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International Accounting Standards Board

INFORMATION FOR OBSERVERS

Board Meeting: **15 November 2007, London**

Project: **Financial Statement Presentation**

Subject: **The statement of cash flows and the reconciliation schedule (Agenda Paper 7A)**

PURPOSE

1. The purpose of the November meetings on financial statement presentation is for the Boards to agree on the content of the initial discussion document related to the statement of cash flows and the reconciliation of the statement of cash flows to the statement of comprehensive income.

ISSUE 1: STATEMENT OF CASH FLOWS

Summary of Boards' Views to Date

2. Existing U.S. GAAP and IFRS require an entity to report investing, financing, discontinued operations, and income taxes based on receipts and payments of cash and cash equivalents (the direct method). Both standards encourage use of the

direct method but permit cash flows from operating activities to be reported using either the direct method or indirect method.

3. The FASB is of the view that an entity should be required to report cash flows from operations using the direct method, while the IASB is of the view that an entity should be encouraged, but not required to report cash flows from operations using the direct method. Both Boards agree that to the extent practical, an entity should use the same line items within the operating category on both the statement of comprehensive income and the statement of cash flows prepared under the direct method. Similar to the existing requirements in FASB Statement No. 95, *Statement of Cash Flows,* an entity would also be required to provide a reconciliation of cash flows from operations to operating income (the indirect schedule) to supplement the statement of cash flows presented using the direct method.

4. Consistent with existing guidance, an entity would disclose in the notes information about all significant activities of an entity during a period that affect recognized assets or liabilities but that do not result in cash receipts or cash payments in the period in the notes to financial statements. Those disclosures could be either narrative or summarized in a schedule, and they would clearly relate the cash and non-cash aspects of transactions involving similar items.

Input from Advisory Group Members and Recasting Participants

5. Preparers (particularly those who participated in the recasting exercise) expressed concerns about the cost of preparing a direct method statement of cash flows (and the reconciliation schedule) at the September 14, 2007 Joint International Group (JIG) and Financial Institutions Advisory Group (FIAG) meeting. At that same meeting, users expressed support for a cash flow statement prepared using the direct

method. There was a discussion of the benefits in the eyes of the users and the costs in the experience of the preparers.

6. There was also a discussion about a less costly way to present cash flows from operations in a direct manner—the "indirect direct" method. Preparer concerns have almost exclusively referred to the costs of accumulating voluminous cash flow information necessary to implement the "direct-direct" method—there has been little reference to obtaining similar information indirectly. Preparer participants at the recent JIG/FIAG meeting observed that preparing a direct method statement of cash flows based on the "indirect-direct" method would be much more tolerable. The users at that meeting expressed that they would be willing to sacrifice a small amount of exactness in order to achieve the direct method presentation and cohesiveness. Participants at the meeting also noted that companies listed in Australia and New Zealand were required to report actual receipts and payments of cash and successfully employed the "indirect-direct" method.

Staff Analysis

Approaches in Preparing the Direct Method Statement of Cash Flows

7. As discussed at the recent JIG/FIAG meeting, there are two approaches in preparing the direct method statement of cash flows, both of which are permitted under existing guidance:

   a. The **"bottom-up"** or **"cash ledger"** approach (some have referred to this approach as the 'direct-direct' method). Under this approach, cash receipts and payments are determined by aggregating the cash flows amount from the cash ledger.
   b. The **"top-down"** or **"financial statement"** approach (some have referred to this approach as the 'indirect-direct' method). Under this approach, cash receipts and payments are determined by adjusting revenue, expense, and gains and losses (items in the statement of comprehensive income) for the change in the related accrual (items in the statement of financial position) over the period.

8. The staff is of the view that the cost for preparing the direct method statement of cash flows under the "top-down" approach and the cost for preparing the indirect method statement of cash flows would not differ significantly. The staff acknowledges that the "bottom-up" approach may result in more accurate information. The "top-down" approach begins with the assumption that all line items in the statement of comprehensive income are cash flow transactions and are adjusted based on the changes in assets and liabilities. Accordingly, any errors in those adjustments would result in a net misstatement of zero, which is difficult to identify and correct. Nevertheless, the staff is of the view that both the "bottom-up" approach and the "top-down" approach should continue to be permitted to be used in preparing a direct method statement of cash flows.

Staff Recommendation

9. The staff understands that most Board members on a conceptual level prefer a direct method cash flow statement. However, IASB members would like to retain the indirect method alternative because of the costs related to the bottom-up approach to preparing a direct method cash flow statement. The staff is unaware of any reason other than cost-benefit consideration that leads to the conclusion that the direct method should be encouraged and the indirect method should be permitted.

10. The staff recommends that the initial discussion document include the following:

Preliminary Views

a. Describe the Boards' conceptual preference for presenting the statement of cash flows based on cash receipts and payments (the direct method)
b. Describe the two approaches (the "bottom-up" approach and the "top-down" approach) for preparing a direct method statement of cash flows
c. Acknowledge the assertions made about both the costs and benefits

Questions

d. Ask questions designed to solicit information about the costs and benefits associated with preparing a direct method statement of cash flows

e. Ask questions seeking input about entities for which a statement of cash flows may not be relevant (such as financial institutions), how that statement should be modified so that is relevant, or what information might be more relevant to be provided in place of the statement of cash flows
f. Ask questions about whether the indirect schedule should continue to be required when both the statement of cash flows is required to be presented under the direct method and the reconciliation of statement of cash flows to statement of comprehensive income is required

Illustrations

g. Include an illustration of the statement of cash flows presented based on the direct method (see page 1 of the Appendix)
h. Include an illustration of the statement of cash flows presented based on the indirect method (see page 1 of the Appendix).

