Full Disclosures in Financial Reporting

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Course Description

The full disclosure principle, one of major accounting principles, requires that information provided in financial statements be sufficiently complete to avoid misleading users of the reports by omitting significant facts of information. The full disclosure principle also refers to revealing information that would be useful in the decision-making processes of informed users. Full disclosure is required for the fair presentation of financial statements. This course discusses the disclosures required of companies, including those related to accounting policies, segmental information, related parties, contingencies, long-term purchase contract obligations, inflation, and derivatives. Sample annual reports addressing this requirement are illustrated.

Field of Study	Accounting
Level of Knowledge	Basic to Intermediate
Prerequisite	Basic Accounting
Advanced Preparation	None

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Full Disclosures in Financial Reporting

Learning Objectives:

After completing this section, you should be able to:

1. Recognize the full disclosure principle and its implementation.
2. Identify the types of major accounting disclosures.
3. Recognize the disclosure requirements for major business segments and related party transactions.
4. Understand the disclosure requirements for derivatives, subsequent and interim financial reports.

Accounting principles are the guidelines, laws, or rules which are adopted by the accounting profession and which serve as guides to accounting practice. A major objective of accounting principles is to reduce the difference and inconsistencies in accounting practice, thereby improving the comparability and credibility of financial reports.

The phrase *generally accepted accounting principles (GAAP)* is a set of standards and rules that are recognized as a general guide to financial reporting. GAAP reflects a consensus of what the accounting profession considers good accounting practices and procedures. GAAP establishes which resources and obligations should be recorded as assets and liabilities, which changes in assets and liabilities should be recorded, when these changes should be recorded, how the recorded assets and liabilities and changes in them should be measured, what information should be disclosed, and which financial statements should be prepared. GAAP is prescribed by authoritative bodies, such as the Financial Accounting Standards Board (FASB). On June 3, 2009, the FASB approved the Codification (http://asc.fasb.org/home). The Accounting Standards Codification (ASC) is not intended to change existing U.S. GAAP, but rather integrates existing accounting standards by multiple standard-setters within the current GAAP hierarchy. The Codification is now the single official source of authoritative, nongovernmental U.S. GAAP, superseding existing FASB, AICPA, EITF, and related literature. For example, Statement of Financial Accounting Standards No. 141R (FAS-141R) (Business Combinations), is now ASC 805-10 (Business Combinations-Overall).

Major accounting principles include the cost principle, the realization principle, the matching principle, the full disclosure principle, the materiality principle, the conservatism principle, the consistency principle, and others.

The *full disclosure principle* requires that information provided in financial statements be sufficiently complete to avoid misleading users of the reports by omitting significant facts of information. It requires disclosure of any financial facts significant enough to influence the judgment of an informed reader. The full disclosure principle also requires revealing information that would be useful in the decision-making processes of informed users. Full disclosure is required for the fair presentation of financial statements. Many disclosures are made in the body of the financial statements and in notes (footnotes), schedules, and supplementary reports, and in a summary of significant policies preceding the first note to financial statements.

According to the *full disclosure principle*, understandable information capable of affecting user decisions should be reported. The financial statements are the primary means of disclosure. However, almost all accounting pronouncements require additional disclosures in the notes. The full disclosure principle implies disclosure of any financial facts significant enough to influence the judgment of an informed reader.

Increase in Reporting Requirements

Disclosure requirements have increased substantially. The reasons for this increase in disclosure requires are varied. Some of them are:

- *Complexity of the Business Environment.* The increasing complexity of business operations magnifies the difficulty of distilling economic events into summarized reports. Such areas as derivatives, leasing, business combinations, pensions, financing arrangements, revenue recognition, and deferred taxes are complex. As a result, companies extensively use notes to the financial statements to explain these transactions and their future effects.

- *Necessity for Timely Information.* Today more than ever before, users are demanding information that is current and predictive. For example, users want more complete interim data. Also, the SEC recommends published financial forecasts, long avoided and even feared by management.

- *Accounting as a Control and Monitoring Device*. The government has recently sought public disclosures of such phenomena as management compensation, off-balance-sheet financing arrangements, and related party transactions. An "Enronitis" concern is expressed in many of these newer disclosure requirements, and the SEC has selected accountants and auditors as the agents to assist in controlling and monitoring these concerns.

SECURITY MARKETS AND FINANCIAL DISCLOSURE

Financial disclosure is one of a number of institutional features that contribute to vibrant security markets. In fact, a recent study of disclosure and other mechanisms (such as civil lawsuits and criminal sanctions) found that good disclosure is the most important contributor to a vibrant market.

The study, which compared disclosure and other legal and regulatory elements across 49 countries, found that countries with the best disclosure laws have the biggest stock markets. Countries with more successful market environments also tend to have regulations that make it relatively easy for private investors to sue corporations that provide bad information. That is, while criminal sanctions can be effective in some circumstances, disclosure and other legal and regulatory elements encouraging good disclosure are the most important determinants of highly liquid and deep securities markets.

These findings hold for nations in all stages of economic development, with particular importance for nations that are in the early stages of securities regulation. The lesson: Disclosure is good for your market.

Source: Rebecca Christie, "Study: Disclosure at Heart of Effective Securities Laws," *Wall Street Journal Online* (August 11, 2003).

COMMON NOTES

The more common notes to the financial statements are as follows.

Major Disclosures

Inventory

Companies should report the basis upon which inventory amounts are stated (lower-of-cost-or-market) and the method used in determining cost (LIFO, FIFO, average cost, etc.). Manufacturers should report, either in the balance sheet or in a separate schedule in the notes, the inventory composition (finished goods, work in process, raw materials). Unusual or significant financing arrangements relating to inventories that may require disclosure include transactions with related parties, product financing arrangements, firm purchase commitments, involuntary liquidation of LIFO inventories, and pledging of inventories as collateral.

Property, Plant, and Equipment

Companies should state the basis of valuation for property, plant, and equipment. It is usually historical cost. Companies also should disclose pledges, liens, and other commitments related to these assets. In the presentation of depreciation, companies should disclose the following in the financial statements or in the notes: (1) depreciation expense for the period; (2) balances of major classes of depreciable assets, by nature and function, at the balance sheet date; (3) accumulated depreciation, either by major classes of depreciable assets or in total, at the balance sheet date; and (4) a general description of the method or methods used in computing depreciation with respect to major classes of depreciable assets. Finally, companies should explain any major impairments.

Creditor Claims

Investors normally find it extremely useful to understand the nature and cost of creditor claims. However, the liabilities section in the balance sheet can provide the major types of liabilities only in the aggregate. Note schedules regarding such obligations provide additional information about how a company is financing its operations, the costs that it will bear in future periods, and the timing of future cash outflows. Financial statements must disclose for each of the five years following the date of the statements the aggregate amount of maturities and sinking fund requirements for all long-term borrowings.

Equity Holders' Claims

Many companies present in the body of the balance sheet information about equity securities: the number of shares authorized, issued, and outstanding and the par value for each type of security. Or, companies may present such data in a note. Beyond that, a common equity note disclosure relates to contracts and senior securities outstanding that might affect the various claims of the residual equity holders. An example would be the existence of outstanding stock options, outstanding convertible debt, redeemable preferred stock, and convertible preferred stock. In addition, it is necessary to disclose certain types of restrictions currently in force. Generally, these types of restrictions involve the amount of earnings available for dividend distribution.

Contingencies and Commitments

A company may have gain or loss contingencies that are not disclosed in the body of the financial statements. These contingencies include litigation, debt and other guarantees, possible tax assessments, renegotiation of government contracts, and sales of receivables with recourse. In addition, companies should disclose in the notes commitments that relate to dividend restrictions, purchase agreements (through-put and take-or-pay), hedge contracts, and employment contracts.

Fair Values

Companies that have assets or liabilities measured at fair value must disclose both the cost and the fair value of all financial instruments in the notes to the financial statements. Fair value measurements may be used for many financial assets and liabilities, investments, impairments of long-lived assets, and some contingencies. Companies also provide disclosure of information that enables users to determine the extent of usage of fair value and the inputs used to implement fair value measurement. This fair value hierarchy identifies three broad levels related to the measurement of fair values (Levels 1, 2, and 3). The levels indicate the reliability of the measurement of fair value information.

Deferred Taxes, Pensions, and Leases

The FASB also requires extensive disclosure in the areas of deferred taxes, pensions, and leases. Users of financial statements should carefully read notes to the financial statements for information about off-balance-sheet commitments, future financing needs, and the quality of a company's earnings.

Changes in Accounting Principles

The profession defines various types of accounting changes and establishes guides for reporting each type. Companies discuss, either in the summary of significant accounting policies or in the other notes, changes in accounting principles (as well as material changes in estimates and corrections of errors).

This course discusses the disclosures required of companies, including those related to accounting policies, segmental information, related parties, contingencies, long-term purchase contract obligations, inflation, and derivatives. The financial reporting and disclosure requirements of development stage companies are also presented. Changes bearing upon the comparability of financial statements should also be disclosed. Comparative statements aid reader comprehension of the significance of trends and their impact on the business.

According to **Accounting Standards Update (ASU)** No. 2010-04 (January 2010), *Accounting for Various Topics—Technical Corrections to SEC Paragraphs*), financial statements presented to the SEC cannot be misleading. Subsequent events must be disclosed. An earnings release does not represent financial statements being issued.

When there is a business combination accounted for as a purchase, pushdown accounting should be used.

Disclosure of Accounting Policies

ASC 235-10-05 and 50-3, *Notes to Financial Statements: Overall*, covers the disclosure of accounting policies. Accounting policies include accounting principles and their methods of application in the preparation of financial statements, including:

- Choosing between alternative generally accepted accounting principles (GAAP).
- Unusual or innovative applications of GAAP.
- Accounting methods peculiar to a particular industry.

A company's major accounting policies should be disclosed in the first footnote or in a section called “Summary of Significant Accounting Policies,” which appears before the footnotes.

This information is important to financial statement readers in determining whether accounting policies are consistently applied from year to year.

Examples of accounting policies to be disclosed in the Summary of Significant Accounting Policies include:

- method used for pricing inventory,
- long-term construction contract method,
- depreciation method,
- consolidation basis,
- amortization method and period for intangibles,
- method to account for bad debts,
- foreign currency translation process,
- recognition of franchise revenue,
- method to amortize deferred revenue,
- definition of cash equivalents in preparing the cash flow statement,
- description of how deferred taxes are calculated,
- method to account for unconsolidated investees, and
- accounting policies for pension plans.

If more than one accounting method is used (e.g., different depreciation methods), the one disclosed in the footnote should be the primary method. Accounting policy disclosures need not duplicate information presented elsewhere in the financial statements.

Disclosure of accounting policies should not repeat what is stated elsewhere in other footnotes or within the face of the financial statements. However, reference may be made to other footnotes. In most cases, accounting policies are expressed broadly, with specifics disclosed in other notes or in the body of the financial statements.

Nonprofit entities must disclose their significant accounting policies. Financial statements not requiring a description of the accounting policies followed include unaudited interim statements (unless a change in principle was adopted after the preparation of the last year-end financial statement) and financial statements issued only for internal use.

Exhibit 1 shows an example from Whirlpool Corporation.

EXHIBIT 1

Whirlpool

2007 Annual Report

(1) Summary of Principal Accounting Policies

General Information

Whirlpool Corporation, a Delaware corporation, is the world's leading manufacturer and marketer of major home appliances. We manufacture appliances in 12 countries under 13 principal brand names in 4 geographic segments and market products in nearly every country around the world. Our Consolidated Financial Statements include all majority-owned subsidiaries. All intercompany transactions have been eliminated upon consolidation.

Use of Estimates

We are required to make estimates and assumptions that affect the amounts reported in the Consolidated Financial Statements and accompanying notes. Actual results could differ materially from those estimates.

Revenue Recognition

Sales are recorded when title passes to the customer. The point at which title passes is determined by the shipping terms. For the majority of our sales, title is transferred to the customer as soon as products are shipped. For a portion of our sales, title is transferred to the customer upon receipt of products at the customer's location. Allowances for estimated returns are made on sales of certain products based on historical return rates for the products involved.

Accounts Receivable and Allowance for Doubtful Accounts

We carry accounts receivable at sales value less an allowance for doubtful accounts. On a periodic basis, we evaluate accounts receivable and establish an allowance for doubtful accounts based on a combination of specific customer circumstances, credit conditions and the history of write-offs and collections. We evaluate items on an individual basis when determining accounts receivable write-offs. Our policy is not to charge interest on trade receivables after the invoice becomes past due. A receivable is considered past due if payments have not been received within agreed upon invoice terms.

Freight and Warehousing Costs

We apply Emerging Issues Task Force (“EITF”) No. 00-10, “Accounting for Shipping and Handling Fees and Costs”. This EITF requires the classification of such costs within cost of products sold, or if classified elsewhere, to be disclosed. Effective January 1, 2006, we reclassified freight and warehousing costs from selling, general and administrative expense to the cost of products sold in the Consolidated Statements of Income. This change was adopted to better reflect these costs being directly tied to product sales. The amounts reclassified from the selling, general and administrative expense to the cost of products sold were $854 million in 2005. There was no change to net earnings as a result of this reclassification.

Cash and Equivalents

All highly liquid debt instruments purchased with an initial maturity of three months or less are considered cash equivalents.

Inventories

Inventories are stated at first-in, first-out (“FIFO”) cost, except U.S. production inventories, which are stated at last-in, first-out (“LIFO”) cost, and Brazilian inventories, which are stated at average cost. Costs do not exceed realizable values. See Note 6 for additional information about inventories.

Goodwill and Other Intangibles

Goodwill and other intangible assets are accounted for in accordance with Statement of Financial Accounting Standards (“SFAS”) No. 142, “Goodwill and Other Intangible Assets” which requires that we evaluate goodwill and other indefinite lived intangible assets for impairment on an annual basis (or whenever events occur which may indicate possible impairment). Goodwill impairment is determined by comparing the fair value of a reporting unit to its carrying amount. If the fair value of the reporting unit exceeds its carrying amount, goodwill of the reporting unit is not considered impaired.

Definite lived intangible assets are amortized over the estimated useful life ranging from 1 to 18 years. See Note 4 for additional information about goodwill and intangible assets.

Property, Plant and Equipment

Property, plant and equipment are stated at cost. Depreciation of property, plant and equipment is computed using the straight-line method based on the estimated useful lives of the assets. Useful lives for buildings range from 25 to 50 years, machinery and equipment range from 3 to 10 years, and computer/software range from 1 to 8 years. Depreciation expense for property, plant and equipment was $562 million, $520 million and $440 million in 2007, 2006 and 2005, respectively.

Accounts Payable Outsourcing

We offer our suppliers access to a payables presentment and settlement service (PPS) provided by a third party processor. This service allows our suppliers to view scheduled Whirlpool payments online, enabling them to better manage their cash flow and reduce payment processing costs. Independent of Whirlpool, the PPS provider also allows suppliers to sell their receivables to financial institutions at the sole discretion of both the supplier and the financial institution. We have no economic interest in the sale of these receivables and no direct relationship with financial institutions concerning this service. All of our obligations, including amounts due, remain to our suppliers as stated in our supplier agreements. As of December 31, 2007 approximately $13 million of our total accounts payable is available for this purpose and approximately $6 million has been sold by suppliers to participating financial institutions.

Research and Development Costs

Research and development costs are charged to expense as incurred. Such costs were $421 million, $375 million and $339 million in 2007, 2006 and 2005, respectively.

Advertising Costs

Advertising costs are charged to expense when the advertisement is first communicated. Such costs were $321 million, $316 million and $239 million in 2007, 2006 and 2005, respectively.

Discontinued Operations

We present the results of operations, financial position and cash flows of operations that have either been sold or that meet the "held for sale accounting" and certain other criteria as discontinued operations. See Note 3 for additional information about discontinued operations.

Foreign Currency Translation

The functional currency for our international subsidiaries and affiliates is typically the local currency. Certain international subsidiaries primarily utilize the U.S. dollar and Euro as the functional currency.

Derivative Financial Instruments

We use derivative instruments designated as cash flow and fair value hedges to manage our exposure to the volatility in material costs, foreign currency and interest rates on certain debt instruments. Derivative instruments are accounted for in accordance with SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended, which requires us to fair value our derivative instruments periodically. Changes in the fair value of derivative assets or liabilities (i.e., gains or losses) are recognized depending upon the type of hedging relationship and whether a hedge has been designated. For those derivative instruments that qualify for hedge accounting, we designate the hedging instrument, based upon the exposure being hedged, as a cash flow hedge, fair value hedge, or a hedge of a net investment in a foreign operation. Changes in fair value of derivative instruments that do not qualify for hedge accounting are recognized immediately in current earnings. See Note 9 for additional information about hedges and derivative financial instruments.

