

Statement of Financial Accounting Standards No. 126

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Exemption from Certain Required Disclosures about
Financial Instruments for Certain Nonpublic Entities

(an amendment of FASB Statement No. 107)

December 1996



Financial Accounting Standards Board
of the Financial Accounting Foundation
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Statement of Financial Accounting Standards No. 126

**Exemption from Certain Required Disclosures about Financial Instruments for
Certain Nonpublic Entities**

an amendment of FASB Statement No. 107

December 1996

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FAS 126: Exemption from Certain Required Disclosures about Financial Instruments for Certain Nonpublic Entities

an amendment of FASB Statement No. 107

FAS 126 Summary

This Statement amends FASB Statement No. 107, *Disclosures about Fair Value of Financial Instruments*, to make the disclosures about fair value of financial instruments prescribed in Statement 107 optional for entities that meet all of the following criteria:

- a. The entity is a nonpublic entity.
- b. The entity's total assets are less than \$100 million on the date of the financial statements.
- c. The entity has not held or issued any derivative financial instruments, as defined in FASB Statement No. 119, *Disclosure about Derivative Financial Instruments and Fair Value of Financial Instruments*, other than loan commitments, during the reporting period.

This Statement shall be effective for fiscal years ending after December 15, 1996. Earlier application is permitted in financial statements that have not been issued previously.

INTRODUCTION

1. The FASB received requests that it exempt certain entities from the requirements of FASB Statement No. 107, *Disclosures about Fair Value of Financial Instruments*. The Board concluded that the disclosures required by Statement 107 should be optional for certain nonpublic entities. The basis for the Board's conclusions is presented in the appendix to this Statement.

STANDARDS OF FINANCIAL ACCOUNTING AND REPORTING

2. Disclosures about the fair value of financial instruments prescribed in Statement 107 shall

be optional for an entity that meets all of the following criteria:

- a. The entity is a nonpublic entity.
- b. The entity's total assets are less than \$100 million on the date of the financial statements.
- c. The entity has not held or issued any derivative financial instruments as defined in FASB Statement No. 119, *Disclosure about Derivative Financial Instruments and Fair Value of Financial Instruments*, other than loan commitments, during the reporting period.

The criteria shall be applied to the most recent year presented in comparative financial statements to determine applicability of this Statement. If disclosures are not required in the current period, the disclosures for previous years may be omitted if financial statements for those years are presented for comparative purposes. If disclosures are required in the current period, disclosures about the fair value of financial instruments prescribed in Statement 107 that have not been reported previously need not be included in financial statements that are presented for comparative purposes.

3. For purposes of this Statement, a nonpublic entity is any entity other than one (a) whose debt or equity securities trade in a public market either on a stock exchange (domestic or foreign) or in the over-the-counter market, including securities quoted only locally or regionally, (b) that makes a filing with a regulatory agency in preparation for the sale of any class of debt or equity securities in a public market, or (c) that is controlled by an entity covered by (a) or (b).

4. This Statement does not change the requirements of FASB Statements No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, and No. 124, *Accounting for Certain Investments Held by Not-for-Profit Organizations* (including disclosures about financial instruments other than equity and debt securities that are measured at fair value in the statement of financial position), or any requirements, other than those specified in paragraph 2, for recognition, measurement, classification, or disclosure of financial instruments in financial statements.

Amendment to Statement 107

5. The following is added at the end of the second sentence of paragraph 7 of Statement 107:

but is optional for those entities covered by FASB Statement No. 126, *Exemption from Certain Required Disclosures about Financial Instruments for Certain Nonpublic Entities*.

Effective Date

6. This Statement shall be effective for fiscal years ending after December 15, 1996. Earlier application is permitted in financial statements that have not been issued previously.

**The provisions of this Statement need
not be applied to immaterial items.**

This Statement was adopted by the unanimous vote of the seven members of the Financial Accounting Standards Board:

Members of the Financial Accounting Standards Board:

Dennis R. Beresford, *Chairman*

Joseph V. Anania

Anthony T. Cope

John M. Foster

Gaylen N. Larson

James J. Leisenring

Gerhard G. Mueller

Appendix

BACKGROUND INFORMATION AND BASIS FOR CONCLUSIONS

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Appendix: BACKGROUND INFORMATION AND BASIS FOR CONCLUSIONS

Introduction

7. This appendix summarizes considerations that were deemed significant by Board members in reaching the conclusions in this Statement. It discusses reasons for accepting certain views and rejecting others. Individual Board members gave greater weight to some factors than to others.