__**Questions for the Boards**__

Question 1: Do the Boards agree with the staff's proposed approach for presenting the Boards' views about the statement of cash flows in the preliminary views document?

Question 2: Does the IASB have concerns about requiring the direct method, other than cost-benefit consideration, which it would like to include in the initial discussion document?

ISSUE 2: THE RECONCILIATION SCHEDULE

11. In June 2007, the Boards discussed three Alternatives for disaggregating changes in assets and liabilities: the statement of financial position reconciliation, the reconciliation of the statement of cash flows to the statement of comprehensive income, and the comprehensive income matrix. Of these Alternatives, the Boards indicated a preference for the reconciliation of the statement of cash flows to the statement of comprehensive income (the reconciliation schedule). That reconciliation schedule would start with the amounts and line items in the statement of cash flows based on the direct method, provide details about the items needed to reconcile to the statement of comprehensive income (disaggregated into the various

components), and end with the amounts and line items presented in the statement of comprehensive income. This format would link the two change statements and would provide information about the changes in assets and liabilities.

12. While both Boards agreed with the reconciliation schedule, the Boards differed on the reconciling items (columns). Their views are described below and illustrated in the Appendix.

FASB View

13. An entity would disaggregate the difference between cash flows and amounts reported in comprehensive income as follows: (columns C-F are non-cash items affecting income) (see illustration on page 2 of the Appendix):

Column B.	Cash flows not affecting income
Column C.	Contractual accruals (for example, changes in payables and receivables; those primarily due to timing differences)
Column D.	Other accruals, systematic allocations, and other non-remeasurements (for example, depreciation expense and bad debt provisions)
Column E.	Recurring fair value changes (as defined in FASB Statement No. 157, *Fair Value Measurements*; this category would include Level 1-3 changes in the Statement 157 hierarchy and would consist of marks of assets and liabilities to fair value from fair value)
Column F.	Remeasurements other than recurring fair value changes (remeasurements are changes in the carrying amount of an asset or a liability due to a change in a price or an estimate).

14. An entity would also disclose the amounts of any an unusual or infrequent event or transaction (as described APB Opinion No. 30, *Reporting the Results of Operations—Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions*):

    a. *Unusual* – the underlying event or transaction should possess a high degree of abnormality and be of a type clearly unrelated to, or only incidentally related to, the ordinary and typical activities of the entity, taking into account the environment in which the entity operates.

b. *Infrequent* – the underlying event or transaction should be of a type that would not reasonably be expected to recur in the foreseeable future, taking into account the environment in which the entity operates.

IASB View

15. An entity would disaggregate the difference between cash flows and amounts reported in comprehensive income as follows (columns C and D are non-cash items affecting income) (see illustration on page 3 of the Appendix):

    Column B. Cash flows not affecting income

    Column C. Valuation adjustments (that is, a change due to subsequent measurement of an asset or liability to a current value, which would include fair value)

    Column D. All other changes.

16. Because valuation adjustments can behave more like other changes in assets and liabilities for certain types of businesses, in preparing the reconciliation schedule the IASB would permit an entity, as a matter of accounting policy, to classify certain valuation adjustments as "other changes." For example, management may consider it more useful not to present inventory impairments as a valuation adjustment.

Input from Advisory Group Members

17. At the September 2007 JIG/FIAG meeting, users expressed overwhelming support for the reconciliation schedule but they were generally indifferent to the level of disaggregation, that is, the FASB view or the IASB view. They did express support for the unusual or infrequent events column in the FASB view. Preparers had trouble distinguishing between contractual accruals and other accruals (columns C and D in the FASB view) and questioned the benefits of such a separation.

Staff Analysis

18. If the Board's respective views are both included in the initial discussion document, the staff is concerned that the comments will focus on the number of columns in one view versus the other rather than the substance of the reconciliation schedule. Thus, the staff's preference is to illustrate only one view of the reconciliation schedule in the preliminary views document.

19. As illustrated on pages 2 and 3 of the Appendix, the two columns in the IASB view (C and D) are roughly a combination of the FASB's four columns (E+F and C+D). The staff recommends that the preliminary views document describe a reconciliation schedule requirement that combines the best attributes of the IASB view and the FASB view:

    a. At a minimum, an entity would disaggregate the reconciling items into the following four columns:

       Column B. Cash flows not affecting income
       Column C. Accruals and Systematic Allocations
       Column D. Recurring valuation changes[1]
       Column E. Remeasurements other than recurring valuation changes.

    b. An entity would **not** be able to classify valuation adjustments in the accruals column based on the view that the alternative classification would be more useful. (That is, the staff would not include this aspect of the IASB view in the disclosure requirement but ask a question about it in the preliminary views document.)

    c. An entity would identify unusual or infrequent events or transactions in the right-most column of the reconciliation (consistent with how those terms are defined in Opinion 30).

20. An illustration of this converged view can be found on page 4 of the Appendix to this memorandum. The staff acknowledges that "contractual accruals" (column C

[1] The staff notes recurring valuation changes are intended to include only marks of assets and liabilities to fair value from fair value as defined by Statement 157.

in FASB view) are conceptually different than "other accruals, systematic allocations and other non-remeasurements" (column D in FASB view). However, the staff has received feedback from preparers who expressed concern over the practicability of distinguishing the two columns. The staff is of the view that combining columns C and D (as in the converged view, column C) does not result in significantly less information because the line items will help users identify the nature of the revenue or expense. For example, even though depreciation expense will be categorized with contractual accruals, it will be clear to a user that depreciation expense represents a systematic allocation, not a contractual accrual.