Income Taxes

We account for income taxes in accordance with SFAS No. 109, "Accounting for Income Taxes." Under SFAS No. 109, deferred tax assets and liabilities are determined based on the difference between the financial statement and tax basis of the respective assets and liabilities, using enacted tax rates in effect for the year in which the differences are expected to reverse. Judgment is required in determining and evaluating our income tax provisions. We establish provisions for income taxes when, based on the technical merits of the uncertain tax position, it is not more likely than not to be substantiated on a review by tax authorities. We evaluate and adjust these accruals in light of changing facts and circumstances. For additional information about income taxes, see Note 13.

Stock Based Compensation

Effective January 1, 2006, we adopted the fair value recognition provisions of SFAS No. 123(R), "Share-Based Payments", using the modified-prospective-transition method. Under that transition method, compensation cost includes: (1) compensation cost for all share-based payments granted prior to, but not yet vested as of, January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS No. 123, and (2) compensation cost for all share-based payments granted subsequent to January 1, 2006, based on the grant date fair value estimated in accordance with the provisions of SFAS No. 123(R). Prior to the adoption of SFAS No. 123(R), we accounted for share based compensation in accordance with Accounting Principles Board No. 25 Accounting for Stock Issued to Employees. Accordingly, we recognized no compensation expense for share based compensation if the exercise price was equal to or more than the fair value of the shares at the date of the grant.

The following table illustrates the effect on net earnings and earnings per share for the year ended December 31, 2005 if we had applied the fair value recognition provisions of SFAS No. 123 to options granted under our stock option plans. For purposes of this pro forma disclosure, the value of the options is estimated using a Black-Scholes option-pricing model with share-based awards amortized over the vesting periods.

millions of dollars, except per share data	*Year Ended December 31, 2005*
Net earnings as reported	$422
Add: Share-based employee compensation expense included in reported net earnings, net of related tax effects	15
Deduct: Total share-based employee compensation expense determined under the fair value based method for all awards, net of related tax effects	(19)
Pro forma net earnings	$418
Earnings per share:	
Basic—as reported	$6.30
Basic—pro forma	$6.23
Diluted—as reported	$6.19
Diluted—pro forma	$6.13

Reclassifications

We adopted SFAS No. 158, “Employers Accounting for Defined Benefit Pensions and Other Postretirement Plans, an amendment of SFAS No. 87, 88, 106 and 132(R)” and reflected the under-funded liability with a corresponding offset in accumulated other comprehensive income on our Consolidated Balance Sheet at December 31, 2006. During adoption, we recorded a long-term deferred tax asset in other long term assets in the amount of $160 million which has been reclassified in the prior year to net with other long term liabilities to conform to current year presentation.

During the first quarter of 2007, we adopted changes to our segment reporting consistent with the methodology the chief operating decision maker now uses to evaluate each segment's operating and financial results. We previously included the financial results for our Caribbean operations and exports of certain portable appliances to Europe within our North America business segment. The results for these businesses are now being reported within the Latin America and Europe segments, respectively. In addition, we have reallocated certain costs previously included within corporate administrative expense to each of the respective regions. Regional results for 2006 and 2005 have been reclassified to reflect these changes to conform to the 2007 presentation.

We reclassified certain other prior period amounts in our Consolidated Financial Statements to be consistent with current period presentation. The effect of these reclassifications is not material.

New Accounting Standards

In December 2007, the FASB issued SFAS No. 141(R), “Business Combinations.” SFAS No. 141(R) requires us to continue to follow the guidance in SFAS No. 141 for certain aspects of business combinations, with additional guidance provided defining the acquirer, recognizing and measuring the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree, assets and liabilities arising from contingencies, defining a bargain purchase and recognizing and measuring goodwill or a gain from a bargain purchase. This statement is effective for all business combinations for which the acquisition date is on or after the beginning of an entity's first fiscal year that begins after December 15, 2008. We will implement SFAS No. 141(R) for any business combinations occurring at or subsequent to January 1, 2009.

In December 2007, the FASB issued SFAS No. 160, “Noncontrolling Interests in Consolidated Financial Statements,” an Amendment of ARB No. 51, “Consolidated Financial Statements.” SFAS No. 160 establishes accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. It clarifies that a noncontrolling interest in a subsidiary is an ownership interest in the consolidated entity that should be reported as equity in the consolidated financial statements. This statement is effective as of the beginning of an entity's first fiscal year that begins after December 15, 2008 with retrospective application. We will implement SFAS No. 160 beginning January 1, 2009 and are currently evaluating the potential impact on our financial statements when implemented.

In September 2006, the FASB issued SFAS No. 157, “Fair Value Measurements”, which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles (GAAP) and expands disclosures about fair value measurements. The expanded disclosures in this statement about the use of fair value to measure assets and liabilities should provide users of financial statements with better information about the extent to which fair value is used to measure recognized assets and liabilities, the inputs used to develop the measurements, and the effect of certain of the measurements on earnings (or changes in net assets) for the period. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. We implemented SFAS No. 157 beginning January 1, 2008. SFAS No. 157 will not impact our financial statements, but will provide expanded disclosure on our fair value measurements.

(2) Maytag Acquisition

On March 31, 2006, we completed the acquisition of Maytag. The results of Maytag's operations have been included in our Consolidated Financial Statements beginning April 1, 2006.

The purchase price for Maytag was approximately $1.9 billion, including approximately $848 million of cash and approximately 9.7 million shares of Whirlpool common stock. The purchase price also included the exchange of fully-vested Whirlpool options for fully-vested Maytag options to become exercisable, in aggregate, for an additional 1.8 million shares of Whirlpool common stock and the settlement of Maytag restricted stock and performance units for cash. The combined value of the above share-based consideration was approximately $920 million. The value of the approximately 9.7 million shares of Whirlpool common stock was determined using the average market price of the common shares for the two days prior to, through the two days after, March 29, 2006.

We assumed Maytag's existing debt of approximately $966 million and incurred approximately $102 million in acquisition-related expenses, which are included in the purchase price. Initially, we borrowed amounts required to fund the cash portion of the purchase price through issuances in the U.S. commercial paper market and in June 2006 refinanced a portion of this commercial paper through the issuance of long-term bonds.

We finalized the purchase price allocation to individual assets acquired and liabilities assumed on March 31, 2007. The final purchase price allocation is based on management and independent appraisers' best estimates.

The following table presents the final purchase price allocation as of March 31, 2006:

millions of dollars	
Current assets	$1,352
Assets of discontinued operations	442
Property, plant and equipment	487
Goodwill	1,585
Intangible assets	1,845
Other non-current assets	19
Total assets acquired	5,730

Current liabilities	1,657
Liabilities of discontinued operations	168
Non-current liabilities	2,035
Total liabilities assumed	3,860
Net assets acquired	$1,870

Goodwill, which is not deductible for tax purposes, has been allocated to the North America operating segment on the basis that the cost efficiencies identified will primarily benefit this segment of the business.

We estimate the fair value of Maytag's identifiable intangible assets is $1,845 million. The allocation of identifiable intangible assets is as follows:

millions of dollars	*Estimated Fair Value*	*Estimated Useful Life*
Trademarks	$1,463	Indefinite life
Customer relationships	288	18 years
Patents and non-compete agreements	94	1 to 7 years
Total intangible assets acquired	$1,845	

Identifiable intangible assets consist of trademarks, customer relationships, patents and noncompete agreements. These intangible assets, excluding trademarks, are definite lived intangible assets and are amortized over their estimated economic lives based on a number of assumptions including customer attrition rates and the life of technology and associated products.

We have also completed the analysis of integration plans, pursuant to incurred costs associated with the elimination of duplicative manufacturing facilities and selling, general and administrative overlap. Certain reserves in the amount of $239 million were established for severance and exit costs relating to the closure of Maytag facilities including manufacturing plants, the former headquarters location and other administrative offices. Costs associated with these actions have not impacted earnings and have been recognized as a component of purchase accounting, resulting in a corresponding increase to recorded goodwill. These reserves are related to closed Maytag facilities in Galesburg, Illinois and Florence, South Carolina, along with the closure of the Maytag facilities mentioned above.

The following table provides pro forma results of operations for the years ended December 31, 2006 and 2005 as if Maytag had been acquired as of the beginning of each period presented. The pro forma results include certain purchase accounting adjustments such as the estimated changes in depreciation and amortization expense on acquired tangible and intangible assets as well as interest expense on borrowings used to finance the integration. However, pro forma results do not include any anticipated cost savings or other effects of the planned integration of Maytag. Accordingly, such amounts are not necessarily indicative of the results that would have occurred if the acquisition had occurred on the dates indicated or that may result in the future.

	Year Ended December 31,	
	2006	2005
Net sales	$19,097	$18,430
Earnings from continuing operations	474	307
Net earnings	421	267
Diluted net earnings per share:		
Earnings from continuing operations	$5.96	$3.93
Loss from discontinued operations	(0.67)	(0.51)
Net earnings	$5.29	$3.42

Certain non-recurring acquisition charges of $52 million recorded by Maytag prior to March 31, 2006, directly related to the acquisition, including $27 million of accelerated stock compensation expense triggered by certain change in control provisions and approximately $25 million of direct transaction costs are not included in the pro forma information presented above.

Review Questions – Section 1

1. The summary of significant accounting policies should disclose the

   A. Pro forma effect of retroactive application of an accounting change.
   B. Basis of profit recognition on long-term construction contracts.
   C. Adequacy of pension plan assets in relation to vested benefits.
   D. Future minimum lease payments in the aggregate and for each of the five succeeding fiscal years.

2. Which of the following information should be disclosed in the summary of significant accounting policies?

   A. Refinancing of debt subsequent to the balance sheet date.
   B. Guarantees of indebtedness of others.
   C. Recognition of revenue from franchising and leasing operations.
   D. Adequacy of pension plan assets relative to vested benefits.

3. The summary of significant accounting policies should disclose the

   A. Maturity dates of noncurrent debts.
   B. Terms for convertible debt to be exchanged for common stock.
   C. Concentration of credit risk of all financial instruments by geographical region.
   D. Depreciation methods, amortization method of intangibles, and inventory pricing method.

4. Which of the following items should be included in Melay, Inc.'s summary of significant accounting policies for the current year?

   A. Property, plant, and equipment is recorded at cost with depreciation computed principally by the straight-line method.
   B. During the current year, the Delay Segment was sold.
   C. Business segment sales for the current year are Alay $1 M, Belay $2M, and Celay $3M.
   D. Future common share dividends are expected to approximate 60% of earnings.

Segmental Reporting

Segmental reporting aids in evaluating a company's financial statements by revealing growth prospects, including earning potential, areas of risk, and financial problems. It facilitates the appraisal of both historical performance and expected future performance. ASC 280-10-05-2, *Segment Reporting: Overall*, requires that the amount reported for each segment item be based on what is used by the *chief operating decision maker* in formulating a determination as to how many resources to assign to a segment and how to appraise the performance of that segment. The term *chief operating decision maker* may apply to the chief executive officer or chief operating officer or to a group of executives. **Note:** The term of *chief operating decision maker* may apply to a function and not necessarily to a specific person. This is a management approach rather than an industry approach in identifying segments. The segments are based on the company's organizational structure, revenue sources, nature of activities, existence of responsible managers, and information presented to the Board of Directors.

Revenues, gains, expenses, losses, and assets should be allocated to a segment only if the chief operating decision maker considers doing so in measuring a segment's earnings for purposes of making a financial or operating decision. The same is true with regard to allocating to segments eliminations and adjustments applying to the company's general-purpose financial statements. Any allocation of financial items to a segment should be rationally based.

In measuring a segment's earnings or assets, the following should be disclosed for explanatory purposes:

- Measurement or valuation basis used.
- Differences in measurements used for the general-purpose financial statements relative to the financial information of the segment.
- A change in measurement method relative to prior years.
- A symmetrical allocation, meaning an allocation of depreciation or amortization to a segment without a related allocation to the associated assets.

Segmental information is required in annual financial statements. Some segmental disclosures are required in interim financial statements. Segmental information is not required for unconsolidated subsidiaries or investees accounted for under the equity method.

An operating segment is a distinct revenue-producing component of the business for which internal financial data are produced. Expenses are recognized as incurred in that segment. **Note:** A start-up operation would qualify as an operating segment even though revenue is not being earned. An operating segment is periodically reviewed by the chief operating decision maker to evaluate performance and to determine what and how many resources to allocate to the segment.

A reportable segment requiring disclosure is one that is an operating segment and meets certain percentage tests, discussed later in this section. If a segment does not generate revenue or insignificant revenue, it is *not* an operating segment to be reported. An example is corporate headquarters.

An aggregation may be made of operating segments if they are similar in terms of products or services, customer class, manufacturing processes, distribution channels, legal entity, regulatory control, geographical area, and government contract.

The accounting principles used in preparing segmental information should be the same as those used in preparing the financial statements. However, intercompany transactions (which are eliminated in consolidation) are included for segmental reporting purposes, and for applying the 10% and 75% rules discussed later. Segmental information may be provided in the body of the financial statements, in separate schedules, or in footnotes. Most companies report segmental data in separate schedules.

Disclosures should be made of how reporting segments were determined (e.g., customer class, products, services, geographical areas). Disclosure should be given identifying those operating segments that have been aggregated. The following should be disclosed for each reportable segment:

- Nature and identification of products or services.
- Sales to unaffiliated customers.
- Method used to allocate costs.
- Tax effects.
- Geographic areas of operations.
- Interest revenue and interest expense.
- Extraordinary and unusual items included in segmental earnings.
- Book values of identifiable assets.
- Capital expenditures.
- Aggregate depreciation, depletion, and amortization expense.
- Effect of a change in method on a segment's operating earnings.
- Other profitability measures, such as contribution margin.
- Transfer pricing method. (Sales or transfers to other industry segments should be noted, including the accounting basis.)
- Equity in unconsolidated subsidiaries or investees.

Disclosures should be in both dollars and percentages.

A reportable segment is determined by:

- Grouping by industry line.
- Identifiable products or services.
- Significant segments to the company in the entirety.

Tests for significance. After the company decides on the possible segments for disclosure, it makes a quantitative materiality test. This test determines whether the segment is significant enough to warrant actual disclosure. An operating segment is deemed significant, and therefore a reportable segment, if it satisfies one or more of the following quantitative thresholds.

- Revenue, including unaffiliated and intersegment sales or transfers, is 10% or more of total revenue of all operating segments.
- Operating profit or loss is 10% or more of the greater, in absolute amount, of the combined operating profit (or loss) of all industry segments with operating profits (or losses).
- Identifiable assets are 10% or more of total assets of all operating segments.

Test Amount	***% of Relevant Amount***
Revenue	≥ 10% of all operating segments
Operating Profit or Loss	≥10% of greater of absolute sum of (1)all profitable operating segments or (2)all loss-reporting operating segments
Identifiable assets	≥ 10% of all operating segments

Operating segments that are not reportable should be combined and disclosed in the "all other" category. Disclosure should be made of the sources of revenue for these segments.

EXAMPLE

A company reports the following information for its reportable segments:

Segment	*Total Revenue*	*Operating Profit*	*Identifiable Assets*
1	$500	$50	$200
2	250	10	150
3	3,500	200	1,950
4	1,500	100	900
	$5,750	$360	$3,200

The revenue test is 10% × $5,750 = $575. Segments 3 and 4 satisfy this test. The operating profit (loss) test is 10% × $360 = $36. Segments 1, 3, and 4 satisfy this test. The identifiable assets test is 10% × $3,200 = $320. Segments 3 and 4 satisfy this test. Therefore, the reportable segments are 1, 3, and 4.

EXAMPLE

A company has six industry segments with operating profits and losses as follows:

Industry Segment		*Operating Profit (Loss)*
1	$400,000	
2	100,000	
3	800,000	Total $1,300,000
4	(200,000)	
5	(80,000)	
6	(1,000,000)	Total ($1,280,000)

The absolute amount of the combined operating profits of all profitable industry segments is $1,300,000, and the absolute amount of the combined operating losses of all industry segments with losses is $1,280,000. The greater of these two absolute amounts is $1,300,000. Thus, all industry segments with operating profits or losses having an absolute amount equal to or greater than $130,000 (10% × $1,300,000) satisfy the operating profit or loss test. Therefore, industry segments 1, 3, 4, and 6 are reportable.

If a segment failed the 10% test this year but was significant in previous years and is expected to be significant in the future, it should still be reported on in the current year. On the other hand, a segment may not be reported this year even though it satisfies the 10% test because of abnormal profits, if it was not reportable in previous years and is not expected to be reportable in the future. In other words, if a segment passes the 10% test in the current year because of some unusual or rare occurrence, it should be excluded from reporting in the current year.

In applying the 10% rule, the following should be noted:

- **Revenue:** Revenue to unaffiliated customers and revenue to other businesses should be separated. Transfer prices are set for intersegment transfers. However, intersegment sales should not include the cost of joint facilities or other joint costs. Interest income on intersegment receivables is includable in intersegment sales, as long as the receivables are part of identifiable assets. However, interest earned on advances or loans to industry segments is excluded from intersegment revenues. Disclosure should be made of the accounting bases used.
- **Operating Profit or Loss:** Operating earnings excludes general (nonallocable) corporate income and expenses, interest expense (unless it is a financial segment), income taxes, extraordinary gain or loss, cumulative effect of a change in accounting principle, minority interest, and income from unconsolidated subsidiaries or investees. Directly traceable and allocable costs should be

charged to segments. Examples of allocation bases for common costs are sales, operating income before common costs, or total assets.

