30 Cannon Street, London EC4M 6XH, United Kingdom
Phone: +44 (0)20 7246 6410 Fax: +44 (0)20 7246 6411
Email: iasb@iasb.org Website: http://www.iasb.org

International Accounting Standards Board

INFORMATION FOR OBSERVERS

Board Meeting:	**25 January 2007, London**
Project:	**Financial Statement Presentation (Phase B)**
Subject:	**Statement of changes in equity and other equity-related issues (Agenda paper 13D)**

INTRODUCTION

1. To date the Boards have discussed how information should be presented on the statement of financial position, the statement of comprehensive income, and the statement of cash flows. The staff has been waiting to finalize discussions related to those statements before addressing the statement of changes in equity—the fourth statement that the Boards agreed (in Phase A) should be a required financial statement. As the overall working format has been agreed to, in January the staff would like the Boards to discuss the statement of changes in equity as well as other issues that relate to the presentation of equity items and transactions with owners in the financial statements. Those issues are as follows:

    a. Whether the statement of comprehensive income should be expanded to include **all** changes in net assets including investments by and distributions to owners (Issue 1)

    b. What format the statement of changes in equity should take (Issue 2)

c. Whether the working format should be modified such that the equity category would be presented as a separate section distinct from the financing section (Issue 3)

d. Whether the Board should be pursuing another statement that would provide information about how capital is allocated (Issue 4)

e. Whether Board members are interested in pursuing a schedule that would present equity items (and possibly financing liabilities) at fair value (Issue 5).

ISSUE 1—POSSIBLE STATEMENT OF CHANGES IN NET ASSETS

2. As highlighted in the table below, under the working format the statement of financial position provides information about equity (owner) items and the statement of cash flows presents equity cash flows (from transactions with owners); however, the statement of comprehensive income does not include an equity category (transactions with owners). Thus, it could be said that the statement of comprehensive income is not cohesive with the other two statements. This issue addresses how, if at all, that lack of cohesiveness can be resolved.

Statement of Financial Position	Statement of Comprehensive Income	Statement of Cash Flows
Business Operating assets and liabilities Investing assets and liabilities	**Business** Operating income Investment income	**Business** Operating cash flows Investment cash flows
Discontinued operations	**Discontinued operations**	**Discontinued operations**
Financing Financing assets Financing liabilities ***Equity***	**Financing** Financing income Financing expenses	**Financing** Financing asset cash flows Financing liability cash flows ***Equity cash flows***
Income taxes	**Income taxes**	**Income taxes**

Statement of Changes in Net Assets

3. One alternative would be to expand the statement of comprehensive income to include changes in net assets that relate to transactions with owners (such as dividends declared) as well as transactions with nonowners—a statement of changes in net assets. That statement would be accomplished by adding a section for investments by and distributions to owners to the bottom of the statement of

comprehensive income. An example of a statement of changes in net assets follows (note: this is an abbreviated statement as it includes only subtotals for each section or category). As illustrated, the statement of changes in net assets would retain the distinction between owner and non-owner changes.

Statement of Changes in Net Assets	**2006**
Business	
Operating income	2855
Investment income	75
Business income	**2930**
Discontinued operations	**(5)**
Income taxes	**(485)**
Financing	
Financing expense	(260)
Financing Income	55
Financing expense	**(205)**
Total Comprehensive Income	**2235**
Equity	
Capital raising (warrants issued)	5
Capital distributions (dividends paid)	(355)
Net distributions to owners	**350**
Total Change in Net Assets	**1880**

4. One can make the following arguments for expanding the statement of comprehensive income to a statement of changes in net assets:

   a. It addresses the fact that because the statement of comprehensive income does not include an equity category, the financial statements as a whole are not entirely cohesive. Expanding the statement of comprehensive income to a statement of changes in net assets would result in both change statements (the cash flow and the comprehensive income statement) including transactions with owners and nonowners.

   b. It would permit owner changes and nonowner changes to be reported on the same statement but allow for those changes to be easily distinguished from each other. Presenting both of those changes in the same statement may be particularly helpful in the current environment where the line between liabilities and equity is not as clear cut as it used to be. (This is the rationale included in the CFA Institute Centre for Financial Market Integrity's Report, *A Comprehensive Business Reporting Model*, which recommends a statement of changes in net assets that is similar to the one illustrated above. That reports states that it is more effective and cost efficient if transactions with shareowners are recorded on a statement of changes in net assets rather than "relegated" to a separate statement or footnote disclosure.)

