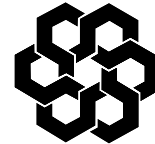

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International
Accounting Standards
Board

This document is provided as a convenience to observers at IASB meetings, to assist them in following the Board's discussion. It does not represent an official position of the IASB. Board positions are set out in Standards.
These notes are based on the staff papers prepared for the IASB. Paragraph numbers correspond to paragraph numbers used in the IASB papers. However, because these notes are less detailed, some paragraph numbers are not used.

INFORMATION FOR OBSERVERS

Board Meeting:	**19 June 2007, London**
Project:	**Financial Statement Presentation**
Subject:	**Presenting Information about the Cause of Change in Reported Amounts of Assets and Liabilities (Agenda Paper 3B)**

INTRODUCTION AND BACKGROUND

1. The purpose of this memorandum is to continue our discussion on applying the working principle that states: "Financial statements should present information in a manner that helps a user understand what caused a change in reported amounts of individual assets and liabilities." The Boards previously discussed this issue in October and December 2006 and in March 2007. A few cautionary reminders:

    a. As discussed previously, application of this working principle would most likely be achieved outside the primary financial statements (that is, in the notes to the financial statements).

    b. The Boards have yet to address the subtotals, totals, or order of information to be presented in the primary financial statements; thus the illustrations should not be viewed as illustrative of the Boards' views on those issues.

    c. The Boards decided to include in the discussion document more than one alternative for presenting other comprehensive income items. The alternative favored by the majority of FASB and IASB members is used for illustrative

purposes in this paper; other alternatives will be included in the discussion document.

2. At the October 2006 joint meeting, the Boards decided that the financial statements should provide information that will allow a user to distinguish between the various changes in assets and liabilities. The Boards noted that some of those changes are due to fair value changes and other changes in prices or estimates (that is, remeasurements), while other changes in assets and liabilities are not due to remeasurements. The Boards also directed the staff to consider which types of changes should be disaggregated, which should be aggregated, and the manner in which that information should be presented.

3. In December 2006, the FASB noted that the statement of cash flows may not be the most effective way to achieve the "cash flow" working principles (see below for the "cash flow" working principle relevant to this issue). The Board directed the staff to explore the possibility of presenting information similar to that currently presented using the direct method and the related reconciliation of operating income to cash flows from operating activities as part of a broader disclosure.

4. At the March 2007 meetings, the Boards decided that the cohesiveness principle should be applied at the line-item level, if practicable. That is, changes in individual line items on the statement of financial position should be linked to similarly classified line items on the statement of comprehensive income and statement of cash flows, to the extent possible. To achieve line-item cohesiveness, the Boards agreed to consider a reconciliation of beginning and ending statements of financial position. The main purpose of this reconciliation would be to provide information that would help users understand what caused a change in reported amounts of assets and liabilities.

5. The Boards decided that in determining what information should be disaggregated in that reconciliation, it would consider the characteristics of persistence and measurement subjectivity, as those are factors that a user takes into account when predicting future cash flows. As the Boards' leanings were in the direction of disaggregating the changes in assets and liabilities that are recognized in the

statement of comprehensive income, and it is the staff's understanding, through conversations with users, that those changes are the most important in predicting future cash flows, the subsequent staff analysis focused on those changes (herein referred to as *amounts recognized as income or expense*).

Advisory Group Input

6. In March, the Boards directed the staff to reach out to constituents to validate the Boards' tentative views and the staff's preliminary leanings on this issue. In May, the staff consulted with members—both users and preparers—of the project's Joint International Group (JIG) and Financial Institution Advisory Group (FIAG); the FASB's advisory council (FASAC), User Advisory Council (UAC), and Investors Technical Advisory Committee (ITAC); and the IASB's Analyst Representative Group (ARG). Again, the purpose of those consultations was to seek input on (a) what information should be presented about what caused a change in the reported amounts of assets and liabilities and (b) how that information could be best presented. Those discussions yielded valuable input that has been incorporated into this memorandum where relevant. [Sentence omitted from Observer Notes].

Structure of Memorandum/Agenda Paper

7. This memorandum/Agenda Paper is organized as follows:
    a. **Issue 1** discusses the basis on which to disaggregate amounts recognized as income or expense (including gains and losses) and asks the following questions:
        (1) Do the Boards agree with disaggregating changes in assets and liabilities recognized as income and expense based on whether the amount recognized as income or expense has predictive value?
        (2) Do the Boards agree that management is in the best position to determine whether amounts recognized as income and expense have predictive value?
        (3) If so, do the Boards agree that both predictive and not predictive amounts should be further disaggregated into fair value and other, resulting in the following four components:

    When reading Issue 1, Board members may want to think in terms of "columns" when they read the term *disaggregate,* as each of the alternatives discussed in Issue 2 would put the disaggregated information in separate columns on a potential supplemental schedule.

b. **Issue 2(a)** discusses how this disaggregated information can be presented in the financial statements and asks the following questions:

   (1) Do the Boards wish to present in the initial discussion document as a supplemental schedule in the notes to the financial statements:

      (a) A statement of financial position reconciliation?