- **Identifiable Assets:** Segmental assets include those directly in the segment and reasonably allocable general corporate assets. Allocation methods should be used consistently. Excluded from identifiable assets are advances or loans to other segments, except for income derived therefrom that is used to compute operating results.

Segments shall represent a significant portion (75% or more) of the entity's total revenue of all operating segments. The 75% test is applied separately each year.

In deriving 75%, no more than 10 segments should be presented because to do otherwise would result in too cumbersome and detailed reporting. If more than 10 are identified, similar segments may be combined. If, on the other hand, the reportable segments identified by the materiality tests account for only 75% of all industry segment revenue from unaffiliated customers, one or more additional industry segments must be included among reportable segments so that at least 75% of all industry segment revenue is accounted for by the reported segments.

Disclosures are not mandated for 90% enterprises (a company obtaining 90% or more of its revenues, operating earnings, and total assets from one segment). In essence, the segment is the business. Dominant industry segments should be identified.

The source of segmental revenue should be disclosed with the percent so derived when:

- 10% or more of revenue is generated from either a foreign government contract or domestic contract.
- 10% or more of sales is made to one customer. A group of customers under common control (e.g., subsidiaries of a parent, federal or local government) is deemed as one customer. Note: Departments or agencies within governments are not considered a single customer. The identity of the customer need not be disclosed.
- 10% or more of revenue or assets are in a particular foreign country or similar group of countries. Similarity might be indicated by proximity, business environment, interrelationships, and economic or political ties. If foreign activities are in more than one geographic area, required disclosures should be made for both—each significant individual foreign area and in total for other insignificant areas. For revenues from foreign operations, the amount of sales to unaffiliated customers and the amount of intracompany sales between geographic areas should be disclosed. The geographic areas that have been disaggregated should be identified along with the percentages derived.

Information about foreign geographic areas and customers is required even if this information is not used by the business in formulating operating decisions.

Under ASC 280-10-50-13, *Segment Reporting: Overall*, operating segments not satisfying the quantitative thresholds can be aggregated into a reportable segment if aggregation is consistent with the objective and basic principles of ASC 280-10, *Segment Reporting: Overall*; the segments have similar economic characteristics; and the segments share a majority of the other aggregation criteria.

In some cases, prior-period segmental financial information, such as for industry segments, foreign operations, and major customers, needs to be restated for comparative purposes when:

- There has been a change in the grouping of products, services, or geographic areas for segment determination and presentation.
- There has been a change in the grouping of foreign activities.
- There has been a change in accounting principle or reporting entity.
- Financial statements of the entire company have been restated.

There should be disclosure of the nature and effect of restatement.

A company does not have to use the same accounting principles for segmental purposes as that used to prepare the consolidated financial statements. There must be a reconciliation between segmental financial data and general-purpose financial statements. The reconciliation is for revenue, operating profit or loss, and assets. Any differences in measurement approaches between the company as a whole and its segments should be explained. If measurement practices have changed over the years regarding the operating segments, that fact should be disclosed and explained. The business must describe its reasoning and methods in deriving the composition of its operating segments.

Exhibit 2 shows the segment disclosure for Johnson & Johnson

EXHIBIT 2

Johnson & Johnson

2008 Annual Report

11. Segments of Business[1] and Geographic Areas

	Sales to Customers[2]		
(Dollars in millions)	*2008*	*2007*	*2006*
Consumer—			
United States	$ 6,937	6,408	4,573
International	9,117	8,085	5,201
Total	16,054	14,493	9,774
Pharmaceutical—			
United States	14,831	15,603	15,092
International	9,736	9,263	8,175
Total	24,567	24,866	23,267
Medical Devices and Diagnostics—			

United States	10,541	10,433	10,110
International	12,585	11,303	10,173
Total	23,126	21,736	20,283
Worldwide total	$63,747	61,095	53,324

(1) See Note 1 for a description of the segments in which the Company operates.

(2) Export sales are not significant. In 2008, 2007 and 2006, the Company did not have a customer that represented 10% of total revenues.

	Operating Profit			Identifiable Assets		
(Dollars in millions)	*2008*(5)	*2007*(6)	*2006*(7)	*2008*	*2007*	*2006*
Consumer	$2,674	2,277	1,374	$23,765	26,550	25,380
Pharmaceutical	7,605	6,540	6,894	19,544	19,780	18,799
Medical Devices and Diagnostics	7,223	4,846	6,126	20,779	19,978	18,601
Total	17,502	13,663	14,394	64,088	66,308	62,780
Less: (Income) Expense not allocated to segments(3)	573	380	(193)			
General Corporate(4)				20,824	14,646	7,776
Worldwide total	$16,929	13,283	14,587	$84,912	80,954	70,556

(3) Amounts not allocated to segments include interest (income) expense, minority interest and general corporate (income) expense.

(4) General corporate includes cash and marketable securities.

(5) Includes $7 million and $174 million of In-Process Research and Development (IPR&D) for the Consumer and Medical Devices and Diagnostics segments, respectively. Includes $379 million of fourth quarter net litigation gain, comprised of a $50 million expense in the Consumer segment and a gain of $429 million in the Medical Devices and Diagnostics segment. The Medical Devices and Diagnostics segment also includes $536 million gain on the divestiture of the Professional Wound Care business of Ethicon, Inc.

(6) Includes $745 million of restructuring expense, comprised of $15 million, $429 million, and $301 million for the Consumer, Pharmaceutical, and Medical Devices and Diagnostics segments, respectively. The Medical Devices and Diagnostics segment includes $807 million of IPR&D. The Pharmaceutical segment also includes $678 million for the write-down of the NATRECOR® intangible asset.

(7) Includes $320 million and $239 million of IPR&D for the Consumer and Medical Devices and Diagnostics segments, respectively. The Medical Devices and Diagnostics segment also includes the Guidant acquisition agreement termination fee, less associated expenses, of $622 million.

	Additions to Property, Plant & Equipment	Depreciation and Amortization

(Dollars in millions)	2008	2007	2006	2008	2007	2006
Consumer	$499	504	344	$489	472	255
Pharmaceutical	920	1,137	1,246	986	1,033	929
Medical Devices and Diagnostics	1,251	919	823	1,146	1,080	861
Segments total	2,670	2,560	2,413	2,621	2,585	2,045
General corporate	396	382	253	211	192	132
Worldwide total	$3,066	2,942	2,666	$2,832	2,777	2,177

	Sales to Customers[2]			Long-Lived Assets[8]		
(Dollars in millions)	*2008*	*2007*	*2006*	*2008*	*2007*	*2006*
United States	$32,309	32,444	29,775	$21,674	21,685	22,432
Europe	16,782	15,644	12,786	14,375	15,578	14,443
Western Hemisphere excluding U.S.	5,173	4,681	3,542	3,328	3,722	3,108
Asia-Pacific, Africa	9,483	8,326	7,221	1,898	1,261	1,206
Segments total	63,747	61,095	53,324	41,275	42,246	41,189
General corporate				785	702	543
Other non longlived assets				42,852	38,006	28,824
Worldwide total	$63,747	61,095	53,324	$84,912	80,954	70,556

[2] Export sales are not significant. In 2008, 2007 and 2006, the Company did not have a customer that represented 10% of total revenues.

[8] Long-lived assets include property, plant and equipment, net for 2008, 2007 and 2006 of $14,365, $14,185 and $13,044, respectively, and intangible assets and goodwill, net for 2008, 2007 and 2006 of $27,695, $28,763 and $28,688, respectively.

Review Questions – Section 2

5. Which of the following qualifies as a reportable operating segment?

   A. Corporate headquarters, which oversees $1 billion in sales for the entire company.
   B. North American segment, whose assets are 12% of the company's assets of all segments, and management reports to the chief operating officer.
   C. South American segment, whose results of operations are reported directly to the chief operating officer, and has 5% of the company's assets, 9% of revenues, and 8% of the profits.
   D. Eastern Europe segment, which reports its results directly to the manager of the European division, and has 20% of the company's assets, 12% of revenues, and 11% of profits.

6. Hyde Corp. has three manufacturing divisions, each of which has been determined to be a reportable operating segment. In Year 4, Clay division had sales of $3 million, which was 25% of Hyde's total sales, and had traceable operating costs of $1.9 million. In Year 4, Hyde incurred operating costs of $500,000 that were not directly traceable to any of the divisions. In addition, Hyde incurred interest expense of $300,000 in Year 4. The calculation of the measure of segment profit or loss reviewed by Hyde's chief operating decision maker does not include an allocation of interest expense incurred by Hyde. However, it does include traceable costs. It also includes nontraceable operating costs allocated based on the ratio of divisional sales to aggregate sales. In reporting segment information, what amount should be shown as Clay's operating profit for Year 4?

   A. $875,000
   B. $900,000
   C. $975,000
   D. $1,100,000

7. Bean Co. included interest expense and transactions classified as extraordinary items in its determination of segment profit, which Bean's chief financial officer considered in determining the segment's operating budget. Bean is required to report the segment's financial data in accordance with GAAP. Which of the following items should Bean disclose in reporting segment data?

   A. Neither interest expense nor extraordinary items
   B. Extraordinary items, but no interest expense
   C. Interest expense, but not extraordinary items
   D. Both interest expense and ordinary items

8. Opto Co. is a publicly traded, consolidated entity reporting segment information. Which of the following items is a required entity-wide disclosure regarding external customers?

   A. The fact that transactions with a particular external customer constitute more than 10% of the total entity revenues.
   B. The identity of any external customer providing 10% or more of a particular operating segment's revenue.
   C. The identity of any external customer considered to be "major" by management.
   D. Information on major customers is not required in segment reporting.

Related Parties

Financial statements should disclose material related party transactions. A related party is essentially any party that controls or can significantly influence the management or operating policies of the reporting entity. Moreover, two or more entities may be under common ownership or management control such that the results of the reporting entity might vary significantly from those obtained if the entities were autonomous. *In these circumstances, the relationship should be disclosed even though no transactions occurred between the parties.*

ASC 850-10-05-3, *Related Party Disclosures: Overall*, covers the accounting for and disclosing of related-party transactions. Related-party transactions take place when a transacting party has the ability to influence significantly or exercise control of another transacting party due to a financial, common ownership, or familial relationship with that party. Related-party transactions may also occur when a nontransacting party can substantially affect the policies of two other transacting parties. Related-party transactions include those involving:

- Activities between a parent and its subsidiaries.
- Activities between affiliates of the same parent company.
- Joint ventures.
- Relationships between the company and its major owners, management, or their immediate families.
- Company and employee trusts established and managed by the company, such as a profit sharing or pension plan.

GAAP require disclosure of

1. The nature of the relationship involved;
2. A description of the transactions for each period an income statement is presented and such other information as is deemed necessary to an understanding of the effects of the transactions;
3. The dollar amounts of transactions for each period an income statement is presented and the effects of any change in the method of establishing their terms;
4. Amounts due from or to related parties as of the date of each balance sheet, including the terms of settlement; and
5. Certain tax information required by GAAP if the entity is part of a group that files a consolidated tax return.

ASC 850-10-05-4 notes that related-party transactions often take place in the ordinary course of business and may include such activities as sales, purchases, services performed or received, property transfers, rentals, filing consolidated tax returns, guarantees, granting loans or incurring debt, compensating balance requirements, and allocating common costs as the basis for billings.

The pronouncement also indicates that related-party transactions are assumed not to be at arm's length. That is, they are not derived under conditions of competitive, free-market dealings. Because of this, GAAP requires that material related-party transactions be disclosed in the financial statements. Exceptions include compensation arrangements (officer’s salaries), expense allowances, and similar items in the normal course of business. *However*, royalties paid to a major shareholder must be disclosed because the shareholder may have considerable influence over the corporation, and the transaction may not be made at arm's length.

ASC 275-10-50-18, *Risks and Uncertainties: Overall*, requires disclosure of concentrations in the volume of transactions with a particular customer if loss of that customer could result in a significant negative impact on the business. The current vulnerability due to concentrations must be disclosed if certain conditions are met. Disclosure is necessary if management knows prior to issuance of the statements that the concentration exists at the balance sheet date, it makes the entity vulnerable to a near-term severe impact, and such impact is at least reasonably possible in the near term. A severe impact may result from loss of all or a part of a business relationship, price or demand changes, loss of a patent, changes in the availability of a resource or right, or the disruption of operations in a market or geographic area.

A transaction between related parties may not have occurred or may have been on different terms if the entities were autonomous and conducted their own best interests, as when:

- A lease of property from the parent to a subsidiary occurs at a significantly different price than if a related-party relationship existed.
- A loan is made at an unusually low interest rate because a bank is associated with the borrower.
- A shell corporation (with no economic substance) buys goods at inflated prices.
- A company pays consulting fees for the year ending December 31, 2002 in the amount of $400,000 to an individual who is a director and stockholder of the company.

Examples of events that suggest that undisclosed related-party transactions may be occurring include:

- Unusual guarantees or pledging of personal assets.
- Low-cost leases.
- Sales with a commitment to repurchase that, if known, would preclude recognition of all or part of revenue.
- Sales at below market rates.
- Interest revenue at above market rates on loans.
- Borrowing at below market rates of interest.
- Loans to parties that do not possess the ability to repay.
- Purchases of assets at prices in excess of fair market value.
- Payments for services at inflated prices.
- Sales without substance, such as funding the other party to the transaction so that the sales price is fully remitted.

Related-party disclosures usually include the following:

- Terms and settlements.
- Nature and substance of relationship.
- Description of the transactions, whether or not dollar amounts are involved.
- Dollar figures for the applicable transactions.
- Balances due from or owed to the related parties at year-end, including payment terms.
- Nature of the control relationship between entities under common ownership or management control.
- Significant customers or leases.

Although related-party transactions are not inherently bad, they have proven to be an easy and effective means to perpetrate a misstatement of economic substance and reality of financial transactions. There are inherent measuring problems with related-party dealings that, by their nature, may not be comparable to what would have occurred had the transactions taken place between unrelated third parties.

Note: The Sarbanes-Oxley Act of 2002 generally prohibits an issuer, as defined by federal securities law, from extending credit to its directors and officers.

Exhibit 3 shows, from the annual report of Tyco International, disclosure of related-party transactions.

Exhibit 3

Tyco International

2010 Annual Report

10. Related Party Transactions

The Company has amounts due related to loans and advances issued to employees in prior years under the Company's Key Employee Loan Program, relocation programs and other advances made to executives. Loans were provided to employees under the Company's Key Employee Loan Program, which is now discontinued, except for outstanding loans for the payment of taxes upon the vesting of shares granted under our Restricted Share Ownership Plans. During the fourth quarter of 2002, the Board of Directors and new senior management adopted a policy under which no new loans are allowed to be granted to any officers of the Company and existing loans are not allowed to be extended or modified. There have been no loans made to any of the Company's current executives. The outstanding loans are not collateralized and bear interest, payable annually, at a rate based on the six-month LIBOR, calculated annually as the average of the rates in effect on the first day of each of the preceding 12 months. Loans are generally repayable in ten years; however, earlier payments are required under certain circumstances, such as when an employee is terminated. In addition, the Company made mortgage loans to certain employees under employee relocation programs. These loans are generally payable in 15 years and are collateralized by the underlying property. During 2010 and 2009, the maximum amount outstanding under these programs was $21 million and $22 million, respectively. Loans receivable under these programs, as well as other unsecured advances outstanding, were $21 million and $22 million as of September 24, 2010 and September 25, 2009, respectively. The total outstanding loans receivable includes loans to L. Dennis Kozlowski, the Company's former chairman and chief executive officer (until June 2002). The amount outstanding under these loans, plus accrued interest, was $28 million and $27 million as of September 24, 2010 and September 25, 2009, respectively, and the rate of interest charged on such loans was 0.5% and 1.9% for 2010 and 2009, respectively. Interest income on these interest bearing loans totaled nil in both 2010 and 2009 and $1 million in 2008. Certain of the above loans totaling $1 million as of both September 24, 2010 and September 25, 2009 are non-interest bearing.

The Company filed civil complaints against Messrs. Kozlowski and its former chief financial officer, Mark Swartz, for breach of fiduciary duty and other wrongful conduct relating to alleged abuses of our Key Employee Loan Program and relocation program, unauthorized bonuses, unauthorized payments, selfdealing transactions and other improper conduct.

