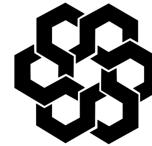

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International Accounting Standards Board

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:	**17 October 2007, London**
Project:	**Financial Statement Presentation**
Subject:	**Miscellaneous issues (Agenda Paper 8A)**

INTRODUCTION

1. The purpose of this memorandum is to address the following miscellaneous issues which the Boards have discussed before:
   a. Which entities should present a classified statement of financial position (Issue 1) (primarily an FASB issue)
   b. Capital management disclosures (Issue 2) (an IASB issue)
   c. Whether "former" cash equivalents can be presented net on the statement of cash flows and whether the existing netting guidance should be retained (Issue 3).

ISSUE 1: CLASSIFIED STATEMENT OF FINANCIAL POSITION

2. In May 2007, the Boards expressed different views on how to describe which entities should be required to present a classified statement of financial position (that is, all assets and liabilities are classified into short- and long-term subcategories within each category, such as operating, investing, and the like).
   a. The FASB tentatively decided, as the staff recommended, that financial institutions (such as banks, investment banks, and insurance companies) would

not be required to present a classified statement of financial position. The FASB also agreed that the initial discussion document would not define the term *financial institution* and would seek feedback on how to operationalize this view.

b. The IASB tentatively decided that, as in IAS 1 *Presentation of Financial Statements*, an entity would not be required to present a classified statement of financial position when a presentation of assets and liabilities in order of liquidity provides information that is reliable and is more relevant. In those cases, an entity would present the statement of financial position in order of increasing or decreasing liquidity.

3. Both Boards agreed that an entity that does not present a classified statement of financial position should present a detailed maturity schedule for short-term contractual assets and liabilities.

Staff Analysis

4. The staff would like the initial discussion document to include a converged preliminary view on which entities should be required to present a classified statement of financial position. The IASB's tentative decision in May 2007 is consistent with both Boards' preference for principles-based guidance and will most likely result in the same entities presenting a classified statement of financial position as would present a classified statement of financial position based on the FASB's tentative decision.

5. FASB members were of the view that it did not make sense for a financial institution to classify its assets and liabilities into short- and long-term categories because:

   a. Financial institutions may have assets and liabilities that are long-term by definition, but that have short-term liquidity implications. Therefore, classifying those items as long-term would be misleading.

   b. The contractual maturities of many financial instruments held by a financial institution do not indicate their liquidity. For example, a financial institution's bond portfolio is not liquid because its contractual maturity is in 12 months or less; rather, it's liquid because there is a liquid market for those bonds.

   c. Financial institutions do not have a conversion cycle.

6. The FASB was silent as to how a financial institution would present its assets and liabilities on the statement of financial position. Given the above rationale for not supporting short-term/long-term classification for financial institutions, an order of

liquidity presentation (consistent with IAS 1) for financial institutions seems reasonable.

7. U.S. GAAP **does not require** the presentation of a classified statement of financial position. Rather, it provides guidance as to how to classify assets and liabilities (that is, segregate assets and liabilities into *current* and *noncurrent*) whenever an entity chooses to do so. Introducing a requirement related to the presentation of assets and liabilities in the statement of financial position would be a change to U.S. GAAP. However, the staff understands that many U.S. entities currently present a classified statement of financial position and that some U.S. financial institutions currently present their assets and liabilities in a manner that appears to be based on liquidity. Thus, introducing the IAS 1 "classified or order of liquidity" requirement in U.S. GAAP most likely would not result in a big change to current practice.

Staff Recommendation

8. The staff recommends that:
   a. The FASB change its view to be consistent with the IASB view
   b. Financial institutions, such as a bank, an investment bank, or an insurance company be included as examples of entities that might not present a classified statement of financial position (incorporating the FASB view in the IASB view).

   Based on that recommendation, the Boards' converged view would be as follows:

   > An entity would be required to present a classified statement of financial position except when presenting assets and liabilities in order of increasing or decreasing liquidity provides information that is reliable and is more relevant. Financial institutions, such as a bank, an investment bank, or an insurance company are examples of entities for which a statement of financial position presented in order of liquidity may be more relevant.

9. Some constituents have questioned how an entity would determine the "order of liquidity" and one of the recasting companies suggested that the term be clarified. The staff views this as a detailed application issue that should be addressed in the next stage of the project. However, the staff recommends that the initial discussion document seek input from those applying IFRS about the operationality of the current IAS 1 requirement.

<u>QUESTION FOR THE FASB</u> (not for discussion by the IASB)

Q1. Does the FASB agree that, as in IAS 1, an entity should be required to present a classified statement of financial position except when presenting assets and liabilities in order of increasing or decreasing liquidity provides information that is reliable and is more relevant? (This would be a change to the FASB view expressed in May 2007.)

<u>QUESTION FOR BOTH THE FASB AND IASB</u>

Q2. Should financial institutions, such as a bank, an investment bank, or an insurance company, be included as examples of entities for which a statement of financial position in order of liquidity may be more relevant?