      (b) A statement of comprehensive income matrix?

      (c) A reconciliation of statements of cash flows and comprehensive income?

   (2) Do the Boards wish to present one of the alternatives as their preliminary view? If yes, which alternative?

   For discussion purposes, Board members should presume that the information discussed in this memorandum will be presented in the notes to the financial statements.

c. **Issue 2(b)** discusses two application issues related to the statements of financial position reconciliation (that will only be addressed if the Boards are interested in including that reconciliation in the discussion document.)

8. Given the timetable of the financial statement presentation project (that is, an initial discussion document issued by the end of 2007), the staff is hopeful that this will be the last meeting in which this topic is discussed before the initial discussion document is issued. To the extent that issues remain unresolved or tentative decisions cannot be reached, the staff recommends that alternative views be presented in the initial discussion document on which respondents would be asked to provide input.

ISSUE 1: DISAGGREGATING CHANGES IN ASSETS AND LIABILITIES

Relevant Working Principles

9. The disaggregation working principle states that line items should be disaggregated "if that disaggregation enhances the usefulness of that information in predicting future cash flows." In applying that working principle, the Boards have reached the following preliminary views:

   a. Assets or liabilities that are measured differently would be presented in separate line items on the statement of financial position (that is, an entity would not be able to combine items with different measurement bases and present them in a single line item).

   b. An entity would be required to disaggregate information in the statement of comprehensive income based on (i) information based on the primary

activities (functions) in which it engages and (ii) within those functions, information about the significant related expenses by their nature.

10. This issue addresses disaggregating changes in assets and liabilities in a manner that will help users understand what caused a change in reported amounts of assets and liabilities—which will be a further application of the disaggregation working principle.

Basis on Which to Disaggregate Amounts Recognized as Income or Expense

11. In March, the staff recommended that information related to changes in assets and liabilities be disaggregated based on whether the information is assigned the same valuation multiple for the same reason. The staff based that recommendation on the view that a different valuation multiple represents a different assessment (predictive value) of the amounts, timing, and uncertainty of an entity's future net cash inflows.

12. The Boards agreed with the notion that predictive value is a reasonable basis for disaggregation, but the Boards were hesitant to develop a disaggregation principle that referred to the valuation multiple. The Boards' preliminary view was that amounts recognized as income or expense should be disaggregated based on the characteristics of *persistence* and *measurement subjectivity,* as those are the primary factors that a user takes into account in making future cash flows predictions. Although the Boards did not address this explicitly, the majority of Board members appeared to agree that the characteristic of persistence should be the first priority in disaggregating amounts recognized as income or expense.

Measurement Subjectivity

13. The staff asserts that assessing measurement subjectivity is in and of itself a highly subjective exercise. Representatives of the preparer community indicated to the staff that disaggregating amounts recognized as income or expense based on the characteristic of measurement subjectivity would be very difficult to operationalize and would require a significant amount of judgment in classifying transactions. As discussed with preparers, measurement subjectivity represents a continuum and almost all measurements of assets and liabilities include some degree of subjectivity. Thus, it would be difficult to objectively determine which amounts recognized as

income or expense an entity should disaggregate as subjective and which it should not. The users of financial statements that the staff spoke with concurred with the preparers, stating that subjectivity, while important, is very difficult because its evaluation is subject to bias itself. Users indicated that they are confident in assessing the subjectivity of some financial statement items based on the nature of that item (line item description). However, users are not confident in assessing the range of estimation error that accompanies that subjectivity. Based on discussions with both users and preparers, the staff believes that it would be difficult to define and operationalize a disaggregation scheme that relies on the notion of measurement subjectivity.

Persistence and Its Components

14. Given the Boards' leaning that persistence should be the first priority in disaggregating amounts recognized as income or expense and the practical difficulties in using measurement subjectivity as a means for disaggregation, the staff focused on further disaggregating based on the characteristic of persistence. For that purpose, the staff deemed a change persistent if:

    The transaction or event is likely to occur in future periods and the amount recognized in income or expense has predictive value.

    That is, the amount to be recognized in future periods will not necessarily be the same as the current amount, but should be useful in predicting those future amounts.

15. As defined above, there are two components of persistence—(a) the underlying event or transaction is *recurring* **and** (b) the amount recognized in income or expense has *predictive value*. An event or transaction can be considered recurring if (i) the transaction or event itself is repetitive or (ii) the measurement (or remeasurement) is repetitive because it is required or permitted by accounting standards.

16. While some use the terms *persistent* and *recurring* interchangeably, the staff is of the view that recurrence is only one aspect of persistence. That is, even though a transaction, event, or remeasurement may occur each reporting period, the amount recognized may not have predictive value. Therefore, if the current amount

recognized for a recurring transaction does not have predictive value, that transaction is not considered persistent.

17. Using the two components of persistence—namely, whether the amounts recognized as income or expense are **recurring** and have **predictive value**—the staff attempted to disaggregate amounts recognized in income or expense based on whether those amounts are recurring, have predictive value, or both. That is, changes could be either (a) predictive and recurring, (b) not predictive and recurring, or (c) not predictive and not recurring. (The predictive and not recurring set would be null—a change must be considered recurring in order to have predictive value.)