In June 2002, the Company filed a civil complaint against Frank E. Walsh, Jr., a former director, for breach of fiduciary duty, inducing breaches of fiduciary duty and related wrongful conduct involving a $20 million payment by Tyco, $10 million of which was paid to Mr. Walsh with the balance paid to a charity of which Mr. Walsh is trustee. The payment was purportedly made for Mr. Walsh's assistance in arranging our acquisition of The CIT Group, Inc. On December 17, 2002, Mr. Walsh pleaded guilty to a felony violation of New York law in the Supreme Court of the State of New York, (New York County) and settled a civil action for violation of federal securities laws brought by the SEC in United States District Court for the Southern District of New York. Both the felony charge and the civil action were brought against Mr. Walsh based on such payment. The felony charge accused Mr. Walsh of intentionally concealing information concerning the payment from Tyco's directors and shareholders while engaged in the sale of Tyco securities in the State of New York. The SEC action alleged that Mr. Walsh knew that the registration statement covering the sale of Tyco securities as part of the CIT Group acquisition contained a material misrepresentation concerning fees payable in connection with the acquisition. Pursuant to the plea and settlement, Mr. Walsh paid $20 million in restitution to Tyco on December 17, 2002. In connection with the Company's civil complaint against Mr. Walsh, in October 2010, the United States District Court for the Southern District of New York ruled that while Mr. Walsh breached his fiduciary duties to the Company, the Company's Board of Directors implicitly ratified the payment to Mr. Walsh in the weeks immediately following the revelation of the payment to the Board of Directors in early 2002. As a result, the Court ruled that the Company is not entitled to damages from Mr. Walsh. The Company believes, based on the facts and the law, that this determination by the Court is incorrect. The Company is in the process of appealing the Court's ruling.

During 2010, 2009 and 2008, the Company engaged in commercial transactions in the normal course of business with companies where the Company's Directors were employed and served as officers. Purchases from these companies during each year aggregated less than 1 percent of consolidated net revenue.

Disclosure of Contingencies and Commitments

Footnote disclosure is required for reasonably possible losses arising from contingencies. The disclosure includes the type of contingency and estimate of probable loss or range of loss. If the loss cannot be estimated, that fact should be stated. Examples of items to be disclosed are guarantees, renegotiation proceedings on government contracts, tax disputes, and environmental risks. Gain contingencies, such as a possible award from a lawsuit, are also disclosed.

Exhibit 4 shows, from the annual report of Texas Instruments, disclosure of contingencies and commitments.

EXHIBIT 4

Texas Instruments

2010 Annual Report

12. Commitments and contingencies

Operating leases: We conduct certain operations in leased facilities and also lease a portion of our data processing and other equipment. In addition, certain longterm supply agreements to purchase industrial gases are accounted for as operating leases. Lease agreements frequently include purchase and renewal provisions and require us to pay taxes, insurance and maintenance costs. Rental and lease expense incurred was $100 million, $114 million and $124 million in 2010, 2009 and 2008.

Capitalized software licenses: We have licenses for certain internal-use electronic design automation software that we account for as capital leases. The related liabilities are apportioned between Accounts payable and Deferred credits and other liabilities on our balance sheets, depending on the contractual timing of the payment.

Purchase commitments: Some of our purchase commitments entered in the ordinary course of business provide for minimum payments.

Summary: At December 31, 2010, we had committed to make the following minimum payments under our non-cancellable operating leases, capitalized software licenses and purchase commitments:

	Operating Leases	*Capitalized Software Licenses*	*Purchase Commitments*
2011	$80	$67	$221
2012	65	54	105

2013	50	7	38
2014	45	6	8
2015	39	-	2
Thereafter	80	-	1

Indemnification guarantees: We routinely sell products with an intellectual property indemnification included in the terms of sale. Historically, we have had only minimal, infrequent losses associated with these indemnities. Consequently, we cannot reasonably estimate or accrue for any future liabilities that may result.

Warranty costs/product liabilities: We accrue for known product-related claims if a loss is probable and can be reasonably estimated. During the periods presented, there have been no material accruals or payments regarding product warranty or product liability. Historically, we have experienced a low rate of payments on product claims. Although we cannot predict the likelihood or amount of any future claims, we do not believe they will have a material adverse effect on our financial condition, results of operations or liquidity. Consistent with general industry practice, we enter into formal contracts with certain customers that include negotiated warranty remedies. Typically, under these agreements our warranty for semiconductor products includes: three years coverage; an obligation to repair, replace or refund; and a maximum payment obligation tied to the price paid for our products. In some cases, product claims may exceed the price of our products.

General: We are subject to various legal and administrative proceedings. Although it is not possible to predict the outcome of these matters, we believe that the results of these proceedings will not have a material adverse effect on our financial condition, results of operations or liquidity. From time to time, we also negotiate contingent consideration payment arrangements associated with certain acquisitions, which are recorded at fair value.

Discontinued operations indemnity: In connection with the 2006 sale of the former Sensors & Controls business, we have agreed to indemnify Sensata Technologies, Inc., for specified litigation matters and certain liabilities, including environmental liabilities. Our indemnification obligations with respect to breaches of representations and warranties and the specified litigation matters are generally subject to a total deductible of $30 million and our maximum potential exposure is limited to $300 million. We have not made any indemnity payments related to this matter and do not expect that any potential payments related to this indemnity obligation would have a material adverse effect on our financial condition, results of operations or liquidity in future periods.

Disclosure of Unconditional Purchase Contract Obligations

ASC 440-10-50-2, *Exit or Disposal Cost Obligations: Overall*, covers the disclosure of long-term unconditional purchase obligations. An *unconditional purchase obligation* is any obligation to provide funds from products and services at a specified price at a later date. An example is a take-or-pay contract in which the purchaser must make periodic specified payments for goods or services even if it did not receive them. Another example is a through-put contract in which the shipper contracts to pay another party stipulated sums to deliver or process the product even if it does not provide the minimum amount of goods for transporting or processing.

Unconditional purchase obligations with a term less than one year do not require disclosure.

Unconditional purchase obligations must be disclosed in the footnotes if the following criteria exist:

- The term is one year or more.
- The obligation is noncancelable. However, it may be cancelable only because of a remote contingency, with the other party's consent, such as a replacement agreement mutually agreed to or a mutual agreement to pay a penalty.

For unrecorded unconditional purchase obligations, disclosure should be made of the fixed and variable amounts, description of variable portions, total amount for the current year and for the next five years, total amount due after five years (labeled “subsequent years”), nature and term, and purchases for each year presented.

Disclosure is optional for the amount of imputed interest required to reduce the unconditional purchase obligation to present value.

When unconditional purchase obligations are recorded in the balance sheet, disclosure should be made of any payments made, maturity dates, sinking fund provisions, and redemptions of capital stock at determinable prices. Disclosure must be made of the payments to be made under the obligation for each of the next five years.

GAAP relevant to disclosure of an unconditional purchase obligation do not apply when the obligation (1) was negotiated as part of the financing arrangement for (a) facilities that will provide contracted goods or services or (b) the related costs, (2) has a remaining term of more than 1 year, and (3) is either noncancelable or cancelable only under specific terms that make continuation or replacement (but not cancelation) of the agreement reasonably assured. **A purchase obligation cancelable upon the payment of a nominal penalty is not unconditional.**

Certain types of leases require disclosure if the leases are noncancelable, involve financing facilities to provide merchandise or services, and have a time period of more than one year.

An example of a typical disclosure required under ASC 440-10-50-2 follows:

ABC Company signed a long-term agreement to buy product XYZ from vendor DEF. The contract is for a 10-year period. ABC Company is obligated to make minimum annual payments to DEF regardless of whether ABC is able to accept delivery of the product XYZ. The minimum total payments of each of the five and later years after December 31, 2X11 follows:

Year	*Total Payments (in thousands)*
2X12	$5,000
2X13	10,000
2X14	12,000
2X15	14,000
2X16	13,000
Later years	20,000
Total	$74,000
Less: imputed interest	28,000
Present value of payments	$46,000

Guarantees

As per ASC 460-10-50, *Guarantees: Overall*, the guarantor must record an initial liability at fair value at the inception of a guarantee or indemnification agreement even if it is *not* probable that future payments will be required. When the liability is recognized because of the issuance of the guarantee, the offsetting debit is based on the nature of the original transaction giving rise to the guarantee. If the guarantee is to an unrelated party *without* consideration, an expense is recorded; however, if consideration exists, the debit is to cash or a receivable. If the guarantee applies to starting a partially owned business or joint venture, the investment account is debited. If the lessee guarantees the salvage value of property in an operating lease, prepaid rent is debited. If the guarantee relates to a part of the sale of assets, a business, or product, the consideration received from the sale is allocated between the guarantee and the assets, business, or product sold.

In the case of product warranties, the guarantor must disclose its accounting policy and method to compute the liability under warranty instead of disclosing the maximum potential amount for future payments. Further, a tabular reconciliation of the changes in the guarantor's product warranty liability for the year is mandated.

The guarantor must disclose the following:

- Nature of the guarantee.
- Time period covered by the guarantee.
- Reasons and circumstances surrounding the guarantee.

- Recourse provisions.
- Occurrence that would obligate the guarantor.
- Maximum exposure in future payments to satisfy the guarantee.
- The carrying value of the liability, if any, on the part of the guarantor.
- Collateral under the agreement to enable the guarantor to be reimbursed for any amounts paid because of the guarantee.
- Obligations under product warranties.

ASC 460-10-30-2, *Guarantees: Overall*, requires the recognition and disclosure of the fair value of an obligation undertaken for a minimum revenue guarantee granted to a business or its owners that the revenue of the business, for a specified period of time, will be a certain minimum amount.

Exhibit 5 shows, from the annual report of Corning, disclosure of guarantees.

EXHIBIT 5

Corning 2008 Annual Report

13. Commitments, Contingencies, and Guarantees

The amount of our obligations follow (in millions):

		Amount of commitment and contingency expiration per period				
	Total	*Less than 1 year*	*1 to 2 years*	*2 to 3 years*	*3 to 4 years*	*5 years and thereafter*
Performance bonds and guarantees	$ 63	$ 35	$ 4	$ 4	$ 2	$ 18
Credit facilities for equity companies	150	25	25	25	25	50
Stand-by letters of credit[(1)]	68	68				
Loan guarantees	11					11
Subtotal of commitment expirations per period	$ 292	$128	$ 29	$ 29	$ 27	$ 79
Purchase obligations	$ 126	$ 77	$ 41	$ 6	$ 1	$ 1
Capital expenditure obligations[(2)]	525	525				
Total debt[(3)]	1,444	77	81	23	23	1,240
Minimum rental commitments	203	45	35	27	22	74
Capital leases[(4)]	113	6	6	34	3	64

Interest on long-term debt[5]	1,146	90	88	84	83	801
Uncertain tax positions[6]	11	4	2	3	2	
Subtotal of contractual obligation payments due by period	3,568	824	253	177	134	2,180
Total commitments and contingencies	$3,860	$952	$282	$206	$161	$2,259

[1] At December 31, 2008, $38 million of the $68 million was included in other accrued liabilities on our consolidated balance sheets.

[2] Capital expenditure obligations, primarily related to our Display Technologies segment expansions, are included on our balance sheet.

[3] At December 31, 2008, $1,605 million was included on our balance sheet. Amounts above are stated at their maturity value.

[4] At December 31, 2008, $25 million of the $113 million represents imputed interest.

[5] The estimate of interest payments assumes interest is paid through the date of maturity or expiration of the related debt, based upon stated rates in the respective debt instruments.

[6] At December 31, 2008, $19 million was included on our balance sheet related to uncertain tax positions. Of this amount, we are unable to estimate when $8 million of that amount will become payable.

FASB Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others" (FIN 45), requires a company, at the time a guarantee is issued, to recognize a liability for the fair value or market value of the obligation it assumes. In the normal course of our business, we do not routinely provide significant third-party guarantees. Generally, third-party guarantees provided by Corning are limited to certain financial guarantees, including stand-by letters of credit and performance bonds, and the incurrence of contingent liabilities in the form of purchase price adjustments related to attainment of milestones. These guarantees have various terms, and none of these guarantees are individually significant.

We have agreed to provide a credit facility related to Dow Corning. The funding of the Dow Corning credit facility will be required only if Dow Corning is not otherwise able to meet its scheduled funding obligations in its confirmed Bankruptcy Plan. The purchase obligations primarily represent raw material and energy-related take-or-pay contracts. We believe a significant majority of these guarantees and contingent liabilities will expire without being funded.

Minimum rental commitments under leases outstanding at December 31, 2008 follow (in millions):

2009	*2010*	*2011*	*2012*	*2013*	*2014 and thereafter*
$45	$35	$27	$22	$21	$53

Total rental expense was $59 million for 2008, $69 million for 2007 and $65 million for 2006.

A reconciliation of the changes in the product warranty liability for the year ended December 31 follows (in millions):

	2008	*2007*
Balance at January 1	$19	$26
Adjustments for warranties issued for current year sales	$7	$7
Adjustments for warranties related to prior year sales	$(7)	$(13)
Settlements made during the current year	$(1)	$(1)
Balance at December 31	$18	$19

Corning is a defendant in various lawsuits, including environmental, product-related suits, the Dow Corning and PCC matters discussed in Note 7 (Investments), and is subject to various claims which arise in the normal course of business. In the opinion of management, the ultimate disposition of these matters will not have a material adverse effect on Corning's consolidated financial position, liquidity, or results of operations. Other than certain asbestos related claims, there are no other material loss contingencies related to litigation.

We have been named by the Environmental Protection Agency under the Superfund Act, or by state governments under similar state laws, as a potentially responsible party for 19 active hazardous waste sites. Under the Superfund Act, all parties who may have contributed any waste to a hazardous waste site, identified by such Agency, are jointly and severally liable for the cost of cleanup unless the Agency agrees otherwise. It is our policy to accrue for the estimated liability related to Superfund sites and other environmental liabilities related to property owned and operated by us based on expert analysis and continual monitoring by both internal and external consultants. At December 31, 2008 and 2007, we had accrued approximately $21 million (undiscounted) and $19 million (undiscounted), respectively, for the estimated liability for environmental cleanup and related litigation. Based upon the information developed to date, we believe that the accrued amount is a reasonable estimate of our liability and that the risk of an additional loss in an amount materially higher than that accrued is remote.

The ability of certain subsidiaries and affiliated companies to transfer funds is limited by provisions of foreign government regulations, affiliate agreements and certain loan agreements. At December 31, 2008, the amount of equity subject to such restrictions for consolidated subsidiaries totaled $1.1 billion. While this amount is legally restricted, it does not result in operational difficulties since we have generally permitted subsidiaries to retain a majority of equity to support their growth programs.

Development Stage Companies

ASC 915-10-05, *Development Stage Entities: Overall*, deal with the accounting, reporting, and disclosure for development stage enterprises. A development stage company is one starting a new business in which either operations have not begun or operations have begun but no significant revenue has been obtained. After the business starts its principal activities and generates substantial revenues, it is no longer in the development stage.

A development stage enterprise usually is involved with such activities as hiring and training workers, obtaining initial financing, beginning production, budgeting and planning, engaging in research, entering markets, testing products, fostering relationships with vendors, and buying operating assets such as machinery.

A development stage company must use the same GAAP and prepare the same required financial statements as an established company. However, the following reporting is required for development stage enterprises:

- In the balance sheet, retained earnings will typically show a deficit. A descriptive caption would be "deficit accumulated in the development stage." For each equity security, the number of shares issued and dollar figures per share must be shown from inception. The dates of issue must also be presented. Besides common stock or preferred stock, the company must provide similar information for stock warrants, stock rights, or other equities. If noncash consideration is received, such consideration must be specified along with the basis of deriving its value.
- In the income statement, the total revenue and expenses from the beginning of the business must be disclosed separately.
- In the statement of cash flows, cumulative cash flows from operating, investing, and financing activities from inception, in addition to current-year amounts, must be shown.

The financial statements must be headed "Development Stage Enterprise." Footnote disclosure is required of the development stage activities and the proposed lines of business. In the first year the company is no longer in the development stage, it must disclose that in prior years it was.

If comparative financial statements are issued, the company must disclose that in previous years it was in the development stage.

Reporting On the Costs of Start-Up Activities

ASC 720-15-15-3 and 25-1, *Other Expenses: Start-Up Costs*, requires that start-up costs be expensed as incurred. Start-up costs are commonly referred to as preopening expenditures. They are those one-time costs that are incurred, for example, when opening a new facility, introducing a new product or service, conducting business in a new territory, conducting business with a new class of customer, or beginning some new operation. In some industries, it was common to defer some of those costs if it could be shown that future net operating results would be sufficient to recover these costs. They would then be expensed when the business opened or over a period not to exceed one year. All start-up costs, including organization costs, are to be expensed as incurred.