5. Board advisors at the May 2006 brainstorming sessions observed (and the Boards confirmed in December 2006) that the distinction between changes in net assets due to transactions with owners and those due to transactions with nonowners is important because those transactions have different priorities (that is, unlike nonowners, owners are not assured of a return nor are they capped from a loss). Board advisors suggested that combining those transactions in a statement of changes in net assets might blur that distinction. They also made the following comments:
   a. A statement of changes in net assets duplicates some of the information that is presented in a statement of changes in equity.
   b. The statement of changes in net assets is just a combination of two existing statements and does not represent an improvement in financial reporting.
   c. The statement of changes in net assets is not something that most users are asking for.
   d. Given the current mixed attribute model, the total "total change in net assets" does not provide useful information—some items are measured at cost and others at fair value—and the change does not reflect the actual value change during the period.
   e. A statement of net assets places less emphasis on net income and earnings per share (which are accounting artifacts) and more emphasis on the economic reality that analysts are looking for. However, it includes transactions with owners which may be better displayed in a statement of changes in equity.

Statement of Changes in Equity Paired with the Statement of Comprehensive Income

6. Another alternative would be to view the statement of changes in equity and the statement of comprehensive income as a pair that together are cohesive with the other two financial statements. To convey that view, the working format might be illustrated as shown below. The staff reminds the Boards that while the statement of changes in equity has yet to be addressed in Phase B of this project, in Phase A the Boards agreed that it should be one of the required financial statements. [Specifics related to the statement of changes in equity are addressed in Issue 2.]

Statement of Financial Position	Statement of Comprehensive Income	Statement of Cash Flows
Business Operating assets and liabilities Investing assets and liabilities	**Business** Operating income Investment income	**Business** Operating cash flows Investment cash flows
Discontinued operations	**Discontinued operations**	**Discontinued operations**
Financing Financing assets Financing liabilities ***Equity***	**Financing** Financing income Financing expenses	**Financing** Financing asset cash flows Financing liability cash flows ***Equity cash flows***
Income taxes	**Income taxes**	**Income taxes**
	Statement of Changes in Equity	

Staff Recommendation

7. The staff is of the view that while expanding the statement of comprehensive income to a statement of changes in net assets might make the financial statements seem more cohesive, the arguments for moving away from a statement of comprehensive income are not very compelling. For that reason and the reasons expressed at the brainstorming session, the staff recommends that the statement of comprehensive income not be expanded to become a statement of changes in net assets. The staff suggests that the statement of changes in equity be viewed together with the statement of comprehensive income, thereby making the set of financial statements cohesive and complete.

Questions for Board members: (Issue 1)

- **Should the statement of comprehensive income be expanded to include all changes in net assets including investments by and distributions to owners? If not, do Board members agree that viewing the statement of changes in equity and the statement of comprehensive income as a pair "resolves" the cohesiveness concern?**

ISSUE 2: STATEMENT OF CHANGES IN EQUITY

8. Regardless of whether the statement of comprehensive income is expanded to include information about transaction with owners, the staff is of the opinion that a statement of changes in equity should remain in the set of required financial statements. This issue addresses what information should be included in that statement and how that information should be presented.