18. However, after considering this possible disaggregation scheme further, the staff came to the view that it would be nearly impossible to develop an operational definition of *recurring*. The staff believes that if *recurring* were used, the Boards would need to define what is meant by *recurring*—for example, how many times in a given time period must a transaction, event, or remeasurement take place in order to be considered recurring.

19. That difficulty led the staff to the view that the *predictive value* aspect of persistence should be the determining factor in deciding whether to disaggregate an amount recognized as income or expense. This is consistent with user views provided in May that excluding income and expense items that have little or no predictive value (little or no indication of future amount recognized) is "probably a better basis for forecasting."

Predictive Value

20. The following examples illustrate how the staff envisions the *predictive value* characteristic being applied:

    a. An entity enters into sales transactions during the year with its customers in the normal course of its operations. The entity's sales have been increasing by 7% the last four years. Sales are expected to continue at this rate. As the sales amounts in the current period would be useful in predicting the amounts recognized in future periods, the sales transactions would be considered to have predictive value.
    b. An entity is depreciating a building over twenty years. As depreciation expense recognized in the current period would be useful in predicting the

amount of depreciation expense in future periods, the expense would be considered to have predictive value.

c. An entity enters into a large sale with a customer that the entity did not have a previous relationship with. The sale was five times as large as any other sale completed during the period. Management does not believe that the relationship with the customer will continue and does not foresee a similar sale occurring in a similar amount in the near future. The amount of the sale would not be useful in predicting future amounts recognized as sales and, therefore, the amount does **not** have predictive value.

d. An entity hires new management and adopts a plan for restructuring. As part of the restructuring, the entity sets up a large restructuring reserve. The entity has not undergone many restructuring plans in the past and does not plan to again for the foreseeable future. As the restructuring reserve would not be useful in predicting future amounts recognized in income or expense, the reserve would **not** have predictive value.

21. The staff acknowledges that determining whether an amount recognized as income or expense has predictive value may require a certain level of judgment and management may have some level of difficulty making that determination. However, the staff believes that management is in the best position to make that determination, particularly since there are instances in which the type of business rather than the type or nature of the income or expense item might dictate whether an amount recognized as income or expense has predictive value or not. For example, a food retailer may consider an inventory impairment to be indicative of the inventory impairment in the next period. Likewise, a fashion retailer may believe that inventory will continue to be written down period after period. However, a seller of large machinery may consider an inventory impairment to be a one-time event that has no predictive value. Furthermore, while the food retailer’s inventory impairment may be considered to have predictive value, that retailer’s building impairment would likely **not** have predictive value. Thus, a one-size-fits-all rule, such as all impairments do not have predictive value, would be inconsistent with a goal of providing relevant information in the financial statements and having those statements serve as a communication tool for management.

22. In our discussions with users, the majority were of the view that management is in the best position to determine whether a current period amount has predictive value. Users indicated a willingness to allow management discretion in making that

determination (that is, in classifying amounts as having predictive value or not). The staff notes that putting that "classification" decision in the hands of management is consistent with the proposed management approach to classifying assets and liabilities into functional categories—that is, based on management's view of its business.

Further Disaggregation of Fair Value Amounts

23. Users of financial statements consistently have expressed an interest in segregating changes in fair value from other changes recognized in income or expense. As explained to the staff, users tend to view fair value adjustments as less relevant for forecasting because the value changes are out of management's direct control and due solely to market forces. For purposes of this discussion, fair value changes include all adjustments resulting from marking an asset or liability to fair value from fair value. The staff is of the view that all fair value changes, regardless of their placement in the fair value hierarchy (as described in FASB Statement No. 157, *Fair Value Measurements*), should be presented together. The majority of users the staff spoke to indicated a willingness to combine Level 3 fair value changes with Level 1 and 2 fair value changes even though Level 3 changes are not due solely to market forces. They stated that differentiating Level 3 changes from other fair value changes can be achieved better through Statement 157 or other similar disclosures.

24. A question for the Boards is whether, in applying the "what causes changes" working principle, fair value changes should be disaggregated from the other amounts recognized in income or expense. That is, should recognized amounts with predictive value and recognized amounts that do not have predictive value be further disaggregated into fair value changes and all other changes? The staff provides the following two alternatives:

    a. **Alternative A—Do Not Further Disaggregate Fair Value Adjustments**—Once amounts are classified as predictive or not, there would be no further disaggregation, thus fair value adjustments would be presented together with other amounts recognized as income or expense.

    b. **Alternative B—Disaggregate Fair Value Adjustments from Other**—Amounts classified as predictive and amounts classified as not predictive

would be further disaggregated into (a) fair value adjustments and (b) all other amounts. (Fair value adjustments would include Level 1, 2, and 3 changes.)