Inflation Information

ASC 225-10-50-6, *Income Statement: Overall*, allows a company to disclose voluntarily, in its annual report, inflation data so management and financial statement readers can better assess the effect of inflation on the company. The pronouncement recommends that businesses present selected summarized financial data based on current costs and adjusted for inflation (in constant purchasing power) for a five-year period. The Consumer Price Index for All Urban Consumers may be used. Inflation information to be disclosed includes sales and operating revenue expressed in constant purchasing power, income from continuing operations (including per share amounts) on a current cost basis, cash dividends per share in constant purchasing power, market price per share restated in constant purchasing power, purchasing power gain or loss on net monetary items, inflation-adjusted inventory, restated fixed assets, foreign currency translation based on current cost, net assets based on current cost, and the Consumer Price Index used.

Collaborative Arrangements

As per ASC 808-10-10, *Collaborative Arrangements: Overall*, a collaborative arrangement is a contractual agreement in which the parties are active participants and have significant risks and rewards that depend on the eventual commercial success of the endeavor. Many collaborative arrangements apply to developing and commercializing intellectual property. A collaborative arrangement can start at any point in the endeavor's life cycle.

According to ASC 808-10-15-2, transactions with third parties (i.e., revenue generated and cost incurred by participants from transactions with parties outside of a collaborative arrangement) should be shown gross or net on the appropriate line item in each participant's respective financial statements. For example, a participant in a collaborative arrangement that is considered to be the principal for a given transaction should record that transaction on a gross basis in its financial statements. Further, the equity method should not be applied to an arrangement that is performed by the participants without creating a separate legal entity for the arrangement.

If one party to an arrangement must make a payment to the other party to reimburse a part of that party's research and development (R&D) cost, that portion of the net payment may be an R&D expense in the payor's financial statements.

A participant in a collaborative arrangement should disclose the following:

- Amounts owed to or due from other participants.
- Accounting policy for collaborative arrangements.

- Rights and obligations under collaborative arrangements.
- Nature and purpose of arrangement.
- Life cycle stage.
- Classification in the income statement and amounts attributable to transactions between participants.

Disclosures for Derivatives

ASC 815-10-50-5, *Derivatives and Hedging: Overall*, requires both qualitative and quantitative disclosures related to derivatives. Qualitative disclosures include the business purpose behind holding or issuing derivatives for both trading and hedging purposes. Qualitative disclosures should be aligned with a discussion of the reporting unit's risk management strategy. ASC 815-10-50-4A and 50-5 requires quantitative disclosure of amounts recognized in the financial statements for derivatives used for trading purposes, as well as for derivatives used for hedging purposes. The company must differentiate between fair value and cash flow hedges and relate these hedges to their intended purposes, such as reduction of risk on firm commitments and hedging of forecasted transactions.

Certain entities must disclose the fair value of financial instruments, whether or not they are recognized in the balance sheet, if it is feasible to estimate such fair values and aggregated fair values are material to the entity. If estimating fair value is not feasible, disclosures include information pertinent to estimating the fair value of the financial instrument or class of financial instruments, such as the carrying amount, effective interest rate, and maturity. The reasons that estimating the fair value is not feasible also should be disclosed.

Exhibit 6 shows, from the annual report of Frontier Oil, disclosure for derivatives.

EXHIBIT 6

Frontier Oil

2007 Annual Report

11. Price Risk Management Activities

The Company, at times, enters into commodity derivative contracts to manage its price exposurto its inventory positions, purchases of foreign crude oil and consumption of natural gas in the refining process or to fix margins on certain future production. The commodity derivative contracts used by the Company may take the form of futures contracts, collars or price swaps and are entered into with creditworthy counterparties. The Company believes that there is minimal credit risk with respect to its counterparties. The Company accounts for its commodity derivative contracts under the hedge (or deferral) method of accounting when the derivative contracts are designated as hedges for accounting purposes, or mark-to-market accounting if the Company elects not to designate derivative contracts as accounting hedges or if such derivative contracts do not qualify for hedge accounting under FAS No. 133, “Accounting for Derivative Instruments and Hedging Activities.” As such, gains or losses on commodity derivative contracts accounted for as fair value hedges are recognized in the related inventory in “Inventory of crude oil, products and other” on the Consolidated Balance Sheets and ultimately, when the inventory is charged or sold, in “Raw material, freight and other costs” on the Consolidated Statements of Income. Gains and losses on transactions accounted for using mark-to-market accounting are reflected in “Other revenues” at each period end. The Company has derivative contracts which it holds directly and also derivative contracts held on Frontier's behalf by Utexam, in connection with the Master Crude Oil Purchase and Sale Contract (see Note 9 “Lease and Other Commitments”). The market value of open derivative contracts is included on the Consolidated Balance Sheets in “Accrued liabilities and other” when the unrealized value is a loss ($15.1 million at December 31, 2007), or in “Other current assets” when the unrealized value is a gain ($2.5 million at December 31, 2006).

Disclosures for Business Combinations

For each acquisition that occurs during the reporting period, or after the reporting period but before financial statements are issued, the acquirer must identify the acquiree and disclose the acquisition date, percentage of voting interest acquired, rationale for the business combination as well as information supporting fair values, contingent consideration, acquisition-related costs, goodwill expected to be deductible for tax purposes, and other supplemental information.

Exhibit 7 shows, from the annual report of IBM, disclosure of joint ventures.

EXHIBIT 7

IBM

2007 Annual Report

Note C. Acquisitions/Divestitures

Acquisitions

In 2007, the company completed 12 acquisitions at an aggregate cost of $1,144 million.

The Software segment completed six acquisitions: in the first quarter, Consul Risk Management International BV and Vallent Corporation, both privately held companies. Four acquisitions were completed in the third quarter: Watchfire Corporation, WebDialogs Inc. and Princeton Softech Inc., all privately held companies, and DataMirror Corporation, a publicly held company. Each acquisition further complemented and enhanced the software product portfolio.

Global Technology Services completed four acquisitions: in the first quarter, Softek Storage Solutions Corporation (Softek) and DM Information Systems, Ltd. (DMIS), both privately held companies. Two acquisitions were completed in the fourth quarter: Novus Consulting Group, Inc. and Serbian Business Systems, both privately held companies. Softek augments the company's unified data mobility offerings and worldwide delivery expertise for managing data in storage array, host and virtualized IT environments. DMIS will enhance and complement the Technology Service offerings. Novus CG, a storage solution company, will provide improved access to business information, enable stronger regulatory and corporate compliance and improve overall information technology performance. Serbian Business Systems establishes the company's maintenance and technical support services business in Serbia.

Global Business Services completed one acquisition in the fourth quarter: IT Gruppen AS, which will add to the company's presence in the retail and media sectors.

Systems and Technology completed one acquisition in the fourth quarter: XIV, Ltd., a privately held company focused on storage systems technology.

Purchase price consideration was paid in cash. These acquisitions are reported in the Consolidated Statement of Cash Flows net of acquired cash and cash equivalents.

The table on page 77 reflects the purchase price related to these acquisitions and the resulting purchase price allocations as of December 31, 2007.

During the fourth quarter of 2007, the company entered into a definitive agreement to acquire Cognos, Inc. The acquisition of Cognos, Inc., a publicly held company, was completed in January 2008. The acquisition of Cognos, Inc. supports the Information on Demand strategy and will provide the company with a strong entry in the Business Intelligence market.

The closing of the Telelogic AB acquisition, announced in the second quarter of 2007, is conditioned upon satisfactory completion of regulatory reviews in the European Union. Regulatory reviews in the U.S. have been completed.

Subsequent Events

The purpose of ASC 855, *Subsequent Events*, is to set forth standards for accounting and disclosure for events taking place between the balance sheet date and the date the financial statements are issued or available to be issued.

The Statement provides for the following information:

1. The period subsequent to the date of the financial statements during which management should appraise events or transactions that may occur for possible recognition or disclosure in the financial statements.
2. The circumstances that a company should recognize events or transactions taking place after the balance sheet date.
3. The disclosures that should be made for subsequent events or transactions.

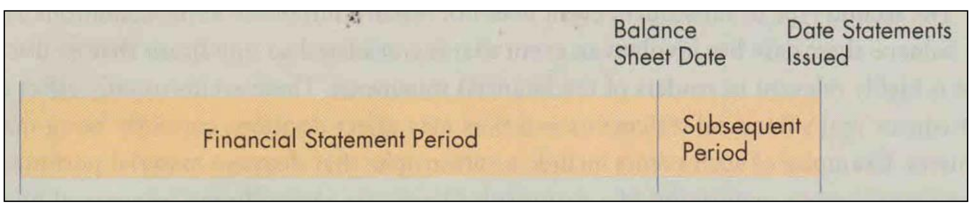
The effective date of the pronouncement is June 15, 2009. It applies to interim and annual financial periods.

Subsequent events are events or transactions that take place *after the balance sheet date but before the financial statements are issued or available to be issued*. The two types of subsequent events are:

1. Event or transaction that provides additional evidence about conditions that existed at the balance sheet date, including the estimates inherent in the process of preparing financial statements.
2. Event providing evidence about conditions that did not exist at the balance sheet date but arose after that date. This is a nonrecognized subsequent event.

The subsequent period is illustrated in Exhibit 8.

EXHIBIT 8
SUBSEQUENT EVENT INTERVAL



A company shall recognize in the financial statements the effect of a subsequent event that provides additional evidence about conditions existing at the balance sheet date. Recognized subsequent events include a settlement amount in a lawsuit different from that estimated at the balance sheet date.

A company should not recognize subsequent events providing evidence about conditions that did not exist at the balance sheet date but arose after the balance sheet date but before the financial statements are issued. Examples are the sale of stocks or bonds after the balance sheet date but before the financial statements are issued, a business combination taking place after the balance sheet date, fire loss on fixed assets and inventory after the balance sheet date, a customer's bankruptcy unexpected filing after year-end but before the issue date of the financial statements, and issuing significant guarantees after the balance sheet date but before the statements are issued.

Disclosure should be made of the date through which subsequent events have been appraised, and whether that date is the date the financial statements were issued or available to be issued.

Some nonrecognized subsequent events may be of such a nature that they must be disclosed to keep the financial statements from being misleading. For this type of event, the company should disclose the nature of the event, and an estimate of its financial effect, or a statement that such an estimate cannot be made.

A company should consider supplementing the historical financial statements with pro forma financial information. In some cases, a nonrecognized subsequent event may be so material that disclosure can best be made by way of pro forma financial data. Such data shall give effect to the event as if it had taken place on the balance sheet date.

According to Accounting Standards Update (ASU) No. 2010-09 (February 2010) (ASC 855, *Subsequent Events*), *Amendments to Certain Recognition and Disclosure Requirements*, a company must appraise subsequent events up to the time of issuance of the balance sheet and income statement. A revised financial statement includes one resulting from an error correction or restatement of previous years because of the adoption of a new accounting method. This amendment is effective for periods ending subsequent to June 15, 2010 (ASC 855-10; 855-10-25-1A; 855-10-65-1).

In addition, as per ASC 855, *Subsequent Events*, a company must appraise subsequent events or transactions through the date the financial statements are issued or available to be issued, depending on the firm's expectation of the distribution of the financial statements. A company must show in the financial statements the impact of all subsequent events that provide additional information about the conditions that existed on the balance sheet date including relevant estimates. The business entity must disclose the last date through which subsequent events were appraised.

Exhibit 9 shows, from the annual report of Coca Cola, disclosure of subsequent events.

EXHIBIT 9

Coca Cola - 2002 Annual Report

Note 19: Subsequent Events

During the first quarter of 2003, the Company initiated steps to streamline and simplify its operations, primarily in North America and Germany.

In North America, the Company is integrating the operations of our three separate North American business units—Coca-Cola North America (including our interest in CCDA), The Minute Maid Company (including our Odwalla business) and Fountain. The integration is expected to result in a headcount reduction of approximately 1,000 people, with the identification of the individuals expected to be completed by the end of the first quarter of 2003.

In Germany, CCEAG has taken steps to improve efficiency in sales and distribution, including the closure of three bottling plants in 2003. The streamlining initiative is expected to affect approximately 900 employees in Germany.

THE THINGS COMPANIES BURY IN THEIR SEC FILINGS

Note disclosures are needed to give a complete picture of a company's financial position. A good example of such disclosures is the required disclosure of debt triggers that may be buried in financing arrangements. These triggers can require a company to pay off a loan immediately if the debt rating collapses; they are one of the reasons Enron crumbled so quickly. But few Enron stockholders knew about the debt triggers until the gun had gone off. Companies are also disclosing more about their bank credit lines, liquidity, and any special purpose entities. (The latter were major villains in the Enron drama.)

How can you get better informed about note disclosures that may contain important information related to your investments? A good web resource for understanding the contents of note disclosures is http://wwwfootnoted.org This site highlights "the things companies bury in their SEC filings." It notes that company reports are more complete of late, but only the largest companies are preparing documents that are readable. As the editor of the site noted, "[some companies] are being dragged kicking and screaming into plain English."

Source: Gretchen Morgenson, "Annual Reports: More Pages, But Better?" *New York Times* (March 17, 2002), and D. Stead, "The Secrets in SEC Filings," *Business Week* (August 25, 2008), p. 12.

Review Questions – Section 3

9. Dean Co. acquired 100% of Morey Corp. prior to Year 6. Dean and Morey are not issuers. During Year 6, they included in their separate financial statements the following: Dean Co. had officer's salaries of $75K, officer's expenses of $20K, loans to officers of $125K and intercompany sales of $150K. Morey had officer's salaries of $50K, officer's expenses of $10K, loans to officers of $50K and no intercompany sales. The amount reported as related party disclosures in the notes to Dean's Year 6 consolidated statements is

A. $150,000
B. $155,000
C. $175,000
D. $330,000

10. Financial statements must disclose significant risks and uncertainties. The required disclosures include

A. Quantified comparisons of the relative importance of the different businesses in which the entity operates.
B. Information about a significant estimate used to value an asset only if it is probable that the financial statement effect of a condition existing at the balance sheet date will change materially in the near term.
C. Risk-reduction techniques that have successfully mitigated losses.
D. Vulnerability due to a concentration if a near-term severe impact is at least reasonably possible.

11. Where in its financial statements should a company disclose information about its concentration of credit risks?

A. No disclosure is required.
B. The notes to the financial statements.
C. Supplementary information to the financial statements.
D. Management's report to shareholders.

12. On January 15, Year 2, before the Mapleview Co. released its financial statements for the year ended December 31, Year 1, it settled a long-standing lawsuit. A material loss resulted and no prior liability had been recorded. How should this loss be disclosed or recognized?

A. The loss should be disclosed, but the financial statements themselves need not be adjusted.
B. The loss should be disclosed in an explanatory paragraph in the auditor's report.
C. No disclosure or recognition is required.
D. The loss must be recognized in the financial statements.

Interim Financial Reports

Interim financial statements are issued during the year, usually quarterly, to gauge periodically the entity's financial health and operating performance. Because of the seasonality of some businesses, the need for increased use of estimates, the need for allocations of costs and expenses among interim periods, and other factors, the usefulness of the information provided by interim financial statements may be limited. Hence, they emphasize *timeliness* over reliability.

ASC 270-10, *Interim Reporting: Overall*, covers interim financial reporting. Interim reporting is presenting financial information for a period less than one year. Each interim period is viewed as an integral part of the annual period. Interim financial reports may be issued semiannually, quarterly, or monthly. Complete financial statements or summarized information may be presented. Typically, interim reports include the operating results of the current interim period and the cumulative year-to-date figures, or last 12 months to date. Comparisons are usually made to results of comparable interim periods for the previous year. The following format is recommended:

ABC Company Interim Financial Information For Quarter Ending March 31, 2X13 and Comparable Periods

Current Quarter			*Twelve Months to Date*	
	Three Months	*Three Months*	*One Year Ending*	*One Year Ending*
Accounts Listed	*Ending 3/31/2X13*	*Ending 3/31/2X12*	*3/31/2X13*	*3/31/2X12*

Quarterly reports are much less detailed than annual reports, often presenting condensed information. Interim statements do not have to be audited. Each page should be labeled "Unaudited."

Interim results should be based on those accounting principles used in the last year's annual report unless a change in accounting has been made subsequently. Further, accounting policies do not have to be disclosed in interim reports unless there has been a change in an accounting policy (principle or estimate).

Income statement information is required in interim reports. However, it is recommended but not required to present a balance sheet and cash flow statement at interim dates. If these statements are not reported, the company must disclose significant changes in liquid assets, working capital, noncurrent liabilities, and stockholders' equity.

Extraordinary items, nonrecurring items, and gain or loss on the disposal of a business segment are recognized in the interim period in which they occur.

Earnings per share determination for interim purposes is handled in a fashion similar to annual reporting.

Materiality should be related to the full fiscal year. However, an item not disclosed in the annual financial statement because of immateriality would still be presented in the interim report if it is material to that interim period.

Revenue and Expense Recognition

Sales or service revenue should be recorded as earned in the interim period. If an advance is received in the first quarter that benefits the whole year, it should be proportionately allocated over all quarters affected.