8. The Board issued an Exposure Draft, *Elimination of Certain Disclosures about Financial Instruments by Small Nonpublic Entities*, on September 20, 1996. The Exposure Draft proposed making the disclosures prescribed by Statement 107 optional for nonpublic entities with total assets of less than \$10 million that do not hold or issue derivative instruments during the reporting period. The Board received 76 comment letters. The Board considered those comments and revised the Exposure Draft by clarifying this Statement's applicability and modifying the criteria for determining if the disclosures required by Statement 107 are optional. The Board concluded that it could reach an informed decision on the basis of existing information without a public hearing.

Benefits and Costs

9. The mission of the Board is to establish and improve standards of financial accounting and reporting for the guidance and education of the public, including issuers, auditors, and users of financial information. In fulfilling that mission, the Board strives to determine that a proposed standard will fill a significant need and that the costs imposed to meet that standard, as compared with other alternatives, are justified in relation to the overall benefits of the resulting information. Present and potential investors, creditors, and others benefit from improvements in financial reporting; however, the costs to implement a new standard may not be borne evenly by all parties. Further, the costs of not issuing a standard are impossible to quantify. Because there is no common gauge by which to judge objectively the costs to implement a standard against the need to improve information in financial statements, the Board's assessment of the costs and benefits of issuing an accounting standard is unavoidably subjective.

10. The Board has a commitment to consider potential disclosure differences between small and large companies on a case-by-case basis. ¹ The Board recognizes that there is an incremental cost of applying Statement 107. The Board has long acknowledged that the cost of any accounting requirement falls disproportionately on small entities because of their limited accounting resources and need to rely on outside professionals. ²

11. In paragraph 79 of Statement 107, the Board observed:

The Board considered whether certain entities should be excluded from the scope of this Statement. In particular, the Board considered the usefulness of the disclosures about fair value required by this Statement for small, nonpublic, or predominantly nonfinancial entities; a number of respondents to the 1990 Exposure Draft suggested exclusions on one or more of those bases. After considering the costs and benefits of those disclosures, the Board concluded that the disclosures are important and should be required for all entities, including small and nonpublic entities. The Board believes that the notion of "practicability" discussed in paragraph 15 ensures that excessive costs do not have to be incurred to comply with the disclosure requirements. In addition, the Board's decision to allow smaller entities additional time to apply the provisions of this Statement recognizes the fact that the costs of compliance can be reduced for those entities because the overall benefits of the information might be less than for larger entities.

12. Public accountants who serve smaller nonpublic entities informed the Board that the practicability provisions of Statement 107 have been useful in reducing the costs of complying with the Statement. However, they also reported that there is a cost of documenting compliance with the Statement, including the reasons why an entity concludes that estimating fair value is impracticable.

13. This Statement will result in some loss of information provided by the financial statements of certain nonpublic entities. However, the Board views that loss as temporary. The Board currently plans to address a number of issues involving the recognition and measurement of financial instruments. As those issues are resolved, the disclosures required by Statement 107 will change. The Board will have the opportunity to consider whether the entities to which this Statement applies should make the revised disclosures.

Fair Value Information in the Financial Statements of Smaller Nonpublic Entities

14. The Board has concluded in its Exposure Draft, *Accounting for Derivative and Similar Financial Instruments and for Hedging Activities*, that fair value is the most relevant measure for financial instruments. Nothing in this Statement changes that view. However, the Board concluded that the disclosures required by Statement 107 likely have limited utility to users of the financial statements of certain nonpublic entities. In reaching that conclusion, the Board considered (a) the types of financial instruments held by smaller nonpublic entities, (b) the extent to which those entities' financial statements already provide information about the fair value of financial instruments, and (c) the extent to which those entities make use of Statement 107's practicability provisions.

Types of Financial Instruments

15. Smaller nonpublic entities are less likely than larger entities to engage in complex financial transactions. Apart from cash and trade receivables, their financial assets tend to be traded securities, investments in other closely held entities, and balances with related parties. Their financial liabilities tend to be trade payables, variable-rate loans, and fixed-rate loans. In contrast, entities that engage in complex financial transactions or that have substantial risk associated with changes in the fair values of financial instruments are likely to use derivative financial instruments. This Statement does not apply to entities that held or issued derivative financial instruments, other than loan commitments, during the reporting period.