The Current Guidance for a Statement of Changes in Equity

9. At the present time, SEC registrants that file a Form 10-K or Form 20-F are required by Rule 3-04 of Regulation S-X to provide information about changes in stockholders' equity (changes related to equity shares, additional paid-in capital, and retained earnings) in a separate statement or in a note for the same periods as required for, and audited to the same extent, as the statements of income. While it can be shown in a statement or a note, most of those SEC registrants find it more convenient to prepare a statement of shareholders' equity with separate columns for each class of capital shares, additional paid-in capital, and retained earnings. That statement reconciles the beginning and ending balances of all equity instruments as well as retained earnings and additional-paid-in capital (APIC).

10. While the Boards did not spend a lot of time in Phase A discussing the format of the statement of changes in equity, both Boards agreed to adopt a format similar to that required by the SEC in part because:

    a. It would be less of a burden for nonpublic entities in the United States as well as public entities to adopt the SEC format as many already use that format

    b. Presentation was inconsistent under IAS 1 because that standard permitted an entity to report the required information in a statement or in the notes.

    The March 2006 IASB Exposure Draft amending IAS 1 proposed that the presentation of the statement of changes in equity be similar to the presentation required by the SEC.

Staff Analysis

11. Consistent with the Boards' decision in Phase A, the staff is of the view that a statement of changes in equity should be based on the requirements found in Regulation S-X and should be required to be presented by all entities. However, the staff suggests that the Boards consider modifications to that format for:

    a. Items reported in additional-paid-in capital under U.S. GAAP which are recognized directly in equity under IFRS.

    b. Accumulated other comprehensive income.

Additional Paid-in Capital

12. Paid-in capital is the result of a number of different transactions. Under U.S. GAAP, there are three standards that require at least a portion of a transaction to be reported as paid-in capital (also referred to as additional-paid-in capital) and therefore more than one type of equity instrument is reported in paid-in capital. Those standards are:

    a. **APB Opinion No. 14*, Accounting for Convertible Debt and Debt Issued with Stock Purchase Warrants*, par. 16—**the portion of the proceeds of debt securities issued with detachable stock purchase warrants that are allocable to the warrants should be accounted for as paid-in capital.

    b. **FASB Statement No. 68, *Research and Development Arrangements*, par. 13—** when warrants or similar instruments are issued in connection with research and development arrangements, an entity is to report a portion of the proceeds to be provided by other parties as paid-in capital.

    c. **FASB Statement No. 123(R), *Share-Based Payment,* pars. 39 and 62-63—**the compensation cost for an award of share-based employee compensation classified as equity should be recognized over the requisite service period, with a corresponding credit to equity (generally, paid-in capital). In addition, the excess tax benefit should be recognized as additional paid-in capital.

13. Under both U.S. GAAP and IFRS, an entity may present certain capital transactions in the statement of changes in equity in more than one column or as a line item separate from the equity instruments that gave rise to them. The staff is of the view that any proceeds from capital transactions should be presented along with the instruments that gave rise to those proceeds rather than presented separately, for example, under a "paid-in capital" heading.

Accumulated OCI

14. At the October joint meeting, the Boards tentatively decided that the mechanism of recycling and, thus, OCI items should be retained, at least for the short-term. OCI items give rise to accumulated OCI, which is presented in the equity section of the statement of financial position. One of the criticisms of the current statement of changes in equity is that it is so congested with changes in individual OCI items (non-owner changes in equity) that the focus on owner changes is lost. The staff is of the view that accumulated OCI should be aggregated on the face of the statement of changes in equity so that the focus of that statement is on owner changes and that the details for each OCI item should be presented in the notes.

Staff Recommendation

15. In summary, the staff recommends that the statement of changes in equity include the following for each component of equity: a reconciliation between the carrying amount at the beginning and the end of the period, separately disclosing each change (such as contributions by and distributions to equity holders or conversions of one type of equity into another). An illustration of the proposed statement is included after paragraph 17.