25. The staff considered whether all fair value changes should be considered to not have predictive value because one could argue that, by their nature, fair value adjustments on an individual instrument basis cannot be used to predict next period's fair value adjustment. However, the staff understands that some entities may view certain current fair value adjustments as having predictive value. For example, certain trading operations may argue (and rightfully so) that their fair value adjustments have predictive value, at least on a portfolio basis. The staff asserts that fair value changes that are actively managed by an entity (such as in a trading operation) have the potential to have predictive value. Accordingly, for those entities income and expense amounts classified as having predictive value and as not as having predictive value could both include fair value adjustments. The question is whether those fair value adjustments should be disaggregated from the other income and expense items. Given users' interest in segregating fair value changes (changes that are out of management's direct control) from other changes (that management can control), the staff believes that fair value changes should be disaggregated from other changes.

Staff Recommendation

Basis of Disaggregation

26. The staff recommends that amounts recognized as income or expense be disaggregated based on whether the amount recognized has predictive value. The staff is of the view that disaggregation on this basis will result in the most useful information and will not be costly to apply. As noted, the staff also considered disaggregating changes in assets and liabilities based on whether the change was recurring or subjective. The staff concluded that neither of those characteristics would be operational for purposes of disaggregating amounts recognized as income or expense. Disaggregation based on the predictive value of an amount recognized in income or expense will disaggregate information in a manner that enhances the usefulness of that information in predicting future cash flows.

Approach to Disaggregation

27. The staff believes that disaggregation on the basis of whether an income or expense amount has predictive value will allow management to communicate effectively information that is of keen interest of financial statement users. Thus, the staff recommends that the document describe what, in principle, is meant by predictive value and provide broad guidelines and examples. Management would, based on their view of the business, classify income and expense items as either having predictive value or not based on those guidelines. In addition, the staff recommends that management be required to disclose their rationale for classifying amounts as not having predictive value if that information is not provided elsewhere in the financial statements (such as in Statement 157 disclosures or management's discussion and analysis).

Disaggregation Components

28. The staff also recommends that both predictive and not predictive amounts recognized as income or expense be further disaggregated into (a) fair value adjustments and (b) all other changes. Disaggregation of amounts recognized as income or expense in this manner will help a user understand the cause of a change in reported amounts of assets and liabilities. The staff is of the view that users can rely on Statement 157 and other similar disclosures to distinguish between Level 1, 2, and 3 fair value changes. Thus, changes in assets and liabilities currently recognized as income or expense would be disaggregated into the following four components:

    Component I: Predictive changes—fair value
    Component II: Predictive changes—other than fair value
    Component III: Not Predictive changes—fair value
    Component IV: Not Predictive changes—other than fair value

Question for the Boards:

1. **Do the Boards agree with disaggregating changes in assets and liabilities recognized as income and expense based on whether the amount recognized as income or expense has predictive value?**

2. **If so, do the Boards agree that both predictive and not predictive amounts should be further disaggregated into fair value and other components?**

3. **Do the Boards agree that management is in the best position to determine whether amounts recognized as income and expense have predictive value?**

ISSUE 2: METHODS OF PRESENTING INFORMATION ABOUT CHANGES IN ASSETS AND LIABILITIES

29. Prior to March 2007, Board discussions on how to provide information that would help investors and other users of financial statements understand the cause of a change in reported amounts of assets and liabilities centered around a multi-column ("matrix") presentation on the statement of comprehensive income. In March, the staff introduced, and the Board agreed to further consider, a reconciliation of beginning and ending statements of financial position to provide that same (and additional) information. In June, the staff would like the Boards to consider yet another alternative—presenting a schedule that would link the amounts presented on the statement of cash flows and the statement of comprehensive income. Accordingly, the staff would like the Boards to consider the following three alternatives for presenting information about what caused a change in the reported amounts of assets and liabilities:

    a. **Alternative A**—Statement of Financial Position Reconciliation
    b. **Alternative B**—Statement of Comprehensive Income Matrix
    c. **Alternative C**—Reconciliation of the Statements of Cash Flows and Comprehensive Income

30. [Paragraph omitted from Observer Notes].

31. As mentioned at the outset, the staff is hopeful that the June meeting will be the last in which this topic is discussed before the initial discussion document is issued. To the extent that issues remain unresolved or tentative Board decisions cannot be reached, the staff believes that alternative views can be presented in the initial discussion document on which respondents would be asked to comment. Accordingly, the Boards will be asked (a) whether they wish to include each of these alternatives in the initial discussion document and, separately, (b) if they wish to indicate one alternative as the Boards' preliminary view.

32. This Issue 2 contains two sub-issues:

    a. Issue 2(a) presents the alternative formats for presenting the disaggregated information (based on the decisions in Issue 1)

    b. Issue 2(b) addresses certain issues unique to a possible statement of financial position reconciliation, which will need to be discussed if the Boards are interested in presenting that reconciliation in the initial discussion document.

Related Working Principles

33. In addition to describing the three possible formats, the following sections discuss those formats in terms of three of the project's working principles related to this issue (see below). While the original purpose for discussing this disaggregation issue was to apply working principle (2), the Boards expressed an interest in the formats helping to achieve (to varying degrees) principles (1) and (3).

Financial statements should present information in a manner that:

(1) Portrays a cohesive financial picture of an entity

(2) Helps a user understand what causes a change in reported amounts of individual assets and liabilities

(3) Helps a user assess the differences between cash transactions and accrual accounting.