21. The staff notes that separating recurring fair value changes (column E in the FASB view) from remeasurements other than recurring fair value changes (column F in the FASB view) is a departure from the IASB's expressed preference (all valuation adjustments in the same column). The staff is of the view that separating recurring fair value changes from other valuation changes adds information content to the reconciliation schedule. The important distinction is that items for which the value will change each period following a "random walk" (column D in converged view) will be separated from items for which the change in value may or may not be more persistent (column E in converged view).

Staff Recommendation

22. The staff recommends that the preliminary views document include the following items related to the reconciliation schedule:

Preliminary Views

a. Describe the reconciliation schedule as the Boards' preference, its objectives, benefits, related costs, and a description of the rationale for disaggregating changes in the manner suggested

b. If the Boards decide to include both the IASB and FASB views of the reconciliation schedule, a discussion focused on the differences between the two views
c. A description of the statement of financial position reconciliation and the comprehensive income matrix

Illustrations

d. An illustration of the reconciliation schedule (see pages 2-4 of the Appendix)
e. An illustration of the statement of financial position reconciliation and the comprehensive income matrix (see pages 5-6 of the appendix)

Questions

f. Questions on the reconciling items (columns), including the definitions of the columns, and if the Boards decide to include the IASB and FASB views of the reconciliation schedule, which view should be adopted
g. A question on whether an entity, as an accounting policy, should be permitted to present certain items in other columns
h. A question on whether the description provided by APB Statement 30 is appropriate for the unusual or infrequent events column or whether the description should provide more flexibility.

Question for the Boards

Question 3: Do the Boards want to include a converged view of the reconciliation or both the IASB and FASB views in the preliminary views document?

a. If the IASB wants to retain its current view, should it be modified in any way (for example, to include unusual/infrequent column)?

b. If the FASB wants to retain its current view, should it be modified in any way (for example, combine contractual accruals (column C) and other accruals/allocations (column D))?

These illustrations are presented for discussion purposes only and should be read only in the context of the meeting papers. Not all aspects of the sample financial statements have been discussed by or represent the current position of the Boards (and those that have are subject to change). Specifically, the Boards have yet to discuss subtotals, totals, and the order in which the sections and categories are presented.

STATEMENT OF CASH FLOWS (DIRECT)

	2006	2005
Cash flows from business activities		
Operating		
Cash received from sales	2,700,000	2,511,000
Cash paid for goods sold		
Inventory purchases	(1,750,000)	(1,627,500)
Labor	(110,000)	(102,300)
Total	(1,860,000)	(1,729,800)
Cash paid for selling activities		
Compensation	(85,000)	(79,050)
Contributions to pension plan	(700)	(651)
Other expenses	(45,000)	(41,850)
Total	(130,700)	(121,551)
Cash paid for general and admin activities		
Rent	(120,000)	(111,600)
Contributions to pension plan	(500)	(465)
Total	(120,500)	(112,065)
Cash flows from other operating activities		
Compensation	(15,000)	(13,950)
Sale of receivables	1,200	-
Research and development	(1,120)	(845)
Capital expenditures	(500,000)	(250,000)
Received from sale of building	17,500	-
Other expenses	(55,000)	(51,150)
Total	(552,420)	(315,945)
Net cash provided by operating activities	36,380	231,639
Investing		
Purchase of investment in affiliates	(710,000)	-
Puchase of available-for-sale securities	(185,000)	-
Sale of available-for-sale securities	5,000	-
Dividends received	9,250	8,603
Net cash used in investing activities	(880,750)	8,603
Net cash used in business activities	(844,370)	240,242
Cash flows from Discontinued Operations		
Net cash flow from disc. Ops. (pre-tax)	(20,000)	
Cash flows from financing activities		
Financing liabilities		
Dividends paid	(35,000)	(32,550)
Interest paid	(125,000)	-
Proceeds from issuance of short-term debt	500,000	-
Proceeds from issuance of bonds	2,500,000	-
Net cash provided by financing activities	2,840,000	(32,550)
Cash flows from income taxes		
Net cash used in income tax activities	(54,639)	(50,814)
Change in cash	1,920,991	156,877
Beginning cash	4,000,000	3,843,123
Ending cash	5,920,991	4,000,000

STATEMENT OF CASH FLOWS (INDIRECT)

	2006	2005
Cash flows from business activities		
Operating		
Net cash provided by operating activities	36,380	231,639
Adjustments to reconcile		
Net cash provided by operating activities		
to comprehensive operating income		
Change in operating assets/liabilities:		
Accounts receivable	247,600	207,984
Less: Allowance for bad debts	(5,278)	(4,434)
Accounts payable	475,000	412,599
Accrued liabilities	(50,000)	(42,000)
Advances from customers	(175,000)	(147,000)
Current portion of lease liability	(9,208)	(7,735)
Inventory	(446,250)	(274,850)
Interest payable	(50,000)	
Share-based compensation liability	(7,500)	(6,300)
Asset retirement obligation	(9,255)	(7,774)
Loss contingency	(2,600)	(2,184)
Leased asset	25,756	21,635
Lease liability (excl current portion)	(24,870)	(20,891)
Accrued pension liability	(2,400)	(2,016)
Building	632,755	262,512
Less: Accumulated depreciation	(156,500)	(131,598)
Comprehensive operating income	478,630	489,588
Investing		
Purchase of investment in affiliates	(710,000)	-
Puchase of available-for-sale securities	(185,000)	-
Sale of available-for-sale securities	5,000	-
Dividends received	9,250	8,603
Net cash used in investing activities	(880,750)	8,603
Net cash used in business activities	(844,370)	240,242
Cash flows from Discontinued Operations		
Net cash flow from disc. Ops. (pre-tax)	(20,000)	
Cash flows from financing activities		
Financing liabilities		
Dividends paid	(35,000)	(32,550)
Interest paid	(125,000)	-
Proceeds from issuance of short-term debt	500,000	-
Proceeds from issuance of bonds	2,500,000	-
Net cash provided by financing activities	2,840,000	(32,550)
Cash flows from income taxes		
Net cash used in income tax activities	(54,639)	(50,814)
Change in cash	1,920,991	189,427
Beginning cash	4,000,000	3,843,123
Ending cash	5,920,991	4,000,000

