

As proposed, the disclosures required in the notes to the abbreviated financial statements are intended to be an extraction of all disclosures included in the registrant's full financial statements that are responsive to the matters specified by Item 305.²¹ Disclosures responsive to a particular matter may be located in several places in the notes to the full financial statements. Proposed Item 305 would require all disclosures included in the notes to the full financial statements that are responsive to a matter specified in Item 305 to be included in the notes to the abbreviated financial statements, regardless of the source of the underlying disclosure requirement or the location of the disclosure in the full financial statements. For example, requirements regarding the disclosure of accounting policies are primarily contained in Accounting Principles Board ("APB") Opinion No. 22,²² but various other FASB and AICPA pronouncements specifically require disclosure of accounting policies with respect to certain matters.²³ In practice, some registrants include all accounting policy disclosures in a single note, while others integrate certain accounting policy disclosures within the detailed disclosure of the matters to which the policies relate. Under the proposed requirements, registrants would have to identify and describe in the notes to the abbreviated financial statements all significant accounting policies used in the preparation of the financial statements, regardless of the particular manner in which they are presented in the notes to the full financial statements.

The specific matters proposed to be required in the notes to the abbreviated financial statements are as follows:²⁴

1. *Basis of presentation.* A note to the abbreviated financial statements would explain that although such statements were prepared using GAAP for measurement and classification, substantially all of the notes necessary for a fair presentation in accordance with GAAP and Regulation S-X have

been omitted.²⁵ The note also would state that the disclosures in the notes to the abbreviated financial statements are limited to those matters specified by Commission rules, and comply with Commission rules for presentation of abbreviated financial statements. The note would contain a reference to the complete note disclosures in the full financial statements.

2. *Accounting policies.* A description of all significant accounting policies used in the preparation of the financial statements, including a description of the accounting principles followed by the reporting entity and the methods of applying those principles that materially affect the determination of financial position, cash flows or results of operations, as specified by APB Opinion No. 22 and related pronouncements, would be provided.²⁶

3. *Changes in accounting principle.* The nature of, and justification for, a change in accounting principle, and the effects of the change, as specified by APB Opinion No. 20²⁷ and related pronouncements, would be furnished.

4. *Restatements and reclassifications.* The nature and effects of a correction of an error in previously issued financial statements, as specified by APB Opinion No. 20 and related pronouncements, would be furnished. Also, the nature and reasons for a change in the reporting entity, and effects of the change, as specified by APB Opinion No. 20 and related pronouncements, would be furnished. Further, the nature and effects of reclassifications materially affecting amounts reported in previously issued financial statements would be explained.

5. *Changes in accounting estimate.* The nature and effects of changes in accounting estimate, as specified by APB Opinion No. 20 and related pronouncements, would be furnished.

6. *Business combinations.* The nature of business combinations during the most recent fiscal year and quantitative disclosures of the effects of the business combinations, as specified by APB Opinion No. 16²⁸ and related pronouncements, would be furnished.

²⁵ The note to the abbreviated financial statements containing basis of presentation disclosures that is included by small business issuers in their delivery documents would refer only to GAAP since small business issuers are not required to comply with Regulation S-X.

²⁶ "Related pronouncement" as used throughout this section refers to a pronouncement constituting GAAP as defined in SAS No. 69 that requires disclosure regarding a matter that would have to be disclosed in the notes to the abbreviated financial statements under proposed Item 305 of Regulation S-X.

²⁷ *Accounting Changes.*

²⁸ *Business Combinations.*

7. *Discontinued operations.* The nature of business operations that were discontinued during the most recent fiscal year, and quantitative disclosures of the effects of the discontinuation, as specified by APB Opinion No. 30²⁹ and related pronouncements, would be furnished.

8. *Circumstances identified in explanatory language added to the independent accountant's standard report.* If the independent accountant's report on the entity's full financial statements includes explanatory language added to the standard report, a note would describe the circumstances identified in SAS No. 58³⁰ necessitating the explanatory language and would include all disclosure set forth in notes to the full financial statements that bears upon an understanding of those circumstances. Disclosure would also be provided for explanatory paragraphs that emphasize a matter regarding the financial statements.

9. *Loss contingencies.* If the entity is exposed to loss contingencies for which a loss exceeding the amount accrued in the financial statements is reasonably possible, a note would describe the nature of the loss and disclose either the amount or range of reasonably possible additional loss, or management's view that such amount or range of loss cannot be estimated, as specified by SFAS No. 5³¹ and related pronouncements.

10. *Events of default under credit agreements.* As presently required by Regulation S-X,³² the facts and amounts concerning any default in principal, interest, sinking fund, or redemption provisions with respect to any material issue of securities or credit agreements, or any breach of covenant of a related indenture or agreement, which default or breach existed at the date of the most recent balance sheet date being filed and has not been subsequently cured, would be described. If a default or breach exists but acceleration of the obligation has been waived for a stated period of time beyond the date of the most recent balance sheet being filed, the amount of the obligation and the period of the waiver would have to be stated.

11. *Related party transactions.* The nature of related party relationships, and a description of transactions, amounts and balances, as specified by

²⁹ *Reporting the Results of Operations—the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions.*

³⁰ *Reports on Audited Financial Statements.*

³¹ *Accounting for Contingencies.*

³² Rule 4-08(c) of Regulation S-X [17 CFR 210.4-08(c)].

statements. Registrants using abbreviated financial statements would be required to disclose supplementary financial information outside of the financial statements elsewhere in the disclosure document.

²¹ Proposed Item 305(b)(3) of Regulation S-K.

²² *Disclosure of Accounting Policies.*

²³ Disclosures responsive to a particular matter may emanate from requirements in various accounting pronouncements. SAS No. 69, *The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles in the Independent Auditor's Report*, defines the sources of accounting principles generally accepted in the United States.

²⁴ Proposed Item 305(b)(3)(i)–(xiii) of Regulation S-K.