Issue 2(a): Possible Presentation Formats

Alternative A—Statement of Financial Position Reconciliation

34. A reconciliation of statements of financial position would start with the beginning balance of a statement of financial position line item (that is, an individual asset, liability, or equity item), present disaggregated changes in the line item (based on the components discussed in Issue 1), and end with the ending balance of the line item. In addition to Components I-IV, a statement of financial position reconciliation requires disaggregation of changes in assets and liabilities that neither affect income or expense nor accompany cash. (The Boards acknowledged and agreed with this separate column, for reconciliation purposes, in March.) This column in the reconciliation would include typical non-cash transactions (such as converting debt to equity or obtaining an asset by entering into a capital lease), as well as transfers

between categories (for example, from the operating category to the discontinued operations category).

35. The reconciliation also includes captions from the statement of cash flows and the statement or comprehensive income that "links" the statement of financial position line items to those two statements. The captions are included so that the relationships among the financial statements are clear, at the line item level, to the extent practicable. This would be the application of the cohesiveness working principle at the line-item level.

36. [Paragraph omitted from Observer Notes].

37. While the statement of financial position reconciliation does not reconcile the statements of comprehensive income and cash flows on the line item basis (as is done in Alternative C), it does provide some information that would help a user assess the differences between cash transactions and accrual accounting—another one of the project's working principles. In Alternative A, the reconciling items between the statement of comprehensive income and statement of cash flows are arranged by what statement of financial position line item they affect—rather than by the differences between the two statements of cash flows and comprehensive income.

38. In addition to the cash aggregation issue described above, there are other difficulties in preparing a statement of financial position reconciliation. Those difficulties are discussed below.

Practical Difficulties in Preparing a Statement of Financial Position Reconciliation

Including foreign currency translation adjustments

39. As noted in Memorandum 52A/Paper 3A, at the March 2007 FASB Board meeting, the FASB indicated its preference to discuss how foreign currency translation adjustments (FCTAs) would be presented in the possible statement of financial position reconciliation before discussing the presentation of FCTAs in the statement of comprehensive income. At that Board meeting, it was suggested that a separate category should be presented in the statement of financial position reconciliation to explain the changes in the balance that is due to FCTAs. One question to consider is

whether the FCTA amounts should be allocated to each individual asset and liability in the reconciliation or whether the FCTA should be aggregated at some higher level. The staff's understanding is that a possible FCTA allocation relates only to the initial and subsequent recognition of FCTAs, as the derecognition of accumulated FCTAs (that is, recycling of the FCTAs) cannot be allocated to individual assets and liabilities.

40. One may argue that an allocation of FCTAs to individual assets and liabilities is inconsistent with the functional currency approach adopted in FASB Statement No. 52, *Foreign Currency Translation,* and IAS 21, *The Effects of Changes in Foreign Exchange Rates.* The Basis for Conclusions of Statement 52 states:

> Fundamental to the functional currency approach is the view that, generally, a U.S. enterprise is exposed to exchange risk to the extent of its net investment in a foreign operation. This view derives from a broad concept of economic hedging. An asset, such as plant and equipment, that produces revenues in the functional currency of an entity can be an effective hedge of debt that requires payments in that currency. Therefore, functional currency assets and liabilities hedge one another, and **only the net assets are exposed to exchange risk.** [Paragraph 94, emphasis added]
>
> If all of a foreign entity's assets and liabilities are measured in its functional currency and are translated at the current exchange rate, **the net accounting effect of a change in the exchange rate is the effect on the net assets of the entity.** That accounting result is compatible with the broad concept of economic hedging on which the net investment view is based. **No gains or losses arise from hedged assets and liabilities and the dollar equivalent of the unhedged net investment increases or decreases when the functional currency strengthens or weakens.** [Paragraph 95, emphasis added]

41. Preserving the view that FCTAs relate to the net assets (or equity) of the investment, allocating FCTAs to individual assets and liabilities can be thought of as "grossing up" the foreign currency translation adjustments. Grossing up amounts is not being representationally faithful to the concept that only net assets are exposed to the risk of foreign currency movements because it allocates risk to every asset.

42. In addition to the conceptual concerns described above, there are practical concerns the Boards need to consider. [Sentence omitted from Observer Notes].

43. The process of allocating FCTAs to individual assets and liabilities is cumbersome and is likely to require significant changes in information systems. It would be particularly costly when an entity does not use a single, average exchange rate for translating transactions and events for the period. Moreover, any systematic method of allocating the amount to individual assets and liabilities developed would be considered arbitrary and mechanical.
44. The staff is of the view that an allocation of FCTAs would enable the statement of financial position reconciliation to reconcile the beginning and ending balances of the individual assets and liabilities. However, considering the conceptual and practical concerns related to the allocation of FCTAs, the staff is not in favor of such an allocation. The staff notes that the effect of FCTAs can be presented as part of the "residual" in the reconciliation and, therefore, not allocating FCTAs does not necessarily mean that a statement of financial position reconciliation cannot be prepared.