16. In presenting that information, the staff recommends the following:
    a. Accumulated OCI should be aggregated, with details of each OCI item presented in the notes to financial statements.
    b. Any proceeds from capital transactions (such as additional paid-in capital) should be aggregated with the item to which it relates and not presented as a separate caption.
    c. Non-owner changes in equity should be aggregated and presented in one line item (or column) labeled *comprehensive income*.

17. As suggested by at least one Board member, and as illustrated below, the recommended format would require that transfers **between** owners be presented on the statement of changes in equity. That is, the statement would include a separate line for conversion of one type of equity into another. This is consistent with the general guidance provided in Rule 3-04 of Regulation S-X, on which the proposed statement is based on.

Statement of Changes in Equity					
	Common Stock*	***Warrants***	***Retained Earnings***	***Accumulated OCI***	***Total Shareholders Equity***
Balance at Dec. 31, 2004	**2200**		**500**	**45**	**2745**
Comprehensive Income			2280	35	2315
Issuance of Warrants		5			5
Dividends			(140)		(140)
Balance at Dec. 31, 2005	**2200**	**5**	**2640**	**80**	**4925**
Comprehensive Income			2240	(5)	2235
Conversion of Warrants		(5)			(5)
Issuance of Common Stock	5				5
Dividends			(355)		(355)
Balance at Dec. 31, 2006	**2205**	**0**	**4525**	**75**	**6805**

* Includes additional paid-in-capital

18. The staff notes that a statement of changes in equity might not be necessary if the Boards were to decide that a statement or schedule reconciling the changes in each balance sheet account were required to be included in the financial statements. That reconciliation will be discussed at a future Board meeting.

Non-controlling Interests

19. The entity used to develop the above illustration does not have any noncontrolling interests, thus the illustrated statement of changes in equity does not include a column for noncontrolling interests. The staff notes that in April 2006, as part of their joint business combinations project, the Boards affirmed the decisions related to the presentation of controlling and noncontrolling interests in the statement of changes in equity and the inclusion in the notes of a separate schedule that presents the effects of any transactions with noncontrolling interests on the equity attributable to the controlling interests. It is the staff's understanding that there are no other presentation issues to discuss related to the noncontrolling portion of the business combinations project. The staff plans to include illustrations that reflect the Boards' noncontrolling interest presentation decisions in the financial statement presentation preliminary views/discussion paper.

Questions for Board members: (Issue 2)

- **Do Board members agree that the statement of changes in equity should include details of the change in the beginning and ending balance of each component of**

equity as recommended by the staff (except for the various OCI items which are to be provided in the notes)?

- **Do Board members agree that proceeds from capital transactions should not be presented as a separate caption (for example, additional paid-in capital), rather it should be aggregated with the item to which it relates (for example, common stock)?**

ISSUE 3—WHETHER THE EQUITY CATEGORY SHOULD BE PRESENTED AS A SEPARATE SECTION DISTINCT FROM THE FINANCING SECTION

20. The Conceptual Framework team has raised the question of whether a hard and fast line should be drawn between liabilities and equity and whether it is possible to draw that line in a way that results in faithful representations of the items that fall on either side. (The staff notes that similar issues are being addressed in the liabilities and equity project.) In November, both Boards agreed that the Conceptual Framework team should further pursue an approach that would move toward defining the elements of the statement of financial position as assets and claims (debt and equity would be considered a single element—claims). This approach would result in blending owner and nonowner financing and it would be consistent with the current categorization scheme that includes equity items and changes in those items in the finance section.

21. A Board member has suggested that equity transactions should be reported separately from other financing activities in the statement of financial position and in the statement of cash flows to ensure transparency and cohesiveness among the financial statements. Following this paragraph is a comparison of the statement of financial position based on the working format and the suggested format; a similar comparison of the statement of cash flows is also presented. The differences between the two formats are highlighted (primarily the subtotal or total before equity items). The statement of comprehensive income is not included, as it does not have an equity section under the current working format or under the suggested format.