Expenses should be deducted in the interim period as incurred. Expenses are matched to related revenue in the same interim period. Matching expenses to revenue includes cost of material used, salaries and fringe benefits, rent, utilities, and warranty expense. Yearly expenses (e.g., insurance, pension, year-end bonuses) should be proportionately allocated to the interim periods affected on some rational basis (e.g., time, activity, benefit derived). For example, insurance premiums and property taxes should be allocated among the interim periods based on time expired. Some expenses (e.g., bad debts) are subject to year-end adjustment.

Gains or losses (extraordinary) that would not be deferred at year-end should be reflected in the interim period in which they arise. It is prohibited to defer a gain or loss to a later interim period unless the deferral would have been allowed in annual reporting.

Inventory

In estimating interim inventory, the gross profit method may be used when interim physical inventory counts do not take place (or in the case of a fire). The method, assumptions, and reconciling adjustments must be disclosed.

ASC 330-10-55-2 covers recognition of inventory market declines at interim reporting dates. If a permanent loss occurs in inventory value in the interim period, it should be recognized immediately. A recovery in a later interim period is recognized as a gain. The gain from price recovery in a later interim period cannot exceed the previously recognized loss. Temporary losses in inventory value are not recognized, because no loss is anticipated for the annual period. In other words, temporary losses are viewed as seasonal price fluctuations. When a market price recovery occurs in an interim period, it should be treated as a change in estimate.

If a temporary liquidation occurs in the last-in, first-out (LIFO) base with replacement anticipated by year-end, the cost of sales should be based on replacement cost.

EXAMPLE

The historical cost of an inventory item is $30,000 with an anticipated replacement cost of $36,000. The entry is:

Cost of sales	36,000	
Inventory		30,000
Reserve for liquidation of LIFO base		6,000

The reserve for liquidation of LIFO base is a current liability.
At the time of inventory replenishment at year-end, the journal entry is:

Reserve for liquidation of LIFO base	6,000	
Inventory	30,000	
Cash		36,000

Disclosure should be made of unusual accounting for computing interim inventories such as LIFO estimations.

IFRS Connection
LIFO liquidation is not an issue in interim (or annual) periods because LIFO is *not* a permitted accounting policy.

IFRS Connection
In an interim period, the lower-of-cost-or-NRV rule applies to inventory measurement even if a market decline is expected to reverse by year-end.

If quantity (volume) discounts are granted to buyers that depend on expected annual purchases, an apportionment is required to the interim period based on the following ratio:

Purchases in the interim period/Total estimated annual purchases

If a standard cost system is used, variances that are expected to reverse by year-end may be deferred to a liability or asset account. However, if variances are not expected to reverse by year-end, they should be recognized in the interim period in which they arose.

Taxes

ASC 740-270, *Income Taxes: Interim Reporting*, covers the accounting for income taxes in interim statements, including the accounting for changes in tax rates.

The federal and local income tax provision for an interim period includes current and deferred taxes and should be cumulative for year-to-date. For example, the total tax expense for the first half of the year should be shown in the second quarter. Further, the second quarter's tax expense may also be presented for the three-month period of the second quarter.

Tax expense is based on income using the anticipated annual effective tax rate. The tax rate should take into account annual earnings, tax rates, tax credits, and alternative tax treatments. The tax rate should be based on continuing operations. A modification may be required to the anticipated annual effective tax rate at the end of each interim period based on new information:

$$\text{Effective tax rate} \quad = \quad \frac{\text{Expected annual income tax expense}}{\text{Expected annual before tax income}}$$

Extraordinary items and prior period adjustments should be shown net of tax in the interim period in which they occur.

The effect of a change in tax law should be recognized in the interim periods affected only after the effective date of the law.

Accounting Changes

ASC 250-10-05, *Accounting Changes and Error Corrections: Overall*, deals with the reporting of accounting changes in interim financial statements. A change in accounting principle made in an interim period shall be reported by retrospective application. If retrospective application to prechange interim periods is not practical, the desired change may only be made as of the beginning of a subsequent fiscal period. Disclosure should be made of the effect of the change in accounting method on income from continuing operations, net income, and related per-share amounts for postchange interim periods. Disclosure should be provided of the nature and justification of the change in principle.

Prior-Period Adjustments

ASC 250-10-45-26, *Accounting Changes and Error Corrections: Overall*, covers prior-period adjustments. Prior-period adjustments in interim reports are presented as follows:

- Net income of the current period should include the part of the effect applicable to current operations.
- Earnings of the affected interim periods of the current year should be restated to include the portion related thereto.
- If the prior-period adjustment impacts previous years, it should be included in the profit of the first interim period of the current year.

Criteria to be satisfied for prior-period adjustments in interim periods are identifiable to a previous interim period, subject to estimate, and material.

Prior-period adjustments for interim reporting include correction of errors, renegotiation proceedings, settlement of a lawsuit or claim, and utility revenue in connection with rate-making issues.

Disclosures

Minimum disclosure in interim reports is as follows:

- Revenue, tax expense, extraordinary items, and net income.
- Earnings per share.
- Seasonal revenue and costs.
- Material changes in tax expense, including reasons for significant differences between tax expense and income subject to tax.
- Information on disposal of a business segment.
- Commitments, contingencies, and uncertainties.
- Significant changes in financial position and cash flows.

Other disclosures peculiar to interim reporting are:

- Seasonal factors bearing on interim results. Seasonal companies should present supplementary information for the current and preceding 12-month periods ending at the interim date so that proper evaluation of the seasonal impact on interim results may be revealed.
- Significant items affecting the interim period.
- Whether a business combination took place and the financial effects thereto.
- Material adjustments to the fourth quarter if such quarter is not presented in the annual report.
- A change in the anticipated effective tax rate.

Exhibit 10 presents the selected quarterly disclosure of Campbell Soup.

EXHIBIT 10

Campbell Soup   2005 Annual Report

22 Quarterly Data (unaudited)				
2005	***First***	***Second***	***Third***	***Fourth***
Net sales	**$2,091**	**$2,223**	**$1,736**	**$1,498**
Cost of products sold	**1,245**	**1,321**	**1,035**	**890**
Net earnings	**230**	**235**	**146**	**96**
Per share—basic				
Net earnings	**0.56**	**0.57**	**0.36**	**0.23**
Dividends	**0.17**	**0.17**	**0.17**	**0.17**
Per share—assuming dilution				
Net earnings	**0.56**	**0.57**	**0.35**	**0.23**
Market place				
High	**$27.13**	**$30.52**	**$29.74**	**$31.60**

Low	$25.21	$26.68	$27.35	$29.53
2004	*First*	*Second*	*Third*	*Fourth*
Net sales	$1,909	$2,100	$1,667	$1,433
Cost of products sold	1,108	1,212	995	872
Net earnings[1]	211	235	142	59
Per share—basic				
Net earnings	0.51	0.57	0.35	0.14
Dividends	0.1575	0.1575	0.1575	0.1575
Per share—assuming dilution				
Net earnings	0.51	0.57	0.34	0.14
Market place				
High	$27.90	$27.39	$28.70	$28.13
Low	$23.26	$24.92	$26.15	$25.03

[1] Net earnings in the fourth quarter include a restructuring charge of $22 or $.05 per share. (See Note 5 to the Consolidated Financial Statements.)

Exhibit 11 presents an overview of the major accounting principles used for the interim income statement.

Revenue	Recognize as earned during an interim period on same basis as used for annual reporting
Costs of goods sold	Product costs for interim period recognized on same basis as used for annual reporting, except for interims: • Estimated gross profit rates may be used to determine interim cost of goods sold. • Temporary liquidations of LIFO-based inventories are charged to cost of goods sold using expected replacement cost of the items. • Lower-of-cost-or-market valuation method allows for loss recoveries for increases in market prices in later interim periods of the same fiscal year. • Standard cost systems should use the same procedures as for annual reporting except that price variances or volume or capacity variances expected to be absorbed by end of the year should be deferred.
All other costs and expenses	Expense as incurred or allocated among interim periods' expenses based on benefits received or other systematic and rational basis.

Income taxes	Based on estimated annual effective tax rate, with recognition of tax benefits of an operating loss if benefits are assured beyond a reasonable doubt; second and subsequent quarters are based on changes in cumulative amount of tax computed, including changes in estimates.
Disposal of a component of the entity, or extraordinary, unusual, infrequently occurring, and contingent items	Recognize in interim period in which they occur.
Accounting Changes: Change in accounting principle Change in an accounting estimate Changing in a reporting entity	 Retrospective application to all prechange interim periods reported. Apply to current and prospective interim periods only. Retrospective application to all prechange interim periods reported.

IFRS versus GAAP about Disclosures

IFRS and GAAP disclosure requirements are similar in many regards. The IFRS standards addressing related-party disclosures are: *IAS 1* ("First Time Adoption of IFRS"); *IAS 24* ("Related Party Disclosures"); disclosure and recognition of subsequent events in *IAS 10* ("Events after the Balance Sheet Date); segment reporting IFRS provisions in *IFRS 8* ("Operating Segments"); and interim reporting requirements in *IAS 34* ("Interim Financial Reporting"). More specific comments are below:

- Due to the broader range of judgments allowed in more principle-based IFRS, note disclosures generally are more expansive under IFRS compared to GAAP.
- Like GAAP, IFRS requires that for transactions with related parties, companies disclose the amounts involved in a transaction, the amount, terms and nature of the outstanding balances, and any doubtful amounts related to those outstanding balances for each major category of related parties. There is no specific requirement to disclose the name of the related party.
- IFRS and GAAP have similar standards on subsequent events. That is, under both sets of GAAP, events that occurred after the balance sheet date that provide additional evidence of conditions that existed at the balance sheet date are recognized in the financial statements.
- Following the recent issuance of IFRS 8, "Operating Segments," the requirements under IFRS and GAAP are very similar. That is, both sets of standards use the management approach to identify reportable segments, and similar segment disclosures are required.
- Neither U.S. GAAP nor IFRS requires interim reports. Rather the SEC and stock exchanges outside the U.S. establish the rules. In the U.S., interim reports generally are provided on a quarterly basis; outside the U.S., 6-month interim reports are common.

The FASB and the IASB are exploring better ways to present information in the financial statements. Recently, these two standard-setters have issued a discussion paper that requests input on a proposed reformatting of the financial statements. The table below provides a "snapshot" of the proposed changes

(Visit www.fasb.org/project/financial_statement_presentation.shtml to learn more about this joint international project).

Statement of Financial Position	Statement of Comprehensive Income	Statement of Cash Flows
Business	Business	Business
• Operating assets and liabilities	• Operating income and expenses	• Operating cash flows
• Investing assets and liabilities	• Investing income and expenses	• Investing cash flows
Financing	Financing	Financing
• Financing assets	• Financing asset income	• Financing asset cash flows
• Financing liabilities	• Financing liability expenses	• Financing liability cash flows
Income Taxes	Income Taxes	Income Taxes

As indicated, each statement will use the same format. While the proposed changes will not affect the measurement of individual financial statement elements, the use of a consistent format (e.g., Business, Financing, Income Taxes), will help users understand the interrelationships in the financial statements. In addition, a new schedule reconciling cash flows to comprehensive income will be provided. As part of this schedule, changes in fair value will be included. It is a good thing the timeline for the project is lengthy, as these changes in presentation are significant.

Chapter Review Questions – Section 4

13. In general, an enterprise preparing interim financial statements should

A. Defer recognition of seasonal revenue.
B. Disregard permanent decreases in the market value of its inventory.
C. Allocate revenues and expenses evenly over the quarters, regardless of when they actually occurred.
D. Use the same accounting principles followed in preparing its latest annual financial statements.

14. Wilson Corp. experienced a $50,000 decline in the market value of its inventory in the first quarter of its fiscal year. Wilson had expected this decline to reverse in the third quarter, and the third quarter recovery exceeded the previous decline by $10,000. Wilson's inventory did not experience any other declines in market value during the fiscal year. What amounts of loss or gain should Wilson report in its interim financial statements for the first and third quarters?

A. $0 in first quarter, and $0 in third quarter
B. $0 in first quarter, and $10,000 gain in third quarter
C. $50,000 loss in first quarter, and $50,000 gain in third quarter
D. $50,000 loss in first quarter, and $60,000 gain in third quarter

15. An inventory loss from a market price decline occurred in the first quarter. The loss was not expected to be restored in the fiscal year. However, in the third quarter the inventory had a market price recovery that exceeded the market decline that occurred in the first quarter. For interim financial reporting, the dollar amount of net inventory should

A. Decrease in the first quarter by the amount of the market price decline and increase in the third quarter by the amount of the market price recovery.
B. Decrease in the first quarter by the amount of the market price decline and increase in the third quarter by the amount of decrease in the first quarter.
C. Decrease in the first quarter by the amount of the market price decline and not be affected in the third quarter.
D. Not be affected in either the first quarter or the third quarter.

16. During the first quarter of Year 4, Tech Co. had income before taxes of $200,000, and its effective income tax rate was 15%. Tech's Year 3 effective annual income tax rate was 30%, but Tech expects its

Year 4 effective annual income tax rate to be 25%. In its first quarter interim income statement, what amount of income tax expense should Tech report?

A. $0
B. $30,000
C. $50,000
D. $60,000

Glossary

Accounting Policies: The specific accounting principles and methods currently employed and considered most appropriate to present fairly the financial statements of an enterprise.

Changes in Accounting Principles: Including material changes in estimates and corrections of errors.

Common costs: Costs that are incurred for the benefit of more than one segment and whose interrelated nature prevents a completely objective division of costs among segments.

Contingencies and Commitments: Contingencies related to litigation, debt, tax assessments, etc. and commitments related to dividend restrictions, purchase agreements, hedge contracts, and employment contracts

Discrete view: Each interim period should be treated as a separate accounting period; deferrals and accruals would therefore follow the principles employed for annual reports.

Full Disclosure Principle: Report any financial facts significant enough to influence the judgment of an informed reader.

Integral View: The interim report is in an integral part of the annual report and deferrals and accruals should take into consideration what will happen for the entire year.

Interim Reports: Reports that cover periods of less than one year.

Notes to the Financial Statements: A means of full disclosure and providing qualitative and supplementary data:

Related Party Transactions: Transactions which have not been carried out on an “arms-length” or free market basis.

Subsequent Events: Events that occur subsequent to date of the financial statements, but before issuance.

Summary Annual Reports: A report that contains a condensed financial presentation in a more readable format than that of the traditional annual report.

Tests for Significance: Made to determine if a segment is significant enough to warrant disclosure.

Index

Appendix - Annual Report References

Note: Skim through this section for more annual report references

ConAgra Foods

2010 Annual Report

18. Contingencies

In fiscal 1991, we acquired Beatrice Company (“Beatrice”). As a result of the acquisition and the significant pre-acquisition contingencies of the Beatrice businesses and its former subsidiaries, our consolidated post-acquisition financial statements reflect liabilities associated with the estimated resolution of these contingencies. These include various litigation and environmental proceedings related to businesses divested by Beatrice prior to its acquisition by us. The litigation includes suits against a number of lead paint and pigment manufacturers, including ConAgra Grocery Products and the Company as alleged successors to W. P. Fuller Co., a lead paint and pigment manufacturer owned and operated by Beatrice until 1967. Although decisions favorable to us have been rendered in Rhode Island, New Jersey, Wisconsin, and Ohio, we remain a defendant in active suits in Illinois and California. The Illinois suit seeks classwide relief in the form of medical monitoring for elevated levels of lead in blood. In California, a number of cities and counties have joined in a consolidated action seeking abatement of the alleged public nuisance.

The environmental proceedings include litigation and administrative proceedings involving Beatrice's status as a potentially responsible party at 36 Superfund, proposed Superfund, or state-equivalent sites; these sites involve locations previously owned or operated by predecessors of Beatrice that used or produced petroleum, pesticides, fertilizers, dyes, inks, solvents, PCBs, acids, lead, sulfur, tannery wastes, and/or other contaminants. Beatrice has paid or is in the process of paying its liability share at 33 of these sites. Reserves for these matters have been established based on our best estimate of the undiscounted remediation liabilities, which estimates include evaluation of investigatory studies, extent of required clean-up, the known volumetric contribution of Beatrice and other potentially responsible parties, and its experience in remediating sites. The reserves for Beatrice-related environmental matters totaled $69.6 million as of May 30, 2010, a majority of which relates to the Superfund and state-equivalent sites referenced above. The reserve for Beatrice-related environmental matters reflects a reduction in pre-tax expense of $15.4 million made in the third quarter of fiscal 2010 due to favorable regulatory developments at one of the sites. We expect expenditures for Beatrice-related environmental matters to continue for up to 20 years.

In limited situations, we will guarantee an obligation of an unconsolidated entity. At the time in which we initially provide such a guarantee, we assess the risk of financial exposure to us under these agreements. We consider the creditworthiness of the guaranteed party, the value of any collateral pledged against the related obligation, and any other factors that may mitigate our risk (e.g., letters of credit from a financial institution). We actively monitor market and entity-specific conditions that may result in a change of our assessment of the risk of loss under these agreements.