Achieving line-item cohesiveness

45. As discussed in the agenda paper for the March meeting, cash transactions that directly affect income or expense are a complicating factor in preparing the reconciliation because cash is to be classified in a single category on the statement of financial position (at the reportable segment level). As described in that agenda paper, the amount presented as *cash provided by operating activities* on the statement of cash flows would not equal the total cash flows affecting operating assets and liabilities on the statement of financial position reconciliation if cash transactions were all presented in the financing assets category on the reconciliation. Thus, in order to achieve line-item cohesiveness, bookkeeping practices would likely need to change in order to get the cash transactions in the appropriate category on the reconciliation.
46. The staff notes that this line-item cohesiveness issue is only relevant when considering a possible statement of financial position reconciliation. This issue is not relevant when considering a possible comprehensive income matrix (Alternative B)

or a reconciliation of the statements of cash flows and comprehensive income (Alternative C).

Alternative B—Statement of Comprehensive Income Matrix

47. [Sentence omitted from Observer Notes]. The [statement of comprehensive income matrix does not reconcile the statements of financial position; rather it disaggregates the changes in assets and liabilities recognized in the statement of comprehensive income into the Components I-IV identified in Issue 1. Those same components are in Alternative A—the statement of financial position reconciliation [sentence omitted from Observer Notes]. The staff decided to re-explore the statement of comprehensive income matrix in light of the practical difficulties and relatively high costs of preparing a statement of financial position reconciliation.

48. While Alternative B provides the same information as Alternative A regarding the components of comprehensive income, it does not include a cash column, the related cash flow caption column, nor the statement of financial position line item related to each item on the statement of comprehensive income. Therefore, the relationships between the statement of financial position and the two change statements are lost. Thus, while the matrix achieves one of the working principles (it provides information about what causes a change in reported amounts of individual assets and liabilities), it does not further the cohesiveness working principle.

49. In addition, Alternative B does not provide information to allow a user to understand the difference between accrual accounting and cash transactions. However, if a reconciliation from *operating income* to *cash flows from operations* were to be provided in the statement of cash flows—as was tentatively agreed to by the Boards—information about accrual accounting would be captured in the statement of cash flows. In order to compare the comprehensive income matrix (Alternative B) with the other alternatives, one must consider that matrix coupled with a statement of cash flows, as the statement of cash flows provides some of the information that is missing in Alternative B when compared to Alternatives A and C.

50. Unlike Alternative A, in Alternative B there is no sense of having to “tick and tie” each of the line items in the statement of financial position. Another difference

between those two Alternatives is that the issues related to achieving line-item cohesiveness (for example, foreign currency translation adjustments and cash transactions) are not an issue with a statement of comprehensive income matrix; those are only an issue for a statement of financial position reconciliation.

Alternative C—Reconciliation of the Statements of Cash Flows and Comprehensive Income

51. A statement of comprehensive income matrix has advantages over a statement of financial position reconciliation in its ease of preparation. However, as noted above, a statement of comprehensive income matrix lacks one of the statement of financial position reconciliation's biggest advantages—its ability to link (or make cohesive) the three primary financial statements. In an attempt to compromise between the high cost of preparing a statement of financial position reconciliation and the increased usefulness resulting from the cohesiveness of that reconciliation, the staff explored the possibility of presenting a schedule that would reconcile two of the primary financial statements—namely, the statement of cash flows and the statement of comprehensive income.

52. This schedule—a reconciliation of the statements of cash flows and comprehensive income—would start with the amounts and line items presented in the statement of cash flows, provide details about items needed to reconcile to the statement of comprehensive income, and end with the amounts and line items presented in the statement of comprehensive income. [sentence omitted from Observer Notes] Board members should note that the reconciliation is from the statement of cash flows **to** the statement of comprehensive income. This is the reverse of how information is presented under the indirect method (that is, operating income is reconciled to cash flow from operations). Researchers have suggested that the "reverse" direction would provide information that is more useful and easier to understand and, accordingly, is likely to decrease forecast errors because, for example, (a) depreciation and amortization, which decrease comprehensive income, are presented with a negative sign, and (b) increases in assets (or decreases in liabilities) are presented with a positive sign.

53. One can view this reconciliation as presenting the comprehensive income matrix in another way (along with other additional information). That is, instead of first disaggregating information based on whether an amount has predictive value (as in done in Alternative B), Alternative C first disaggregates amounts based on whether they are due to a cash transaction. Then the non-cash amounts are disaggregated based on whether they have predictive value or not. Said differently, the first disaggregation in Alternative B is based on the predictive value characteristic, while the first disaggregation in Alternative C is based on whether cash flows are present. Disaggregating cash transactions from other transactions provides valuable information in that cash transactions are often viewed as being less subjective (more certain) and more capable of predicting future cash flows than income and expense amounts.

54. There are two categories of reconciling items between the statement of cash flows and the statement of comprehensive income:

    a. Cash transactions or events not recognized as income or expense
    b. Non-cash transactions or events recognized as income or expense.