STATEMENT OF FINANCIAL POSITION CURRENT WORKING FORMAT	2006	2005	2004
BUSINESS			
Operating assets and liabilities			
Short-term:			
Accounts receivable	1,405	1,310	1,515
Inventory	825	630	915
Accounts payable	(1,215)	(845)	(1,250)
Net short-term operating assets	1,015	1,095	1,180
Long-term:			
PP&E	5,395	5,110	4,450
Identifiable intangible assets	850	975	1,100
Pension obligation	(335)	(295)	(225)
Goodwill	630	650	650
Net long-term operating assets	6,540	6,440	5,975
Net operating assets	7,555	7,535	7,155
Investing assets and liabilities			
Short-term:			
AFS securities	125	105	115
Long-term:			
Equity method investment	135	110	90
Net investing assets	260	215	205
Net business assets	7,815	7,750	7,360
DISCONTINUED OPERATIONS			
Discontinued operation assets	65	-	-
Discontinued operation liabilities	(105)	-	-
Net discontinued operation (liabilities)	(40)	-	-
INCOME TAXES			
Short-term:			
Income tax payable	(360)	(375)	(350)
Net short-term deferred tax asset	25	75	125
Net short-term income tax assets	(335)	(300)	(225)
Long-term:			
Net long-term deferred tax (liabilities)	(230)	(155)	(85)
Net long-term income tax (liabilities)	(230)	(155)	(85)
Net income tax (liabilities)	(565)	(455)	(310)
FINANCING			
Financing assets			
Short-term:			
Cash and cash equivalents	1,085	805	1,225
Interest receivable	25	20	15
Total financing assets	1,110	825	1,240
Financing liabilities			
Short-term:			
Interest payable	(40)	(30)	(25)
Commercial paper payable	(125)	(190)	(160)
Long-term:			
Bank loan payable	(1,350)	(2,975)	(5,360)
Total financing (liabilities)	(1,515)	(3,195)	(5,545)
Equity			
Common stock (APIC)	(2,205)	(2,200)	(2,200)
Warrants		(5)	
Retained earnings	(4,525)	(2,640)	(500)
Accumulated OCI	(75)	(80)	(45)
Total (equity)	(6,805)	(4,925)	(2,745)
Net financing (liabilities and equity)	(7,210)	(7,295)	(7,050)

STATEMENT OF FINANCIAL POSITION PROPOSED PRESENTATION - SEPARATE EQUITY SECTION	2006	2005	2004
BUSINESS			
Operating assets and liabilities			
Short-term:			
Accounts receivable	1,405	1,310	1,515
Inventory	825	630	915
Accounts payable	(1,215)	(845)	(1,250)
Net short-term operating assets	1,015	1,095	1,180
Long-term:			
PP&E	5,395	5,110	4,450
Identifiable intangible assets	850	975	1,100
Pension obligation	(335)	(295)	(225)
Goodwill	630	650	650
Net long-term operating assets	6,540	6,440	5,975
Net operating assets	7,555	7,535	7,155
Investing assets and liabilities			
Short-term:			
AFS securities	125	105	115
Long-term:			
Equity method investment	135	110	90
Net investing assets	260	215	205
Net business assets	7,815	7,750	7,360
DISCONTINUED OPERATIONS			
Discontinued operation assets	65	-	-
Discontinued operation liabilities	(105)	-	-
Net discontinued operation (liabilities)	(40)	-	-
INCOME TAXES			
Short-term:			
Income tax payable	(360)	(375)	(350)
Net short-term deferred tax asset	25	75	125
Net short-term income tax assets	(335)	(300)	(225)
Long-term:			
Net long-term deferred tax (liabilities)	(230)	(155)	(85)
Net long-term income tax (liabilities)	(230)	(155)	(85)
Net income tax (liabilities)	(565)	(455)	(310)
FINANCING			
Financing assets			
Short-term:			
Cash and cash equivalents	1,085	805	1,225
Interest receivable	25	20	15
Total financing assets	1,110	825	1,240
Financing liabilities			
Short-term:			
Interest payable	(40)	(30)	(25)
Commercial paper payable	(125)	(190)	(160)
Long-term:			
Bank loan payable	(1,350)	(2,975)	(5,360)
Total financing (liabilities)	(1,515)	(3,195)	(5,545)
Net financing (liabilities)	(405)	(2,370)	(4,305)
Total net assets	6,805	4,925	2,745
EQUITY			
Common stock (includes APIC)	(2,205)	(2,200)	(2,200)
Warrants		(5)	
Retained earnings	(4,525)	(2,640)	(500)
Accumulated OCI	(75)	(80)	(45)
Total (equity)	(6,805)	(4,925)	(2,745)