Information Already Provided in Financial Statements

16. The financial statements of entities covered by this Statement generally provide significant information about fair value of financial instruments, even without the requirements of Statement 107. Trade receivables and payables and variable-rate instruments are already carried at amounts that approximate fair value. Investments in securities addressed by Statements 115 and 124 are carried at fair value (as trading or available-for-sale) or, if carried at cost, the fair values are disclosed. Existing disclosures about fixed-rate long-term debt include information about interest rates and repayment terms. That information should allow users to estimate whether the fair value of the long-term debt is significantly different from the carrying amount.

Use of the Practicability Exception

17. The Board has been informed that smaller entities make frequent use of Statement 107's practicability exception when considering whether to disclose the fair value of many financial instruments, especially investments in other closely held entities and balances with related parties.

18. After considering the issues discussed in paragraphs 14-17, the Board concluded that, pending resolution of the underlying recognition and measurement issues, certain entities should have the option of not making disclosures mandated by Statement 107.

Factors Considered in Determining Scope

19. In considering which entities might be removed from the scope of Statement 107, the Board considered questions of size, financial activity, and ownership.

20. Previous FASB Statements that provided differential disclosure requirements have done so based on whether the entity is nonpublic. That criterion alone would have removed many large, nonpublic entities with complicated financial activities from the scope of Statement 107. The Board does not believe that it is appropriate to exempt those entities from the scope of Statement 107.

21. The Board decided that a size criterion was necessary to supplement the nonpublic criterion used in earlier pronouncements. The Exposure Draft proposed \$10 million of total assets. The majority of the respondents to the Exposure Draft said that that amount was too low. The Board considered the nature of financial instruments in smaller nonpublic firms that do not use derivative financial instruments and decided that a higher threshold was acceptable. The Board settled on \$100 million of total assets as an amount. In reaching its decision, the Board noted that exempting certain entities from current fair value disclosures is a practical matter and that the criteria used in paragraph 2 of this Statement are not meant to carry over into or influence future considerations about the usefulness of disclosures about financial instruments or other matters.

22. Some respondents said that total-asset size was not the best indicator of the relevance of disclosures about financial instruments. Some firms would not qualify for exemption as a result of having significant inventory or other physical assets. The Board considered changing the criterion to total financial instruments or to the amount of financial instruments not included within the scope of Statement 115 or Statement 124. While a criterion based on financial instruments may be more pertinent to the decision to exempt certain entities from the disclosure requirements in Statement 107, the Board decided that such a criterion would unnecessarily complicate the standard. The objective of this Statement is to reduce complexity for certain entities, and requiring them to make decisions as to what is and what is not a financial instrument would not contribute to that objective. A total-asset criterion is easier to apply and could accomplish much of the same effect.

23. A larger total-asset criterion also exempts more financial institutions and other entities with higher concentrations of financial instruments. Some Board members were concerned that disclosures about fair values of financial instruments are particularly relevant for those entities. However, the Board decided to exempt entities with less than \$100 million of total assets that meet the other criteria in this Statement. In reaching that decision, the Board considered (a) available evidence about the composition of assets at smaller financial institutions and (b) regulatory requirements for reporting fair values to the Federal Deposit Insurance Corporation.

24. The Board had concluded in the Exposure Draft that an entity that uses derivative financial instruments subject to the requirements of Statement 119 should remain within the scope of Statement 107. Statements 119 and 107 interact with one another, and their requirements are not easily separated. More important, an entity that uses derivative financial instruments is not, by virtue of its utilization of complex financial instruments, the type of entity to which this Statement is intended to apply. Several respondents to the Exposure Draft indicated that the definition of derivative financial instruments in Statement 119 includes loan commitments and, as such, many entities would be precluded from applying this Statement. The Board agreed that loan commitments should not preclude entities from applying the provisions of this Statement.

25. Some respondents noted that the Exposure Draft was not clear on whether disclosures are required when previous periods are presented for comparative purposes. The Board determined

that it would not be cost beneficial to provide information for periods presented for comparative purposes unless those disclosures were presented in prior periods and the disclosures prescribed by Statement 107 are required in the current period. The following table presents the requirements for disclosures when prior periods are presented in comparative financial statements.

If Disclosures for the Current Period Are:	And Disclosures for Prior Periods Were:	Then Disclosures for Prior Periods Presented in Comparative Statements Are:
Optional	Optional	Optional
Optional	Required	Optional
Required	Optional	Optional
Required	Required	Required

Footnotes

1

FAS126, Appendix, Footnote 1--"Board Responds to Concerns about 'Standards Overload,' "
FASB *Status Report*, No. 150, November 22, 1983.

2

FAS126, Appendix, Footnote 2--"FASB Analyzes Small Business Concerns about Accounting
Standards," FASB *Status Report*, No. 181, November 3, 1986.