    As category (b) items are recognized as income or expense during the period, those reconciling items can be disaggregated into the same components as the income and expense items in Alternatives A and B. Because all cash transactions (including those recognized in income and those not recognized in income—category (a) items) are already included in the statement of cash flows, those transactions are not further disaggregated into those components under the Alternative C reconciliation format. [Sentence omitted from Observer Notes]

55. Conversely, in Alternative B the total sales amount is broken down into its components. Thus, some may view Alternative C as not fully presenting information about what causes a change in reported amounts of individual assets and liabilities. However, what is gained over Alternative B is an identification of the amounts collected in cash during the current period. What is lost is the disaggregation of the [omitted from Observer Notes] sales received in cash into Components I-IV. Those who support Alternative C might argue that knowing the amount of cash flows during

the period is more informative than knowing whether an amount has predictive value, is due to a fair value change, or both.

56. The reconciliation of the statements of cash flows and comprehensive income helps achieve two of the project working principles—it (a) presents information about the differences between cash transactions and accrual accounting and (b) provides a link between two of the three primary financial statements. Importantly, Alternative C provides a meaningful reconciliation between the statement of cash flows and the statement of comprehensive income (at the line item level, where practicable). Alternative C presents the information that is currently required to be presented under both the direct and the indirect method of reporting cash flow from operations. The columns simply disaggregate the reconciling items. Thus, Alternative C could replace the statement of cash flows and eliminate the direct versus indirect method debate.

57. As explained in paragraph 54, one could view Alternative C as not fully achieving the "what caused the changes" working principle because it only provides "cause of change" information for the items needed to reconcile between the statement of cash flows and the statement of comprehensive income. Alternative B provides that "cause of change" information for all comprehensive income line items. Others view Alternative C as providing different, but more valuable information than Alternative B. For example, those that believe disaggregating cash flows is more useful than disaggregating predictive changes would presumably favor Alternative C as that Alternative captures information about cash flows that is not captured in Alternative B.

Advisory Group Input on Presentation Formats

58. At the time the staff spoke to preparers and users, Alternative C (reconciliation of the statements of cash flows and comprehensive income) had not yet been developed, thus advisory group members only received an illustration of the statement of financial position reconciliation (Alternative A) and the comprehensive income matrix (Alternative B). However, both groups were told that the staff was working on a reconciliation of the statements of cash flows and comprehensive income. [omitted

from Observer Notes] the following paragraphs briefly describe both prepare and user views on the alternative formats. There were both preparers and users who conceptually liked the idea of the statement of financial position reconciliation and urged the staff and Boards not to abandon it. However, almost all of the advisory group members the staff received input from said that the reconciliation is too detailed and complicated to be an effective communication tool. Preparers also commented on how complex it would be to prepare because of foreign currency translation, consolidation entries, and intercompany eliminations.

59. Almost all of the users the staff spoke to indicated a preference for providing information about changes in assets and liabilities from an income statement perspective. In addition, many noted that it would be best if there could be some connection provided between the income statement and the statement of cash flows. One user stated a preference for the comprehensive income matrix because he liked the balance between simplicity of presentation and the detail provided in one place. Some users expressed a preference for the matrix because it was more concise, more understandable, and easier to read—but acknowledged that it was less useful. About half of the users stated that it didn't matter whether the information presented about amounts recognized as income or expense were presented in a format that linked to other statements. Some users noted that the indirect method already provided a link between the income statement and the statement of cash flows.

Staff Recommendation

60. The staff recommends presenting more than one of the alternatives in the initial discussion document and seeking input on the alternative formats. However, if possible, the staff would like the Boards to express a preliminary view as to the preferable method of presenting information about what caused a change in the reported amounts of assets and liabilities. Accordingly, the following paragraphs aim to identify that preferred method.

61. Due to the practical difficulties, perceived high cost, and administrative burden imposed by a statement of financial position reconciliation (Alternative A), the staff believes that such a reconciliation would **not** be the best way to present information

about what caused a change in the reported amounts of assets and liabilities. In addition, users and preparers tended to agree that such a reconciliation was too complex and costly to be justified in terms of its added usefulness.

62. The staff notes that achieving line-item cohesiveness in this reconciliation will require certain practical accommodations that would be arbitrary, potentially less representationally faithful, and result in potentially less decision-useful information. However, because of the conceptual appeal of the reconciliation and the fact that it helps achieve three of the project working principles (particularly cohesiveness), the staff recommends that the statement of financial position reconciliation be included in the initial discussion document as an alternative that the Boards considered. Issue 2(b) addresses issues related to preparing the reconciliation if the Boards agree to include that alternative in the discussion document.

63. Both the comprehensive income matrix (Alternative B) and the reconciliation of the statements of cash flows and comprehensive income (Alternative C) could be significantly more cost-beneficial and impose less of an administrative burden on entities than would a statement of financial position reconciliation. The comprehensive income matrix only achieves the "what causes changes" working principle—it does not further the cohesiveness working principle or provide information about cash/accrual basis of accounting. On the other hand, the reconciliation of the statements of cash flows and comprehensive income does provide information about cash/accrual basis of accounting and also partially achieves the cohesiveness and "what causes changes" working principles. Thus, the staff's leaning is toward including a reconciliation of the statements of cash flows and comprehensive income (Alternative C) as the preferred presentation format in the discussion document.