STATEMENT OF CASH FLOWS CURRENT WORKING FORMAT	2006	2005
Cash flows from business activities		
Operating		
Cash received from customers	15,380	15,105
Cash paid to suppliers and employees	(10,855)	(10,355)
Cash contributions to pension plan	(60)	(25)
Capital expenditure	(1,310)	(1,535)
Proceeds from sale of PP&E	500	400
Net cash provided by operating activities	3,655	3,590
Investing		
Acquisition of AFS securities	(25)	(30)
Proceeds from sale of AFS securities	60	100
Dividends received from equity method inv.	20	20
Net cash provided by investing activities	55	90
Net cash provided by business activities	3,710	3,680
Cash flows from discontinued operations		
Net cash used by discontinued operations	(810)	(1,105)
Cash flows from income taxes		
Net cash used in income tax activities	(375)	(350)
Cash flows from financing activities		
Financing assets		
Interest received	50	45
Net cash provided by financing assets	50	45
Financing liabilities		
Interest paid	(250)	(200)
Proceeds from short-term debt	230	400
Repayments of short-term debt	(295)	(370)
Proceeds from long-term debt	2,195	2,695
Repayments of long-term debt	(3,820)	(5,080)
Net cash used in financing liability activities	(1,940)	(2,555)
Equity		
Issuance of Warrants	-	5
Dividends	(355)	(140)
Net cash used in equity activities	(355)	(135)
Net cash used in financing activities	(2,245)	(2,645)
Change in cash and cash equivalents	280	(420)
Beginning cash and cash equivalents	805	1,225
Ending cash and cash equivalents	1,085	805

STATEMENT OF CASH FLOWS PROPOSED PRESENTATION - SEPARATE EQUITY SECTION	2006	2005
Cash flows from business activities		
Operating		
Cash received from customers	15,380	15,105
Cash paid to suppliers and employees	(10,855)	(10,355)
Cash contributions to pension plan	(60)	(25)
Capital expenditure	(1,310)	(1,535)
Proceeds from sale of PP&E	500	400
Net cash provided by operating activities	3,655	3,590
Investing		
Acquisition of AFS securities	(25)	(30)
Proceeds from sale of AFS securities	60	100
Dividends received from equity method inv.	20	20
Net cash provided by investing activities	55	90
Net cash provided by business activities	3,710	3,680
Cash flows from discontinued operations		
Net cash used by discontinued operations	(810)	(1,105)
Cash flows from income taxes		
Net cash used in income tax activities	(375)	(350)
Cash flows from financing activities		
Financing assets		
Interest received	50	45
Net cash provided by financing assets	50	45
Financing liabilities		
Interest paid	(250)	(200)
Proceeds from short-term debt	230	400
Repayments of short-term debt	(295)	(370)
Proceeds from long-term debt	2,195	2,695
Repayments of long-term debt	(3,820)	(5,080)
Net cash used in financing liability activities	(1,940)	(2,555)
Net cash used in financing activities	(1,890)	(2,510)
Cash flows from activities with non-equity holders	635	(285)
Cash flows from equity activities		
Issuance of warrants	-	5
Dividends	(355)	(140)
Net cash used in equity activities	(355)	(135)
Change in cash and cash equivalents	280	(420)
Beginning cash and cash equivalents	805	1,225
Ending cash and cash equivalents	1,085	805