Note: the operating section of this statement can be seen as the indirect schedule that is provided if the direct method is used

These illustrations are presented for discussion purposes only and should be read only in the context of the meeting papers. Not all aspects of the sample financial statements have been discussed by or represent the current position of the Boards (and those that have are subject to change). Specifically, the Boards have yet to discuss subtotals, totals, and the order in which the sections and categories are presented.

RECONCILIATION OF THE STATEMENTS OF COMPREHENSIVE INCOME AND CASH FLOWS (FASB View)

	A	B	C	D	E	F	G		I
FASB View			Non Cash Items Affecting Income						
	Cash Flows	Cash Flows Not Affecting Income	Contractual Accruals	Other Accruals, Systematic Allocations, and Other Non-Remeasurements	Recurring Fair Value Changes	Remeasurements Other than Recurring Fair Value Changes	Comprehensive Income (A-B+C+D+E+F)		Unusual or Infrequent Events or Transactions
CASH FLOWS FROM BUSINESS								**BUSINESS**	
Operating								**Operating**	
Cash received from sales	2,700,000		75,000				2,775,000	Sales	
Cash paid for goods sold								Cost of goods sold	
				(446,250)			(446,250)	Change in inventory	
Inventory purchases	(1,750,000)		475,000				(1,275,000)	Materials	
Labor	(110,000)						(110,000)	Labor	
				(100,000)			(100,000)	Overhead - depreciation of buikding	
				(5,944)			(5,944)	Overhead - depreciation of leased asset	
			(50,000)				(50,000)	Interest expense	
Total	(1,860,000)		425,000	(552,194)			(1,987,194)	Total	
							787,806	Gross profit on sales	
Cash paid for selling activities								Selling expenses	
Compensation	(85,000)						(85,000)	Compensation expense	
Contributions to pension plan	(700)			(1,300)			(2,000)	Pension expense	
				(9,358)		3,080	(6,278)	Bad debt expense (decreased allowance)	
Operating expenses	(45,000)		(25,000)				(70,000)	Other operating expenses	
Total	(130,700)		(25,000)	(10,658)		3,080	(163,278)	Total	
Cash paid for general and admin activities								General and administrative expenses	
Rent	(120,000)						(120,000)	Rent expense	
Contributions to pension plan	(500)			(1,100)			(1,600)	Pension expense	
					(7,500)		(7,500)	Stock compensation expense	
				(77,000)			(77,000)	Depreciation expense	
				(500)			(500)	Accretion expense on ARO	
Total	(120,500)			(78,600)	(7,500)		(206,600)	Total	
Cash paid for other operating activities								Other operating expenses	
Compensation	(15,000)						(15,000)	Compensation expense	
				(2,600)			(2,600)	Litigation expense	(2,600)
			(2,378)				(2,378)	Interest expense on lease liability	
Sale of receivables	1,200			(1,600)		200	(200)	Loss on sale of receivables	
Research and development	(1,120)						(1,120)	Research and development	
Sale of building	17,500					(15,500)	2,000	Gain on sale of building	
Capital expenditures	(500,000)	(500,000)							
Other expenses	(55,000)		(25,000)				(80,000)	Other operating expenses	
Total	(552,420)	(500,000)	(27,378)	(4,200)		(15,300)	(99,298)	Total	
Net cash provided by operating activities	36,380	(500,000)	447,622	(645,652)	(7,500)	(12,220)	318,630	Total operating income	
								Other comprehensive income	
						160,000	160,000	Gain on revaluation of building	
							160,000	Total other comprehensive income	
Net cash provided by operating activities	36,380	(500,000)	447,622	(645,652)	(7,500)	147,780	478,630	Comprehensive operating income	
Investing								**Investing**	
				12,250			12,250	Equity in earnings of affiliate	
					840		840	Fair value adjustment on affiliate	
Sale of available-for-sale securities	5,000			(5,000)	450		450	Realized gain on available-for-sale	
Dividends received	9,250						9,250	Dividend income	
Purchase of investment in affiliates	(710,000)	(710,000)							
Purchase of AFS securities	(185,000)	(185,000)							
Net cash used in investing activities	(880,750)	(895,000)		7,250	1,290		22,790	Net investing income	
								Other comprehensive income	
					10,650		10,650	Unrealized gain on available-for-sale sec.	
Net cash used in investing activities	(880,750)	(895,000)		7,250	11,940		33,440	Comprehensive investing income	
Net cash used in business activities	(844,370)	(1,395,000)	447,622	(638,402)	4,440	147,780	512,070	Comprehensive business income	
CASH FLOWS FROM DISC OPS									
Cash flows from discontinued operations	(20,000)		(10,000)			(50,000)	(80,000)	Loss from discontinued operations	
CASH FLOWS FROM FINANCING								**FINANCING**	
Dividends paid	(35,000)	(35,000)							
Interest paid	(125,000)		(125,000)				(225,000)	Interest expense	
Proceeds from issuance of st debt	500,000	500,000							
Proceeds from issuance of bonds	2,500,000	2,500,000							
Net cash provided by financing activities	2,840,000	2,965,000	(125,000)				(225,000)	Comprehensive financing (expense)	
							287,070	Comprehensive income before tax and disc ops	
CASH FLOWS FROM INCOME TAXES								**INCOME TAXES**	
Income taxes paid	(54,639)		(20,812)				(75,451)	Current tax expense	
				(33,120)			(33,120)	Deferred tax expense	
Net cash used for income taxes	(54,639)		(20,812)	(33,120)			(108,571)	Comprehensive income tax (expense)	
Net cash flows	1,920,991	1,570,000	301,810	(671,522)	4,440	147,780	98,499	Total comprehensive income	
Change in cash	1,920,991								
Beginning cash	4,000,000								
Ending cash	5,920,991								