We guarantee certain leases and other commercial obligations resulting from the 2002 divestiture of our fresh beef and pork operations. The remaining terms of these arrangements do not exceed six years and the maximum amount of future payments we have guaranteed was $16.0 million as of May 30, 2010.

We have also guaranteed the performance of the divested fresh beef and pork business with respect to a hog purchase contract. The hog purchase contract requires the divested business to purchase a minimum of approximately 1.2 million hogs annually through 2014. The contract stipulates minimum price commitments, based in part on market prices, and, in certain circumstances, also includes price adjustments based on certain inputs. We have not established a liability for any of the fresh beef and pork divestiture-related guarantees, as we have determined that the likelihood of our required performance under the guarantees is remote.

We are a party to various potato supply agreements. Under the terms of certain such potato supply agreements, we have guaranteed repayment of short-term bank loans of the potato suppliers, under certain conditions. At May 30, 2010, the amount of supplier loans we have effectively guaranteed was $29.0 million. We have not established a liability for these guarantees, as we have determined that the likelihood of our required performance under the guarantees is remote.

We are a party to a supply agreement with an onion processing company. We have guaranteed repayment of a loan of this supplier, under certain conditions. At May 30, 2010, the term of the loan is 14 years. The amount of our guaranty was $25 million as of May 30, 2010. In the event of default on this loan by the supplier, we have the contractual right to purchase the loan from the lender, thereby giving us the rights to the underlying collateral. We have not established a liability in connection with this guaranty, as we believe the likelihood of financial exposure to us under this agreement is remote.

Federal income tax credits were generated related to our sweet potato production facility currently under construction in Delhi, Louisiana. Third parties invested in certain of these income tax credits. We have guaranteed these third parties the face value of these income tax credits over their statutory lives, a period of seven years, in the event that the income tax credits are recaptured or reduced. The face value of the income tax credits was $21 million as of May 30, 2010. We believe the likelihood of the recapture or reduction of the income tax credits is remote, and therefore we have not established a liability in connection with this guarantee.

We are a party to a number of lawsuits and claims arising out of the operation of our business, including lawsuits and claims related to the February 2007 recall of our peanut butter products and litigation we initiated against an insurance carrier to recover our settlement expenditures and defense costs. We recognized a charge of $24.8 million during the third quarter of fiscal 2009 in connection with the disputed coverage with this insurance carrier. During the second quarter of fiscal 2010, a Delaware state court rendered a decision on certain matters in our claim for the disputed coverage favorable to the insurance carrier. We intend to appeal this decision and continue to pursue this matter vigorously.

In June 2009, an accidental explosion occurred at our manufacturing facility in Garner, North Carolina. See Note 5 for information related to this matter.

An investigation by the Division of Enforcement of the U.S. Commodity Futures Trading Commission ("CFTC") of certain commodity futures transactions of a former Company subsidiary has led to an investigation of us by the CFTC. The investigation may result in litigation by the CFTC against us. The former subsidiary was sold on June 23, 2008, as part of the divestiture of our trading and merchandising operations. The CFTC's Division of Enforcement has advised us that it questions whether certain trading activities of the former subsidiary violated the Commodity Exchange Act and that the CFTC has been evaluating whether we should be implicated in the matter based on the existence of the parent-subsidiary relationship between the two entities at the time of the trades. Based on information we have learned to date, we believe that both we and the former subsidiary have meritorious defenses. There have been discussions with the CFTC concerning resolution of this matter. We also believe the sale contract with the purchaser of the business provides us indemnification rights. Accordingly, we do not believe any decision by the CFTC to pursue this matter will have a material adverse effect on our financial condition or results of operations. If litigation ensues, we intend to defend this matter vigorously.

We are a party to several lawsuits concerning the use of diacetyl, a butter flavoring ingredient that was added to our microwave popcorn until late 2007. The cases are primarily consumer personal injury suits claiming respiratory illness allegedly due to exposures to vapors from microwaving popcorn. Another was brought by an ex-employee alleging that we fraudulently concealed the risks of diacetyl and therefore his recovery should not be limited to the otherwise exclusive remedy of workers compensation benefits. The final case is a putative class action contending that our packaging information with respect to diacetyl is false and misleading. We do not believe these cases possess merit and are vigorously defending them.

After taking into account liabilities recognized for all of the foregoing matters, management believes the ultimate resolution of such matters should not have a material adverse effect on our financial condition, results of operations, or liquidity. It is reasonably possible that a change in one of the estimates of the foregoing matters may occur in the future. Costs of legal services are recognized in earnings as services are provided.

14. Environmental and Legal Matters

Government Regulation and Environmental Matters—The operations of the Company, like those of other companies engaged in the Household Products and Personal Care businesses, are subject to various federal, state, foreign and local laws and regulations intended to protect the public health and the environment. These regulations relate primarily to worker safety, air and water quality, underground fuel storage tanks and waste handling and disposal. The Company has received notices from the U.S. Environmental Protection Agency, state agencies and/or private parties seeking contribution, that it has been identified as a “potentially responsible party” (PRP) under the Comprehensive Environmental Response, Compensation and Liability Act, and may be required to share in the cost of cleanup with respect to eight federal “Superfund” sites. It may also be required to share in the cost of cleanup with respect to state-designated sites or other sites outside of the U.S.

Accrued environmental costs at September 30, 2010 were $10.2, of which $2.8 is expected to be spent in fiscal 2011. This accrual is not measured on a discounted basis. It is difficult to quantify with certainty the cost of environmental matters, particularly remediation and future capital expenditures for environmental control equipment. Nevertheless, based on information currently available, the Company believes the possibility of material environmental costs in excess of the accrued amount is remote.

Certain of the Company's products are subject to regulation by the United States Food and Drug Administration (FDA), including tampons and sun care products.

Legal Proceedings—The Company and its subsidiaries are parties to a number of legal proceedings in various jurisdictions arising out of the operations of the Energizer business. Many of these legal matters are in preliminary stages and involve complex issues of law and fact, and may proceed for protracted periods of time. The amount of liability, if any, from these proceedings cannot be determined with certainty. However, based upon present information, the Company believes that its ultimate liability, if any, arising from pending legal proceedings, asserted legal claims and known potential legal claims which are likely to be asserted, are not reasonably likely to be material to the Company's financial position, results of operations, or cash flows, taking into account established accruals for estimated liabilities.

Brown-Forman

2009 Annual Report

5. Commitments

We have contracted with various growers and wineries to supply some of our future grape and bulk wine requirements. Many of these contracts call for prices to be adjusted annually up or down, according to market conditions. Some contracts set a fixed purchase price that might be higher or lower than prevailing market price. We have total purchase obligations related to both types of contracts of $29 in 2010, $24 in 2011, $16 in 2012, $11 in 2013, $8 in 2014, and $15 after 2014.

We also have contracts for the purchase of agave, which is used to produce tequila. These contracts provide for prices to be determined based on market conditions at the time of harvest, which, although not specified, is expected to occur over the next 10 years. As of April 30, 2009, based on current market prices, obligations under these contracts totaled $10.

We made rental payments for real estate, vehicles, and office, computer, and manufacturing equipment under operating leases of $19 in 2007, $19 in 2008, and $21 in 2009. We have commitments related to minimum lease payments of $16 in 2010, $13 in 2011, $8 in 2012, $5 in 2013, $3 in 2014, and $3 after 2014.

Sonic Foundry

2009 Annual Report

10. Related-Party Transactions

The Company incurred fees of $255 and $249 thousand during the years ended September 30, 2009 and 2008, respectively, to a law firm whose partner is a director and stockholder of the Company. The Company had accrued liabilities for unbilled services of $19 thousand at September 30, 2009 to the same law firm. There were no unbilled services at September 30, 2008.

The Company recorded Mediasite product and customer support revenue related to $600 and $580 thousand of billings during the years ended September 30, 2009 and 2008 to Mediasite KK, a Japanese reseller in which the Company has an equity interest. Mediasite KK owed the Company $128 and $108 thousand on such billings at September 30, 2009 and 2008, respectively. The Company accounts for its investment in Mediasite KK under the equity method. The recorded value as of September 30, 2009 and 2008 is zero.

During the years ended September 30, 2009 and 2008, the Company had a loan outstanding to an executive totaling $26 thousand. The loan is collateralized by company stock.

Note 6—Commitments

Ship Commitments

At November 30, 2009, we had 13 ships under contract for construction with an aggregate passenger capacity of 30,442. The estimated total cost of these ships is approximately $8.2 billion, which includes the contract price with the shipyard, design and engineering fees, capitalized interest, construction oversight costs and various owner supplied items. We have paid $770 million through November 30, 2009 and anticipate paying the remaining estimated total costs as follows: $3.4 billion, $2.2 billion and $1.8 billion in fiscal 2010, 2011 and 2012, respectively.

Operating Leases, Port Facilities and Other Commitments

Rent expense under our operating leases, primarily for office and warehouse space, was $54 million, $52 million and $46 million in fiscal 2009, 2008 and 2007, respectively. At November 30, 2009, minimum amounts payable for our operating leases, with initial or remaining terms in excess of one year, and for the annual usage of port facilities and other contractual commitments with remaining terms in excess of one year, were as follows (in millions):

Fiscal Year	*Operating Leases*	*Port Facilities and Other*
2010	$49	$146
2011	43	112
2012	37	87
2013	33	77
2014	24	50
Thereafter	115	490
Total	$301	$962

Note 7—Contingencies

Litigation

In the normal course of our business, various claims and lawsuits have been filed or are pending against us. Most of these claims and lawsuits are covered by insurance and, accordingly, the maximum amount of our liability, net of any insurance recoverables, is typically limited to our self-insurance retention levels. However, the ultimate outcome of these claims and lawsuits which are not covered by insurance cannot be determined at this time.

Contingent Obligations—Lease Out and Lease Back Type ("LILO") Transactions

At November 30, 2009, Carnival Corporation had estimated contingent obligations totaling $585 million, excluding termination payments as discussed below, to participants in LILO transactions for two of its ships. At the inception of these leases, the aggregate of the net present value of these obligations was paid by Carnival Corporation to a group of major financial institutions, one of which includes American International Group Inc. ("AIG"), who agreed to act as payment undertakers and directly pay these obligations. Accordingly, these contingent obligations are considered extinguished, and neither the funds nor the contingent obligations have been included in our accompanying Consolidated Balance Sheets.

In the event that Carnival Corporation were to default on its contingent obligations and assuming performance by all other participants, we estimate that we would, as of November 30, 2009, be responsible for a termination payment of approximately $95 million. In 2017 we have the right to exercise options that would terminate these two LILO transactions at no cost to us.

In certain cases, if the credit ratings of the financial institutions who are directly paying the contingent obligations fall below AA-, then Carnival Corporation will be required to replace these financial institutions with other financial institutions whose credit ratings are at least AA or meet other specified credit requirements. In such circumstances we would incur additional costs, although we estimate that they will be immaterial to our financial statements. All of the financial institution payment undertakers subject to this AA- credit rating threshold have credit ratings of AAA. If Carnival Corporation's credit rating, which is BBB+, falls below BBB, it will be required to provide a standby letter of credit for $67 million, or, alternatively, provide mortgages for this aggregate amount on these two ships.

In September 2008, the credit ratings of AIG and its subsidiaries involved in one of the above LILO transactions were downgraded from AA- to A-. As a result of this downgrade, AIG pledged collateral to support its obligations as a payment undertaker under the terms of this LILO transaction and, accordingly, AIG is no longer subject to the AA- credit rating threshold discussed above.

Carnival Corporation and AIG were also parties to a third LILO transaction. In September 2008, we replaced AIG as the payment undertaker under this third LILO transaction by purchasing $80 million of U.S. Treasury strip securities using funds substantially all of which were provided by AIG. In February 2009, Carnival and the remaining participants voluntarily unwound this LILO transaction. Accordingly, the $80 million of long-term U.S. Treasury strip securities that we held as collateral for our recorded LILO obligation were released to extinguish this obligation. As a result of the unwinding of this third LILO transaction, we recorded a $15 million nonoperating gain in February 2009, which had originally been deferred at the inception of the LILO transaction and was being amortized over its term.

Contingent Obligations—Indemnifications

Some of the debt agreements that we enter into include indemnification provisions that obligate us to make payments to the counterparty if certain events occur. These contingencies generally relate to changes in taxes and changes in laws that increase lender capital costs and other similar costs. The indemnification clauses are often standard contractual terms and were entered into in the normal course of business. There are no stated or notional amounts included in the indemnification clauses and we are not able to estimate the maximum potential amount of future payments, if any, under these indemnification clauses. We have not been required to make any material payments under such indemnification clauses in the past and, under current circumstances, we do not believe a request for material future indemnification payments is probable.

11. Commitments and contingencies

Operating leases: We conduct certain operations in leased facilities and also lease a portion of our data processing and other equipment. In addition, certain long-term supply agreements to purchase industrial gases are accounted for as operating leases. Lease agreements frequently include purchase and renewal provisions and require us to pay taxes, insurance and maintenance costs. Rental and lease expense incurred was $114 million, $124 million and $123 million in 2009, 2008 and 2007.

Capitalized software licenses: We have licenses for certain internal use electronic design automation software that we account for as capital leases. The related liabilities are apportioned between Accounts payable and Deferred credits and other liabilities on our balance sheets, depending on the contractual timing of the payment.

Purchase commitments: Some of our purchase commitments entered in the ordinary course of business provide for minimum payments.

Summary: At December 31, 2009, we had committed to make the following minimum payments under our non-cancellable operating leases, capitalized software licenses and purchase commitments:

	Operating Leases	*Capitalized Software Licenses*	*Purchase Commitments*
2010	$ 86	$ 83	$159
2011	75	63	72
2012	56	50	72
2013	47	8	25
2014	43	8	14
Thereafter	130	-	27

Indemnification guarantees: We routinely sell products with an intellectual property indemnification included in the terms of sale. Historically, we have had only minimal, infrequent losses associated with these indemnities. Consequently, we cannot reasonably estimate or accrue for any future liabilities that may result.

Warranty costs/product liabilities: We accrue for known product-related claims if a loss is probable and can be reasonably estimated. During the periods presented, there have been no material accruals or payments regarding product warranty or product liability. Historically, we have experienced a low rate of payments on product claims. Although we cannot predict the likelihood or amount of any future claims, we do not believe they will have a material adverse effect on our financial condition, results of operations or liquidity.

Consistent with general industry practice, we enter into formal contracts with certain customers that include negotiated warranty remedies. Typically, under these agreements our warranty for semiconductor products includes: three years coverage; an obligation to repair, replace or refund; and a maximum payment obligation tied to the price paid for our products. In some cases, product claims may exceed the price of our products.

General: We are subject to various legal and administrative proceedings. Although it is not possible to predict the outcome of these matters, we believe that the results of these proceedings will not have a material adverse effect on our financial condition, results of operations or liquidity.

Discontinued operations indemnity: In connection with the sale of the former Sensors & Controls business in 2006, we have agreed to indemnify Sensata for specified litigation matters and certain liabilities, including environmental liabilities. Our indemnification obligations with respect to breaches of representations and warranties and the specified litigation matters are generally subject to a total deductible of $30 million and our maximum potential exposure is limited to $300 million. We have not made any indemnity payments related to this matter and do not expect that any potential payments related to this indemnity obligation would have a material adverse effect on our financial position, results of operations or liquidity in future periods.

14. Segment and Geographic Area Data

Our financial reporting structure comprises three reportable segments. These reportable segments, which are established along major product lines having unique design and development requirements, are as follows:

Analog—Analog semiconductors change real-world signals—such as sound, temperature, pressure or images—by conditioning them, amplifying them and often converting them to a stream of digital data that can be processed by other semiconductors, such as DSPs. Analog semiconductors are also used to manage power distribution and consumption. Analog includes high-performance analog, high-volume analog & logic and power management products.

Embedded Processing—Our Embedded Processing products include our DSPs (other than DSPs specific to our Wireless segment) and microcontrollers. DSPs perform mathematical computations almost instantaneously to process or improve digital data. Microcontrollers are designed to control a set of specific tasks for electronic equipment. We make and sell standard, or catalog, Embedded Processing products used in many different applications and custom Embedded Processing products used in specific applications, such as communications infrastructure equipment and automotive.

Wireless—Cell phones require a modem or “baseband” to connect to the wireless carrier's network. Many of today's advanced cell phones, which contain email, media, games and computing capability, also require an applications processor to run the phone's software and services, and semiconductors to enable connectivity to Bluetooth® devices, WiFi networks or GPS location services.

We design, make and sell products to satisfy each of these requirements. Our Wireless portfolio includes both standard products and custom products.

We also have Other, which includes other operating segments that neither meet the quantitative thresholds for individually reportable segments nor are they aggregated with other operating segments. These operating segments primarily include our smaller semiconductor product lines such as DLP® products (primarily used in projectors to create high-definition images); RISC microprocessors (designed to provide very fast computing and are often implemented in servers); and, custom semiconductors known as ASICs. Other also includes handheld graphing and scientific calculators and royalties received for our patented technology that we license to other electronics companies.