22. Those who favor the proposed change to the working format are of the view that:

a. It clearly illustrates that owner financing is different from non-owner financing—as non-owner financing items are normally capped and receive higher priority in the event of bankruptcy.

b. The statements of financial position and cash flows (excluding the equity section) and the statement of comprehensive income all focus on the same set of activities—activities of the reporting entity with non-owners—that is, the group of activities that need to be reported to aid the user in making future cash flow predictions and valuations for the reporting entity.

c. Items presented in the financing section of the statements of financial position and the cash flow are presented in a more consistent (cohesive) manner with the statement of comprehensive income.

23. Those who do not favor the proposed change to the working format are of the view that:

   a. It presumes that the Board will conclude that equity should continue to be distinguished from debt in the liabilities and equity project.
   b. It makes a distinction that may be irrelevant to investors.
   c. It may give the appearance that the owners of the business are the common shareholders and that the common shareholders, not management, decide how the wealth of the business will be distributed.

Staff Analysis and Recommendation

24. The staff would like to approach this and all related issues within the confines of current GAAP. While issues being discussed in the framework project and the liabilities and equity project might influence Board member views, the Boards need to address presentation issues as they relate to current GAAP because the framework project is not that far along. If this project establishes the right principles, the presentation model should be adaptable to future changes in GAAP.

25. The staff is of the view that the current categorization scheme (with appropriate subtotals) can accomplish much of what the Board member is suggesting (the staff acknowledges that subtotals have not been discussed by the Board). That is, there could be a subtotal drawn within the financing section before the equity items are presented—thus providing the ability to look across the financial statements at information exclusive of transactions with owners—if Board members prefer to draw such a line.

26. In their deliberations so far, the Boards decided to include equity in the financing section because equity is a form of financing just as liabilities are. That delineation is also consistent with one of the primary working principles:

    > [P]resent information in a manner that separates an entity's financing activities from its business and other activities and **further separates financing activities into transactions with owners in their capacity as owners and all other financing activities** (emphasis added).

27. As noted in Issue 1, the staff is not overly concerned that there is not an equity category in the statement of comprehensive income. The staff notes that if the statement of comprehensive income and the statement of changes in equity are

viewed as a pair, that pair is cohesive with the statements of financial position and cash flows.

28. The staff is of the view that the current categorization scheme is most consistent with the working principle and therefore recommends that the financing section continue to include an equity category. However, if the Boards are inclined to follow the suggestion, the staff suggests that the labels for those sections be reconsidered—for example, the equity section could be titled "equity financing" and the financing section could be titled "debt financing."

Question for Board Members: (Issue 3)

- **Should equity items be presented separately in the financial statements or continue to be a category within the financing section?**

ISSUE 4—A STATEMENT THAT WOULD PROVIDE INFORMATION ABOUT HOW CAPITAL IS ALLOCATED

29. There has been some discussion about a possible new statement that would provide financial statement users with information about how capital is allocated/distributed. That statement might look like the following (which is based on a schedule prepared by a Board member but uses the working format categorization scheme):

Wealth Creation and Capital Allocation

Business		
Operating income		2,855
Investment income		75
Business Income		2,930
Discontinued Operations		(5)
Income Taxes		(485)
	Wealth Creation	2,440
Capital Allocation		
Financing Expense		205
Common dividends		355
Non-controlling interest		--
Other		--
	Residual	**1880**

30. This statement provides users with information about (a) changes in an entity's value during the current period (wealth creation) and (b) how that wealth (capital) is

allocated in the current period. The "total" on this statement is the residual wealth available for management and the board of directors to distribute as they deem appropriate in the future (for example, dividends to common shareholders, stock repurchases, or funds retained in the enterprise to fund future operations). The top section of this statement is similar to the statement of comprehensive income in that it focuses on value creation; however, the focus is on economic income, which excludes capital transactions. As explained to the staff, economic income consists of flows (cash and accruals) and changes in the value of stocks (assets and liabilities) that may be largely unrealized because many of those items are not remeasured. The bottom part of the statement presents the changes in capital—capital raised and capital distributed—and thus includes changes in financing assets and liabilities.