RECONCILIATION OF THE STATEMENTS OF COMPREHENSIVE INCOME AND CASH FLOWS (IASB View)

	A	B	C	D	E	F
			Non Cash Items Affecting Income			
IASB view	Cash Flows	Cash Flows Not Affecting Income	Valuation Adjustments	All Other Changes	Comprehensive Income (A-B+C+D)	Caption in Statement of Comprehensive Income
CASH FLOWS FROM BUSINESS						**BUSINESS**
Operating						**Operating**
Cash received from sales	2,700,000			75,000	2,775,000	Sales
Cash paid for goods sold						Cost of goods sold
				(446,250)	(446,250)	Change in inventory
Inventory purchases	(1,750,000)			475,000	(1,275,000)	Materials
Labor	(110,000)				(110,000)	Labor
				(100,000)	(100,000)	Overhead - depreciation of buikding
				(5,944)	(5,944)	Overhead - depreciation of leased asset
				(50,000)	(50,000)	Interest expense
Total	(1,860,000)			(127,194)	(1,987,194)	Total cost of goods sold
					787,806	Gross profit on sales
Cash paid for selling activities						Selling expenses
Compensation	(85,000)				(85,000)	Compensation expense
Pension plan	(700)			(1,300)	(2,000)	Pension expense
			3,080	(9,358)	(6,278)	Bad debt expense
Cash paid for other operating expenses	(45,000)			(25,000)	(70,000)	Other operating expenses
Total	(130,700)		3,080	(35,658)	(163,278)	Total selling expenses
Cash paid for general and admin activities						General and administrative expenses
Rent	(120,000)				(120,000)	Rent expense
Contributions to pension plan	(500)			(1,100)	(1,600)	Pension expense
			(7,500)		(7,500)	Stock compensation expense
				(77,000)	(77,000)	Depreciation expense
				(500)	(500)	Accretion expense on ARO
Total	(120,500)		(7,500)	(78,600)	(206,600)	Total G&A expenses
Cash flows from other operating activities						Other operating expenses
Compensation	(15,000)				(15,000)	Compensation expense
				(2,600)	(2,600)	Litigation expense
				(2,378)	(2,378)	Interest expense on lease liability
Sale of receivables	1,200		200	(1,600)	(200)	Loss on sale of receivables
Research and development	(1,120)				(1,120)	Research and development
Sale of building	17,500		(15,500)		2,000	Gain on sale of building
Capital expenditures	(500,000)	(500,000)				
Other expenses	(55,000)			(25,000)	(80,000)	Other operating expenses
Total	(552,420)	(500,000)	(15,300)	(31,578)	(99,298)	Total other operating expenses
Net cash provided by operating activities	36,380	(500,000)	(19,720)	(198,030)	318,630	Net operating income
						Other comprehensive income
			160,000		160,000	Gain on revaluation of building
					160,000	Total other comprehensive income
Net cash provided by operating activities	36,380	(500,000)	140,280	(198,030)	478,630	Comprehensive operating income
Investing						**Investing**
				12,250	12,250	Equity in earnings of affiliate
			840		840	Fair value adjustment on affiliate
Sale of available-for-sale securities	5,000		450	(5,000)	450	Realized gain on available-for-sale
Dividends received	9,250				9,250	Dividend income
Purchase of investment in affiliates	(710,000)	(710,000)				
Purchase of available-for-sale securities	(185,000)	(185,000)				
Net cash used in investing activities	(880,750)	(895,000)	1,290	7,250	22,790	Net investing income
						Other comprehensive income
			10,650		10,650	Unrealized gain on available-for-sale sec.
Net cash used in investing activities	(880,750)	(895,000)	11,940	7,250	33,440	Comprehensive investing income
Net cash used in business activities	(844,370)	(1,395,000)	152,220	(190,780)	512,070	Comprehensive business income
CASH FLOWS FROM DISC OPS						
Cash flows from discontinued operations	(20,000)		(50,000)	(10,000)	(80,000)	Loss from discontinued operations
CASH FLOWS FROM FINANCING						**FINANCING**
Dividends paid	(35,000)	(35,000)				
Interest paid	(125,000)			(125,000)	(225,000)	Interest expense
Proceeds from issuance of short-term debt	500,000	500,000				
Proceeds from issuance of bonds	2,500,000	2,500,000				
Net cash provided by financing activities	2,840,000	3,000,000		(125,000)	(225,000)	Comprehensive financing (expense)
					287,070	Comprehensive income before tax and disc ops
CASH FLOWS FROM INCOME TAXES						**INCOME TAXES**
Income taxes paid	(54,639)			(20,812)	(75,451)	Current tax expense
				(33,120)	(33,120)	Deferred tax expense
Net cash used in income tax activities	(54,639)			(53,932)	(108,571)	Comprehensive income tax (expense)
Net cash provided by acts with non-equity holders	1,920,991	1,605,000	152,220	(369,712)	98,499	Total comprehensive income
Change in cash	1,920,991					
Beginning cash	4,000,000					
Ending cash	5,920,991					

