What is the Full Disclosure Principle?

Worksheet

The full disclosure principle states that financial statements and their accompanying notes must include all material information - anything that could change how an informed user interprets the company's financial position or performance.

Questions

1. What does the full disclosure principle require?
A) Only the balance sheet needs to be accurate
B) All information that could affect a user's judgment must be reported
C) Only tax information needs to be disclosed
D) Disclosure is optional if the company is profitable

2. A pending lawsuit with an uncertain, reasonably possible outcome should be:
A) Ignored until resolved
B) Recorded as a definite liability
C) Disclosed in the notes as a contingent liability
D) Recorded as revenue

3. Where are most full-disclosure items reported?
A) In the CEO's letter
B) In the notes to the financial statements
C) In the marketing materials
D) Nowhere - they're kept private

4. A factory fire three weeks after year-end, before statements are issued, is an example of a:
A) Contingent asset
B) Subsequent event
C) Realization event
D) Consistency violation

5. A company is being sued for $2 million and the outcome is uncertain but the loss is reasonably possible. How should this be handled under full disclosure?

6. A company changes its inventory costing method from FIFO to weighted-average. What must full disclosure require?

7. Three weeks after year-end (before the financial statements are issued), a company's factory burns down. Should this appear anywhere in the annual report?

8. Define: What does the full disclosure principle require?

9. Define: Where do most disclosures under this principle appear?

10. Define: Give an example of something disclosed under full disclosure.

Answer Key

1. B) All information that could affect a user's judgment must be reported - Full disclosure requires reporting anything material to a reasonable user's decisions.
2. C) Disclosed in the notes as a contingent liability - Uncertain but reasonably possible losses are disclosed in notes, not booked as liabilities.
3. B) In the notes to the financial statements - Notes to the financial statements are the primary home for required disclosures.
4. B) Subsequent event - Material events after year-end but before issuance are 'subsequent events' and must be disclosed.
5. Since the loss is not probable and estimable enough to record as a liability, it isn't put directly on the balance sheet. Instead, it must be disclosed in the notes as a contingent liability, describing the nature of the claim and the potential exposure.
6. The notes must disclose the nature of the change, the reason for it, and its dollar effect on the financial statements. This lets users understand why reported numbers differ from prior periods.
7. This is a subsequent event that materially affects the company's financial position. Even though it happened after year-end, it must be disclosed in the notes as a subsequent event.
8. That financial statements and notes include all information that could affect a user's judgment.
9. In the notes to the financial statements, not the main statements themselves.
10. Contingent liabilities, like a pending lawsuit.