an equity security subject to contractual restrictions that prohibit the sale of an equity security. The lack of clarity of the guidance has led to a diversity in practice in the accounting for such instruments.

The ASU also adds new disclosure requirements for equity securities subject to contractual sale restrictions that are measured at fair value in accordance with Topic 820.

Under this ASU a contractual restriction on the sale of an equity security is not considered part of the unit of account of the equity security and, therefore, is not considered in measuring fair value. Also, an entity cannot, as a separate unit of account, recognize and measure a contractual sale restriction.

The ASU adds the following disclosures related to such securities:

1. The fair value of equity securities subject to contractual sale restrictions reflected in the balance sheet.
2. The nature and remaining duration of the restriction(s).
3. The circumstances that could cause a lapse in the restriction(s).

The effective date for ASU No. 2022-03 is as follows:

- Public business entities – Fiscal years beginning after December 15, 2023, and interim periods within.
- All other entities – Fiscal years beginning after December 15, 2024, and interim periods within.

Early adoption is permitted. ASU No. 2022-03 should be applied on a prospective basis.

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