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RECONCILIATION OF THE STATEMENTS OF COMPREHENSIVE INCOME AND CASH FLOWS (Converged View)

	A	B	C	D	E	F		G
			Non Cash Items Affecting Income					
Converged View	Cash Flows	Cash Flows Not Affecting Income	Accruals and Systematic Allocations	Recurring Valuation Changes	Remeasurements Other than Recurring Valuation Changes	Comprehensive Income (A-B+C+D+E)		Unusual or Infrequent Events or Transactions
CASH FLOWS FROM BUSINESS							**BUSINESS**	
Operating							**Operating**	
Cash received from sales	2,700,000		75,000			2,775,000	Sales	
Cash paid for goods sold							Cost of goods sold	
			(446,250)			(446,250)	Change in inventory	
Inventory purchases	(1,750,000)		475,000			(1,275,000)	Materials	
Labor	(110,000)					(110,000)	Labor	
			(100,000)			(100,000)	Overhead - depreciation of buikding	
			(5,944)			(5,944)	Overhead - depreciation of leased asset	
			(50,000)			(50,000)	Interest expense	
Total	(1,860,000)		(127,194)			(1,987,194)	Total cost of goods sold	
						787,806	Gross profit on sales	
Cash paid for selling activities							Selling expenses	
Compensation	(85,000)					(85,000)	Compensation expense	
Pension plan	(700)		(1,300)			(2,000)	Pension expense	
			(9,358)		3,080	(6,278)	Bad debt expense	
Cash paid for other operating expenses	(45,000)		(25,000)			(70,000)	Other operating expenses	
Total	(130,700)		(35,658)		3,080	(163,278)	Total selling expenses	
Cash paid for general and admin activities							General and administrative expenses	
Rent	(120,000)					(120,000)	Rent expense	
Contributions to pension plan	(500)		(1,100)			(1,600)	Pension expense	
				(7,500)		(7,500)	Stock compensation expense	
			(77,000)			(77,000)	Depreciation expense	
			(500)			(500)	Accretion expense on ARO	
Total	(120,500)		(78,600)	(7,500)		(206,600)	Total G&A expenses	
Cash flows from other operating activities							Other operating expenses	
Compensation	(15,000)					(15,000)	Compensation expense	
			(2,600)			(2,600)	Litigation expense	(2,600)
			(2,378)			(2,378)	Interest expense on lease liability	
Sale of receivables	1,200		(1,600)		200	(200)	Loss on sale of receivables	
Research and development	(1,120)					(1,120)	Research and development	
Sale of building	17,500				(15,500)	2,000	Gain on sale of building	
Capital expenditures	(500,000)	(500,000)						
Other expenses	(55,000)		(25,000)			(80,000)	Other operating expenses	
Total	(552,420)	(500,000)	(31,578)		(15,300)	(99,298)	Total other operating expenses	
Net cash provided by operating activities	36,380	(500,000)	(198,030)	(7,500)	(12,220)	318,630	Net operating income	
							Other comprehensive income	
					160,000	160,000	Gain on revaluation of building	
						160,000	Total other comprehensive income	
Net cash provided by operating activities	36,380	(500,000)	(198,030)	(7,500)	147,780	478,630	Comprehensive operating income	
Investing							**Investing**	
			12,250			12,250	Equity in earnings of affiliate	
				840		840	Fair value adjustment on affiliate	
Sale of available-for-sale securities	5,000		(5,000)	450		450	Realized gain on available-for-sale	
Dividends received	9,250					9,250	Dividend income	
Purchase of investment in affiliates	(710,000)	(710,000)						
Purchase of available-for-sale securities	(185,000)	(185,000)						
Net cash used in investing activities	(880,750)	(895,000)	7,250	1,290		22,790	Net investing income	
							Other comprehensive income	
				10,650		10,650	Unrealized gain on available-for-sale sec.	
Net cash used in investing activities	(880,750)	(895,000)	7,250	11,940		33,440	Comprehensive investing income	
Net cash used in business activities	(844,370)	(1,395,000)	(190,780)	4,440	147,780	512,070	Comprehensive business income	
CASH FLOWS FROM DISC OPS								
Cash flows from discontinued operations	(20,000)		(10,000)		(50,000)	(80,000)	Loss from discontinued operations	
CASH FLOWS FROM FINANCING							**FINANCING**	
Dividends paid	(35,000)	(35,000)						
Interest paid	(125,000)		(125,000)			(225,000)	Interest expense	
Proceeds from issuance of short-term debt	500,000	500,000						
Proceeds from issuance of bonds	2,500,000	2,500,000						
Net cash provided by financing activities	2,840,000	3,000,000	(125,000)			(225,000)	Comprehensive financing (expense)	
						287,070	Comprehensive income before tax and disc ops	
CASH FLOWS FROM INCOME TAXES							**INCOME TAXES**	
Income taxes paid	(54,639)					(75,451)	Current tax expense	
			(20,812)			(33,120)	Deferred tax expense	
Net cash used in income tax activities	(54,639)		(33,120)			(108,571)	Comprehensive income tax (expense)	
Net cash provided by acts with non-equity holders	1,920,991	1,605,000	(53,932)			98,499	Total comprehensive income	
Change in cash	1,920,991							
Beginning cash	4,000,000							
Ending cash	5,920,991							