64. For Board members who may prefer Alternative B over Alternative C because it fully meets the initial working principle the staff was trying to address, note the following:

    a. While the comprehensive income matrix (Alternative B) does not further the cash/accrual working principle, information about the differences between cash and accrual basis of accounting is currently provided in the statement of cash flows (either the direct method with a reconciliation or the indirect

method). FASB Board members were supportive of direct method of cash flows plus a reconciliation. IASB Board members were evenly split on the direct method and the indirect method. However, whether the direct or indirect method is ultimately used, information about cash/accruals will be provided in the statement of cash flows—it may not be presented as clearly as it would if Alternative C were used, but it is provided.

b. While Alternative B does not further the cohesiveness principle, that principle is being achieved in other ways: (1) line item descriptions on each of the financial statements are to be similar to the extent possible and (2) there is to be a consistent classification scheme (operating, investing, and financing) on the primary financial statements.

65. In discussing this issue, the staff considered whether the priority of the working principles might guide us to the "preferred" format. That is, if cohesiveness is the governing principle, one could argue that the Boards should not lean towards the comprehensive income matrix as it does not further that principle. However, if the cohesiveness principle could be considered secondary because it is already being achieved in other ways (consistent classification scheme and similar line item descriptions), then the comprehensive income matrix and the reconciliation of the statements of cash flows and comprehensive income are viable alternatives.

66. If the staff discards the statement of financial position reconciliation in all cases because it is too complex and, while not a working principle, simplicity and clear communication are clearly important in financial statement presentation, then one would lean toward:

    a. Alternative B if the "what causes changes" working principle is primary and the "cohesiveness" and "cash/accrual" working principles are adequately covered elsewhere in the financial statements, or
    b. Alternative C if the "understanding differences between cash and accruals" is primary and the "cohesiveness" and "what causes changes" working principles can also be (at least partially) achieved.

67. On balance, the staff recommends presenting Alternative C as the preferred method to present further disaggregated financial statement information as it (a) provides insights into what caused the changes in reported amounts of assets and liabilities, (b) more fully achieves the cohesiveness principle (particularly among the statement of cash flows and statement of comprehensive income), and (c) provides a meaningful reconciliation of cash flow information to income and expense information.

68. In summary, the staff recommends including Alternatives A, B, and C as part of the initial discussion document together with questions on which respondents would be asked to provide input on. The staff recommends that the Boards identify one of the Alternatives as the Boards' preferred approach; the staff recommends that Alternative C—the reconciliation of the statements of cash flows and comprehensive income—be identified as the preferred approach.

Question for the Boards:

4. **Do the Boards wish to present in the initial discussion document as a supplemental schedule in the notes to financial statements:**
    a. **A statement of financial position reconciliation?**
    b. **A statement of comprehensive income matrix?**
    c. **A reconciliation of statements of cash flows and comprehensive income?**
5. **Do the Boards wish to present one of the alternatives as their preliminary view? If yes, which alternative?**

Issue 2(b): Incorporating FCTA and Acquisitions and Disposals in a Statement of Financial Position Reconciliation (to be discussed if the Boards favor presenting a statement of financial position reconciliation in the initial discussion document)

Foreign Currency Translation Adjustments

69. Paragraphs 39-44 [omitted from Observer Notes] address how FCTAs could be presented in the statement of financial position reconciliation. As described earlier, the staff is of the view that the allocation of FCTAs would enable the statement of financial position reconciliation to indeed reconcile. However, considering the conceptual and practical concerns related to the allocation of FCTAs the staff recommends that FCTAs not be allocated to individual assets and liabilities in the statement of financial position reconciliation.

70. The staff notes that the effect of FCTAs can be presented as part of the "residual" in the reconciliation and, therefore, a decision not to require the allocation of FCTAs does not necessarily mean that a statement of financial position reconciliation cannot be prepared. [Sentence omitted from Observer Notes].

Acquisitions and Disposals

71. If, as recommended in Memorandum 52A/Paper 3A, a separate Acquisitions and Disposals section is to be presented in the statement of comprehensive income and the statement of cash flows, cohesiveness will not be fully achieved. That is, certain changes in assets and liabilities that are classified in a specific category on the statement of financial position would not be classified in that same category in those other statements. For example, certain income and expenses related to operating assets and liabilities would be presented in the "Acquisitions and Disposals" section rather than in the operating category.

72. The staff recommends that the changes in assets and liabilities that give rise to the Acquisitions and Disposals section should be classified separately from other changes in assets and liabilities in the potential statement of financial position reconciliation.

Staff Recommendation

73. The staff recommends the following:

    a. Foreign currency translation adjustments not be allocated to individual line items; the effects would be presented as a "residual" in the reconciliation

    b. Changes that give rise to the "acquisitions and disposals" section—business combinations and asset acquisitions—be presented separately in the reconciliation.

Questions for the Boards:

6. If the Boards wish to present a statement of financial position reconciliation, how should:

   a. Foreign currency translation adjustments be included in the reconciliation?

   b. The effects of business combinations and asset acquisitions be included in the reconciliation?