Other may also include certain unallocated income and expenses such as gains and losses on sales of assets; sales tax refunds; and certain litigation costs, settlements or reserves. Except for the few unallocated items just mentioned, we allocate all of our expenses associated with corporate activities to our operating segments based on specific methodologies, such as percentage of operating expenses or headcount.

With the exception of goodwill, we do not identify or allocate assets by operating segment, nor does the chief operating decision maker evaluate operating segments using discrete asset information. There was no significant intersegment revenue. The accounting policies of the segments are the same as those described in the summary of significant accounting policies.

Segment Information

	Analog	*Embedded Processing*	*Wireless*	*Other*	*Total*
Revenue					
2009	**$4,270**	**$1,471**	**$2,558**	**$2,128**	**$10,427**
2008	4,857	1,631	3,383	2,630	12,501
2007	4,927	1,588	4,195	3,125	13,835
Operating profit					
2009	**$ 753**	**$ 194**	**$ 332**	**$ 712**	**$ 1,991**
2008	1,050	268	347	772	2,437
2007	1,548	290	763	896	3,497

See Note 2 for restructuring expenses impacting segment results.

The following geographic area data includes revenue, based on product shipment destination and royalty payor location, and property, plant and equipment based on physical location:

Geographic Area Information

	U.S.	*Asia*	*Europe*	*Japan*	*Rest of*	*Total*

					World	
Revenue						
2009	**$1,140**	**$6,575**	**$1,408**	**$976**	**$328**	**$10,427**
2008	1,551	7,387	1,875	1,268	420	12,501
2007	1,758	8,013	2,258	1,423	383	13,835
Property, plant and equipment, net						
2009	**$1,727**	**$1,013**	**$161**	**$244**	**$13**	**$3,158**
2008	1,785	988	200	314	17	3,304
2007	2,188	965	190	252	14	3,609

Major Customer

Direct sales to the Nokia group of companies were 21 percent of our revenue in 2009, 18 percent of our revenue in 2008 and 16 percent of our revenue in 2007; if indirect sales such as to contract manufacturers are included, Nokia accounted for 21 percent, 20 percent and 19 percent of our 2009, 2008 and 2007 revenue. Revenue from sales to Nokia is reflected primarily in our Wireless segment.

Review Question Answers

1. The summary of significant accounting policies should disclose the

A. Incorrect. ASC 250-10-05, Accounting Changes and Error Corrections: Overall (FAS-154, Accounting Changes and Error Corrections—A Replacement of APB Opinion No. 20 and FASB Statement No. 3) states that the pro forma effect of retroactive application of an accounting change should be shown on the face of the income statement.
B. **Correct.** APB 22 (Disclosure of Accounting Policies) (ASC 235-10-05; 235-10-50-3) explicitly lists certain items as commonly required disclosures in a summary of significant accounting policies. These items include the basis of consolidation, depreciation methods, amortization of intangibles, inventory pricing, recognition of profit on long-term construction-type contracts, and recognition of revenue from franchising and leasing operations.
C. Incorrect. The adequacy of pension plan assets in relation to vested benefits is not a disclosure required by APB 22 (Disclosure of Accounting Policies) (ASC 235-10-05; 235-10-50-3).
D. Incorrect. The future minimum lease payments in the aggregate and for each of the five succeeding fiscal years should be disclosed but not in the summary of significant accounting policies.

2. Which of the following information should be disclosed in the summary of significant accounting policies?

A. Incorrect. In this case the refinancing of debt is a subsequent event to the balance sheet date, and it should be disclosed in the footnotes per the subsequent event rules.
B. Incorrect. Guarantees of indebtedness of others are not an accounting policy but is an item disclosed in the footnotes. Among other things, the guarantor must disclose maximum exposure in future payments to satisfy the guarantee, and the carrying value of the liability, if any, on the part of the guarantor.
C. **Correct.** APB 22 (Disclosure of Accounting Policies) (ASC 235-10-05; 235-10-50-3) requires that all significant accounting policies be disclosed as an integral part of the financial statements. These include recognition of revenue from franchising and leasing operations.
D. Incorrect. The adequacy of pension plan benefits is not an accounting policy but is an item disclosed in the footnotes.

3. The summary of significant accounting policies should disclose the

A. Incorrect. Maturity dates for debt would be disclosed in the balance sheet notes.
B. Incorrect. This information would more commonly be included in an equity note disclosure.

C. Incorrect. The summary of significant accounting policies does not duplicate details presented elsewhere in the statements.
D. **Correct.** APB 22 (Disclosure of Accounting Policies) (ASC 235-10-05; 235-10-50-3) explicitly lists certain items as commonly required disclosures in a summary of significant accounting policies. These items include the basis of consolidation, depreciation methods, amortization of intangibles, inventory pricing, recognition of profit on long-term construction-type contracts, and recognition of revenue from franchising and leasing operations.

4. Which of the following items should be included in Melay, Inc.'s summary of significant accounting policies for the current year?

A. **Correct.** Certain items are commonly required disclosures in a summary of significant accounting policies: (1) the basis of consolidation, (2) depreciation methods, amortization of intangible assets (excluding goodwill), inventory pricing, (5) recognition of profit on long-term construction-type contracts, and (6) recognition of revenue from franchising and leasing operations. Hence, the summary of significant accounting policies should include information about property, plant, and equipment depreciated by the straight-line method.
B. Incorrect. The sale of a segment is a transaction, not an accounting principle. It is reflected in the discontinued operations section on the income statement.
C. Incorrect. Specific segment information does not constitute an accounting policy. An accounting policy is a specific principle or a method of applying it.
D. Incorrect. Future dividend policy is a financial management policy decision.

5. Which of the following qualifies as a reportable operating segment?

A. Incorrect. A corporate headquarters is not an operating segment. Any revenues it earns are incidental to the entity's activities.
B. **Correct.** An operating segment engages in business activities, is reviewed by the company's chief operating decision maker, and has discrete financial information available. For an operating segment to be reportable, it must meet one or more of the following quantitative thresholds: (1) Reported revenue is at least 10% of the combined revenue of all operating segments; (2) reported profit or loss is at least 10% of the greater (in absolute amount) of the combined reported profit of all operating segments that did not incur a loss, or the combined reported loss of all operating segments that did report a loss; or (3) its assets are at least 10% of the combined assets of all operating segments. North American segment holds 12% of the company's assets and reports to the chief operating officer, so it meets the requirements of an operating segment.
C. Incorrect. This segment does not meet the asset, revenue, or profit (or loss) quantitative threshold to qualify as an operating segment.
D. Incorrect. This segment does not report to the chief operating decision maker.

6. Hyde Corp. has three manufacturing divisions, each of which has been determined to be a reportable operating segment. In Year 4, Clay division had sales of $3 million, which was 25% of Hyde's total sales, and had traceable operating costs of $1.9 million. In Year 4, Hyde incurred operating costs of $500,000 that were not directly traceable to any of the divisions. In addition, Hyde incurred interest expense of $300,000 in Year 4. The calculation of the measure of segment profit or loss reviewed by Hyde's chief operating decision maker does not include an allocation of interest expense incurred by Hyde. However, it does include traceable costs. It also includes nontraceable operating costs allocated based on the ratio of divisional sales to aggregate sales. In reporting segment information, what amount should be shown as Clay's operating profit for Year 4?

A. Incorrect. No amount of interest expense should be included in the calculation.
B. Incorrect. Clay's share of interest expense ($300,000 x 25% = $75,000) is excluded from the calculation of profit.
C. **Correct.** The amount of a segment item reported, such as profit or loss, is the measure reported to the chief operating decision maker for purposes of making resource allocation and performance evaluation decisions regarding the segment. However, the FASB does not stipulate the specific items included in the calculation of that measure. Consequently, allocation of revenues, expenses, gains, and losses are included in the determination of reported segment profit or loss only if they are included in the measure of segment profit or loss reviewed by the chief operating decision maker. Given that this measure for Clay reflects traceable costs and an allocation of nontraceable operating costs, the profit is calculated by subtracting the $1,900,000 traceable costs and the $125,000 ($500,000 x 25%) of the allocated costs from the division's sales of $3,000,000. The profit for the division is $975,000.
D. Incorrect. The allocated nontraceable operating costs must also be subtracted.

7. Bean Co. included interest expense and transactions classified as extraordinary items in its determination of segment profit, which Bean's chief financial officer considered in determining the segment's operating budget. Bean is required to report the segment's financial data in accordance with GAAP. Which of the following items should Bean disclose in reporting segment data?

A. Incorrect. Items that contribute to the profit and loss of a segment should be disclosed in the segment's data.
B. Incorrect. Interest expense affects the profit and loss of a business segment and should be reported.
C. Incorrect. Extraordinary items affect the profit and loss of a business segment and should be reported.
D. **Correct.** The objective is to provide information about the different types of business activities of the entity and the economic environments in which it operates. Disclosures include a measure of profit or loss and total assets for each reportable segment. Items that are typically

included are revenues from external customers and other operating segments, interest revenue and expense, depreciation, depletion, amortization, unusual items, equity in the net income of equity-based investees, income tax expense or benefit, extraordinary items, and other significant noncash items.

8. Opto Co. is a publicly traded, consolidated entity reporting segment information. Which of the following items is a required entity-wide disclosure regarding external customers?

A. **Correct.** Information about products and services and geographical areas is reported if it is feasible to do so. If 10% or more of revenues is derived from one external customer, (1) that fact, (2) the amount from each such customer, and (3) the segment(s) reporting the revenues must be disclosed.
B. Incorrect. The identity of the segment(s) reporting the revenues must be disclosed, not that of the customer.
C. Incorrect. The identity of any external customer, regardless of whether it meets the revenue criterion or is considered to be "major" by management, does not have to be disclosed.
D. Incorrect. The entity must disclose information about each major customer, that is, one providing at least 10% of revenues.

9. Dean Co. acquired 100% of Morey Corp. prior to Year 6. Dean and Morey are not issuers. During Year 6, they included in their separate financial statements the following: Dean Co. had officer's salaries of $75K, officer's expenses of $20K, loans to officers of $125K and intercompany sales of $150K. Morey had officer's salaries of $50K, officer's expenses of $10K, loans to officers of $50K and no intercompany sales. The amount reported as related party disclosures in the notes to Dean's Year 6 consolidated statements is

A. Incorrect. The interentity sales equal $150,000.
B. Incorrect. The officers' salaries and expenses equal $155,000.
C. **Correct.** GAAP require the disclosure of material related party transactions other than (1) compensation arrangements, (2) expense allowances, and (3) other similar items in the ordinary course of business. Related party transactions that are eliminated in consolidated or combined statements also are not required to be disclosed in those statements. Accordingly, the compensation arrangements (officers' salaries and expenses) and the intercompany sales, which will be eliminated in the consolidated statements, need not be disclosed. However, other transactions between an entity and its management, such as borrowings and lendings, must be disclosed. Dean should therefore report as related party disclosures the $175,000 ($125,000 + $50,000) of loans to officers. The Sarbanes-Oxley Act of 2002 generally prohibits an issuer, as defined by federal securities law, from extending credit to its directors and officers.
D. Incorrect. The officers' salaries and expenses plus the loans to officers equals $330,000.

10. Financial statements must disclose significant risks and uncertainties. The required disclosures include

A. Incorrect. Disclosures about the nature of operations need not be quantified.
B. Incorrect. A material financial statement effect need only be reasonably possible in the near term.
C. Incorrect. The criteria for required disclosures about significant estimates may not be met if the entity has successfully employed risk-reduction techniques. In these circumstances, disclosure of those techniques is encouraged but not required.
D. **Correct.** The current vulnerability due to concentrations must be disclosed if certain conditions are met. Disclosure is necessary if management knows prior to issuance of the statements that the concentration exists at the balance sheet date, it makes the entity vulnerable to a near-term severe impact, and such impact is at least reasonably possible in the near term. A severe impact may result from loss of all or a part of a business relationship, price or demand changes, loss of a patent, changes in the availability of a resource or right, or the disruption of operations in a market or geographic area.

11. Where in its financial statements should a company disclose information about its concentration of credit risks?

A. Incorrect. Disclosure in the basic statements is required.
B. **Correct.** An entity must disclose significant concentrations of risk arising from most instruments. These disclosures should be made in the basic financial statements, either in the body of the statements or in the notes.
C. Incorrect. Disclosure in supplementary information is normally done when certain entities are excluded from the scope of the requirements. However, the required disclosures are to be made by all entities.
D. Incorrect. Management's report to shareholders is not part of the basic statements.

12. On January 15, Year 2, before the Mapleview Co. released its financial statements for the year ended December 31, Year 1, it settled a long-standing lawsuit. A material loss resulted and no prior liability had been recorded. How should this loss be disclosed or recognized?

A. Incorrect. The loss must be recognized in the financial statements.
B. Incorrect. The audit report need not be modified.
C. Incorrect. Failure to recognize a material loss on an asset that existed at year-end is a departure from GAAP.

D. **Correct.** Subsequent events that provide additional evidence with the respect to conditions that existed at the balance sheet date, including the estimates inherent in preparing the financial statements, must be recognized in the current financial statements. Settlement of a lawsuit is indicative of conditions existing at year-end and calls for recognition in the statements.

13. In general, an enterprise preparing interim financial statements should

A. Incorrect. Seasonal revenue is not deferred. However, an entity with material seasonal fluctuations must disclose the seasonal nature of its activities and should consider making additional disclosures.
B. Incorrect. Inventory losses from nontemporary market declines must be recognized at the interim date. Recovery during the fiscal year is treated as a change in estimate.
C. Incorrect. Revenue is recognized as earned during an interim period on the same basis followed for the annual period.
D. **Correct.** Each interim period is viewed primarily as an integral part of an annual period. Ordinarily, interim results are based on the same principles applied in annual statements. Certain principles and practices used for annual reporting, however, may require modification so that interim reports may relate more closely to the results of operations for the annual period.

14. Wilson Corp. experienced a $50,000 decline in the market value of its inventory in the first quarter of its fiscal year. Wilson had expected this decline to reverse in the third quarter, and the third quarter recovery exceeded the previous decline by $10,000. Wilson's inventory did not experience any other declines in market value during the fiscal year. What amounts of loss or gain should Wilson report in its interim financial statements for the first and third quarters?

A. **Correct.** A market decline reasonably expected to be restored within the fiscal year may be deferred at an interim reporting date because no loss is anticipated for the year. Inventory losses from nontemporary market declines, however, must be recognized at the interim reporting date. If the loss is recovered later during the fiscal year (in another quarter), it should be treated as a change in estimate. The price recovery recognized is limited to the extent of the losses previously recognized.
B. Incorrect. Gains in the market value of inventory that are not recoveries of nontemporary declines are not recognized.
C. Incorrect. A loss reasonably expected to be restored in a later interim period is deferred.
D. Incorrect. Gains in the market value of inventory that are not recoveries of nontemporary declines are not recognized.

15. An inventory loss from a market price decline occurred in the first quarter. The loss was not expected to be restored in the fiscal year. However, in the third quarter the inventory had a market price recovery that exceeded the market decline that occurred in the first quarter. For interim financial reporting, the dollar amount of net inventory should

A. Incorrect. The recovery recognized in the third quarter is limited to the amount of the losses previously recognized.
B. **Correct.** A market price decline in inventory must be recognized in the interim period in which it occurs unless it is expected to be temporary, i.e., unless the decline is expected to be restored by the end of the fiscal year. This loss was not expected to be restored in the fiscal year, and the company should report the dollar amount of the market price decline as a loss in the first quarter. When a market price recovery occurs in an interim period, it should be treated as a change in estimate. The market price recovery recognized in the third quarter is limited, however, to the extent of losses previously recognized, whether in a prior interim or annual period. Accordingly, the inventory should never be written up to an amount above its original cost.
C. Incorrect. Assuming no market price decline had been recognized prior to the current year, the first quarter loss and the third quarter recovery would be offsetting. The recognized third quarter gain is limited to the amount of the first quarter loss, and the year-end results would not be affected.
D. Incorrect. The inventory amount is affected in both the first and third quarters.

16. During the first quarter of Year 4, Tech Co. had income before taxes of $200,000, and its effective income tax rate was 15%. Tech's Year 3 effective annual income tax rate was 30%, but Tech expects its Year 4 effective annual income tax rate to be 25%. In its first quarter interim income statement, what amount of income tax expense should Tech report?

A. Incorrect. Zero excludes any income tax expense.
B. Incorrect. The amount of $30,000 uses Tech's quarterly effective income tax rate.
C. **Correct.** At the end of each interim period, the entity should estimate the annual effective tax rate. This rate is used in providing for income taxes on a current year-to-date basis. Tech's ordinary income before taxes for the first quarter is $200,000, and the estimated annual effective tax rate for Year 4 is 25%. The provision for income taxes for the first interim period is therefore $50,000 ($200,000 x 25%).
D. Incorrect. The amount of $60,000 uses Tech's Year 3 effective annual income tax rate.