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Appendix Page 5

Statement of Comprehensive Income Matrix - Converged View

	A	B	C	D	E
			Non Cash Items Affecting Income		
	Comprehensive Income (B+C+D+E)	Cash Flows	Accruals and Systematic Allocations	Recurring Valuation Changes	Remeasurements Other than Recurring Valuation Changes
BUSINESS					
Operating					
Sales	2,775,000	2,700,000	75,000		
Cost of goods sold					
Change in inventory	(446,250)		(446,250)		
Materials	(1,275,000)	(1,750,000)	475,000		
Labor	(110,000)	(110,000)			
Overhead - depreciation of buikding	(100,000)		(100,000)		
Overhead - depreciation of leased asset	(5,944)		(5,944)		
Interest expense	(50,000)	(125,000)	75,000		
Total cost of goods sold	(1,987,194)	(1,985,000)	(2,194)		
Gross profit on sales	787,806				
Selling expenses					
Compensation expense	(85,000)	(85,000)			
Pension expense	(2,000)	(700)	(1,300)		
Bad debt expense	(6,278)		(9,358)		3,080
Other operating expenses	(70,000)	(45,000)	(25,000)		
Total selling expenses	(163,278)	(130,700)	(35,658)		3,080
General and administrative expenses					
Rent expense	(120,000)	(120,000)			
Pension expense	(1,600)	(500)	(1,100)		
Stock compensation expense	(7,500)			(7,500)	
Depreciation expense	(77,000)		(77,000)		
Accretion expense on ARO	(500)		(500)		
Total G&A expenses	(206,600)	(120,500)	(78,600)	(7,500)	
Other operating expenses					
Compensation expense	(15,000)	(15,000)			
Litigation expense	(2,600)		(2,600)		
Interest expense on lease liability	(2,378)		(2,378)		
Loss on sale of receivables	(200)	1,200	(1,600)		200
Research and development	(1,120)	(1,120)			
Gain on sale of building	2,000	17,500			(15,500)
Other operating expenses	(80,000)	(55,000)	(25,000)		
Total other operating expenses	(99,298)	(552,420)	(31,578)		(15,300)
Net operating income	318,630	(88,620)	(73,030)	(7,500)	(12,220)
Other comprehensive income					
Gain on revaluation of building	160,000				160,000
Total other comprehensive income	160,000				
Comprehensive operating income	478,630	(88,620)	(73,030)	(7,500)	147,780
Investing					
Equity in earnings of affiliate	12,250		12,250		
Fair value adjustment on affiliate	840			840	
Realized gain on available-for-sale	450	5,000	(5,000)	450	
Dividend income	9,250	9,250			
Net investing income	22,790	(880,750)	7,250	1,290	
Other comprehensive income					
Unrealized gain on available-for-sale sec.	10,650			10,650	
Comprehensive investing income	33,440	(880,750)	7,250	11,940	
Comprehensive business income	512,070	(969,370)	(65,780)	4,440	147,780
Loss from discontinued operations	(80,000)	(20,000)	(10,000)		(50,000)
FINANCING					
Interest expense	(225,000)	(125,000)	(125,000)		
Comprehensive financing (expense)	(225,000)	2,840,000	(125,000)		
Comprehensive income before tax and disc ops	287,070				
INCOME TAXES					
Current tax expense	(75,451)	(54,639)			
Deferred tax expense	(33,120)		(20,812)		
Comprehensive income tax (expense)	(108,571)	(54,639)	(33,120)		
Total comprehensive income	98,499	1,795,991	(53,932)		