31. Those who favor this statement do so because it captures economic income and it shows how an entity's wealth is distributed among **all** capital providers, not just stockholders.

32. Those who do not favor this statement note the following:
    a. It does not include dividends that are declared but not paid because those distributions are not made in the current period
    b. It may be misleading because allocation of the residual is at the discretion of management and the board of directors and, therefore, the residual is not necessarily distributed to common stockholders
    c. It may infer that an allocation of capital in the current period is limited to wealth created during the current period when in fact there can be an allocation of capital even if there is a "loss" in the current period.

Questions for Board Members: (Issue 4)

- **Are Board members interested in pursuing a statement or supplemental schedule of this nature? If so, how (if at all) should it be modified?**

ISSUE 5: A SCHEDULE THAT WOULD PRESENT EQUITY ITEMS (AND POSSIBLY FINANCING LIABILITIES) AT FAIR VALUE

33. The current statement of changes in equity does not provide information about changes between ownership interests (the staff recommendation in Issue 2 would) nor does it consider debt instruments with characteristics similar to equity. One member of each Board has asked the staff to consider a schedule that would roll forward an entity's total capitalization (debt plus equity) at fair value. The two Board members are in agreement that that schedule should reconcile the beginning and ending fair values for all debt and equity instruments (including common stock) and that comparing the amounts reported on that schedule to the statement of changes in equity would allow users to assess whether conversion and possibly dilution is likely. The total capitalization schedule might look like the following:

Total Capitalization at Fair Value						
	Beg of Year	Issuances	Repurchases Expirations	Changes in Value	Distributions	End of Year
Non Redeemable Capital						
Common Stock[1]						
Preferred Stock						
Minority Interest						
Target Stocks						
Employee Stock Options						
Stock Purchase Warrants						
Subtotal						
Contingently Redeemable						
Preferred Stock						
Convertible Debt						
Subtotal						
Redeemable						
Debt						
Preferred Stock						
Subtotal						
Total Capitalization						

[1]This schedule includes paid in capital within the common stock category under the presumption that all paid in capital relates to the conversion to common stock.

34. Those who favor this statement note that:

   a. It better represents the economics of the entity.

   b. Public entities are likely to track the fair value information available for all of the items that would be presented in this schedule.

   c. It has the potential for providing investors with information about possible dilution of value.

d. It separately identifies capital sources that are non-redeemable, contingently redeemable, or redeemable.

35. Those who do not favor this statement note that:

a. Current GAAP does not require that all components of equity and debt be measured at fair value; as a result, companies may lack systems to be able to report that information. .

b. Many nonpublic companies may not have the fair value information available for all of the items that would be presented in this schedule.

c. While the schedule may be useful because it presents information at fair value, it may not have much relevance given the current mixed attribute reporting model (that is, fair value information is not available for all assets and liabilities).

d. While it provides information that may be useful to the holders of common stock, the schedule does not present information from the entity's perspective.

Staff View

36. Currently, many equity instruments are not reported at fair value, nor are instruments that are convertible to equity instruments reported at fair value prior to their conversion. While the proposed schedule might provide investors with useful information and could be limited to public companies that likely have this information available, the staff asserts that it may not be appropriate to require a schedule that presents fair value information about items that are not currently reported at fair value in a project that does not address measurement issues.

37. In addition, because the information in the supplemental schedule would not tie to the information on the other financial statements (because not all items are reported at fair value), the schedule would not articulate with the financial statements. Thus, the staff is not inclined to pursue this idea in this project any further.

Question for Board Members: (Issue 5)

- **Should the staff pursue further a schedule of this nature in the financial statement presentation project?**