STATEMENT OF FINANCIAL POSITION RECONCILIATION

	A	B	C	D	E	F	G	H		I	J
	2006 Beginning Balance	Total Cash Flows ------- Inflows (Outflows)	Caption in Statement of Cash Flows	Cash Flows Not Affecting Income	Accruals and Systematic Allocations	Recurring Valuation Changes	Remeasurements other than Recurring Valuation Changes	Total Comprehensive Income (B-D+E+F+G)	Caption in Statement of Comprehensive Income	Non-Cash / Non-Income	2006 Ending Balance (A+D+E+F+G+I)
BUSINESS											
Operating assets and liabilities											
Accounts receivable	395,000	2,500,000	Cash received from sales		250,000			2,750,000	Sales	(1,000)	642,600
		1,200	Cash received from sale of receivables		(1,600)		200	(200)	Loss on sale of receivables		
Less: Allowance for bad debts	(20,000)				(9,358)		3,080	(6,278)	Bad debt expense	1,000	(25,278)
Inventory	580,000				(446,250)			(446,250)	COGS-Change in Inventory		133,750
		(110,000)	Cash paid for Labor					(110,000)	COGS-Labor		
		(300,000)	Cash paid for inventory purchases					(300,000)	COGS-Materials		
Accounts payable	(750,000)	(1,450,000)	Cash paid for inventory purchases		475,000			(975,000)	COGS-Materials		(275,000)
Accrued liabilities	(8,000)	(100,000)	Cash paid for other expenses		(50,000)			(150,000)	Other expenses		(58,000)
Advances from customers	(15,000)	200,000	Cash received from sales		(175,000)			25,000	Sales		(190,000)
Interest payable					(50,000)			(50,000)	Interest expense		(50,000)
Current portion of lease liability					(2,378)			(2,378)	Interest expense		
										(6,830)	(9,208)
Share-based compensation liability	(6,000)					(7,500)		(7,500)	Stock compensation expense		(13,500)
Leased asset					(5,944)			(5,944)	COGS - MOH dep of leased asset	31,700	25,756
Building	3,600,000	(500,000)	Cash paid for capital expenditures	(500,000)			160,000	160,000	Gain on revaluation of building	8,755	
		17,500	Cash received from sale of building				(15,500)	2,000	Gain on sale of building	(20,500)	4,232,755
Less: Accumulated depreciation	(100,000)				(177,000)			(177,000)	Depreciation expense	20,500	(256,500)
Asset retirement obligation					(500)			(500)	Accretion expense	(8,755)	(9,255)
Loss contingency					(2,600)			(2,600)	Litigation expense		(2,600)
Lease liability (excl current portion)										(24,870)	(24,870)
Accrued pension liability	(2,400)	(1,200)	Cash contributions to pension plan	(1,200)	(3,600)			(3,600)	Pension expense		(4,800)
Net Operating Assets	**3,673,600**										**4,115,850**
		(1,120)	Cash paid for research and development					(1,120)	Research and development expense		
		(100,000)	Cash paid for compensation					(100,000)	Compensation expense		
		(120,000)	Cash paid for rental expenses					(120,000)	Rent expense		
		36,380	**Net Cash provided by Operating Activities**	**(501,200)**	**(199,230)**	**(7,500)**	**147,780**	**478,630**	**Comprehensive operating income**		
INVESTING ASSETS AND LIABILITIES											
Available-for-sale securities		(185,000)	Purchase of available-for-sale securities	(185,000)							
		5,000	Sale of available-for-sale securities		(5,000)	450		450	Realized gain on available-for-sale	10,650	191,100
Investment in affiliate--equity method		(400,000)	Purchase of invest in affiliate	(400,000)	12,250			12,250	Equity in earnings of affiliate		412,250
Investment in affiliate--at fair value		(310,000)	Purchase of invest in affiliate	(310,000)		840		840	Fair value adjustment on affiliate		310,840
		9,250	Dividends received					9,250	Dividend income		
Total investing assets		**(880,750)**	**Net Cash used in investing activities**	**(895,000)**	**7,250**	**1,290**		**22,790**	**Net Investing Income**		**914,190**
						10,650		10,650	Unrealized gain on available-for-sale sec.		
								33,440	Comprehensive investing income		
		(880,750)	Net cash provided by investing activities								
		(844,370)	**Net Cash used in business activities**	**(1,396,200)**	**(191,980)**	**4,440**	**147,780**	**512,070**	**Comprehensive business income**		
DISCONTINUED OPERATIONS											
Assets classified as held for sale	420,000	(20,000)	Cash flow from discops		(10,000)		(50,000)	(80,000)	Loss from Discontinued operations		360,000
Liabilities classified as held for sale	(120,000)										(120,000)
Net assets held for sale	**300,000**	**(20,000)**	**Cash flow from discops**		**(10,000)**		**(50,000)**	**(80,000)**	**Loss from Discontinued operations**		**240,000**
FINANCING											
Financing assets											
Short term											
Cash	4,000,000	1,920,991	Change in cash								5,920,991
Total financing assets	4,000,000	1,920,991	Change in cash								5,920,991
Financing liabilities											
Short term											
Dividends payable	(37,450)	(35,000)		(35,000)						(70,000)	(72,450)
Short-term debt		500,000	Proceeds from issuance of short-term debt	500,000							(500,000)
Long term											
Interest payable		(125,000)	Cash paid for interest		(100,000)			(225,000)	Interest expense		(100,000)
Bonds payable		2,500,000	Proceeds from issuance of bonds	2,500,000							(2,500,000)
Total financing (liabilities)	(37,450)										(3,172,450)
Net financing assets	**3,962,550**	**4,760,991**	**Net cash provided by financing activities**	**2,965,000**	**(100,000)**			**(225,000)**	**Comprehensive financing expense**		**2,748,541**
INCOME TAXES								(225,000)	Comprehensive financing expense		
Short term											
Income tax payable	(54,639)	(54,639)	Cash paid on income tax payable		(20,812)			(75,451)	Current income tax expense		(75,451)
Deferred tax liability	(23,699)				(33,120)			(33,120)	Deferred income tax expense		(56,819)
Net income tax (liabilities)	**(78,338)**	**(54,639)**	**Net cash used in income tax activities**		**(53,932)**			**(108,571)**	**Comprehensive income tax expense**		**(132,270)**
Total net assets	**7,857,812**										**7,886,311**
		1,920,991	**Net Cash Flows**	**1,568,800**	**(355,912)**	**4,440**	**97,780**	**98,499**	**Comprehensive income**		
EQUITY											
Common stock and APIC	(5,000,000)										(5,000,000)
Treasury stock	100,000										100,000
Retained earnings	(2,803,185)			1,568,800	(355,912)	(6,210)	(62,220)	(72,151)	Income before OCI		(2,661,034)
Accumulated OCI	(154,627)					10,650	160,000	170,650	Other Comprehensive Income		(325,277)
Total (equity)	**(7,857,812)**		**Net cash used in equity activities**	**1,568,800**	**(355,912)**	**4,440**	**97,780**	**98,499**	**Comprehensive income**		**(7,886,311)**