ISSUE 2: CAPITAL MANAGEMENT DISCLOSURES (IASB ONLY)

10. The Boards tentatively decided in May that, as required by IAS 1 (revised 2007) (paragraphs 134-136), all entities should disclose the following capital management information:

    a. Qualitative information about an entity's objectives, policies, and processes for managing capital, including (but not limited to):
        i. A description of what it manages as capital
        ii. When an entity is subject to externally imposed capital requirements, the nature of those requirements, and how those requirements are incorporated into the management of capital
        iii. How it is meeting its objectives for managing capital
    b. Summary quantitative data about what an entity manages as capital
    c. Any changes in the above qualitative and quantitative data from the previous period
    d. Whether during the period an entity complied with any externally imposed capital requirements to which it is subject
    e. When the entity has not complied with such externally imposed capital requirements, the consequences of such non-compliance.

11. The FASB was of the view that the term *capital* could include items in the operating category as well as items in the financing and equity sections and agreed that the document should clarify what is meant by *capital*. Thus, the FASB would add "(including as appropriate, operating, financing, and equity items)" to the end of paragraph 10(a)(i) above. While asking the IASB to make a similar change could be viewed as a drafting issue, given the history behind the capital management

disclosures in IAS 1, the staff thought it was prudent to explicitly discuss this issue with the IASB.

Staff Analysis

12. The staff understands that capital management disclosures under IAS 1 primarily include information regarding equity as defined in IFRS and some financial liabilities that an entity manages as capital. The basis for conclusion of IAS 1 (paragraph BC91) states "The Board noted that, although for the purpose of this disclosure capital would often equate with equity as defined in IFRSs, it might also include or exclude some components. The Board also noted that this disclosure is intended to give entities the opportunity to describe how they view the components of capital they manage, if this is different from what IFRSs define as equity." Therefore, while the disclosures under IAS 1 are considered to focus primarily on the components of capital that would be included in the equity and financing sections of the statement of financial position, it is not explicitly limited to those components.

13. As the FASB discussed in May 2007, the staff is of the view that the capital management disclosures should include items in the operating category that an entity manages as capital (that is, working capital). The staff notes that there are items in the operating category, particularly short-term assets and liabilities such as accounts receivable and accounts payable, that impact an entity's ability to meet its short-term financial commitments.

Staff Recommendation

14. Following the FASB's decision in May 2007, the staff recommends that the IASB agree to make a similar modification to the capital management disclosures required by IAS 1 to clarify that an entity should include any operating assets and liabilities it manages as capital in its capital management disclosures (along with items in the financing and equity sections).

15. The staff considered recommending that information regarding components of capital included in the financing and equity sections be provided separately from components of capital included in the operating category. However, the staff is of the view that this level of detail is not necessary for the initial discussion document.

<u>QUESTION FOR THE IASB</u> (not for discussion by the FASB)

Q3. Does the IASB agree to modify the capital management disclosures to clarify that what an entity manages as capital may include items in the operating category as well as items in the financing and equity sections?

ISSUE 3: NETTING ON THE STATEMENT OF CASH FLOWS

16. At their respective March 2007 Board meetings, the Boards decided that "cash" rather than "cash and cash equivalents" should be used as the basis for presenting the statement of cash flows. At those meetings, the Boards directed the staff to consider whether **net** amounts of cash receipts and payments related to items currently classified as cash equivalents could be presented on the statement of cash flows.

17. In September 2006, the Boards agreed that, as a general working principle, entities should prepare financial statements using a gross presentation except when:

    a. Net presentation is required or permitted by the authoritative accounting literature; or

    b. There is no incremental value in the additional information provided in a gross presentation – that is, there is no benefit in a user of the financial statements knowing the two amounts; the net amount provides all of the information that is necessary (referred to herein as the *netting principle*).

18. At their October 2007 meetings, the staff would like the Boards to confirm that net presentation of "former" cash equivalents is appropriate and to discuss whether the existing guidance on netting cash flows should be retained in addition to the new netting principle.

Gross or Net Presentation on the Statement of Cash Flows

19. In general, gross presentation of cash flow information is more meaningful than net presentation, but for certain transactions, the gross amount of cash inflows and outflows is potentially misleading and often less informative than the net change. Purchases and sales of items formerly known as cash equivalents can be viewed as part of an entity's cash management activities. For example, cash payments and receipts from purchasing and subsequently selling short-term highly liquid investments (such as commercial paper or revolving credit arrangements) are

essentially changes from one form of liquid funds to another form of liquid funds. In those cases, the gross cash payments and cash receipts would not be meaningfully presented as cash inflows and outflows. Paragraph 79 of FASB Statement No. 95, *Statement of Cash Flows,* explains how gross presentation of cash flows relating to certain items may be misleading.

> For very short-term investments, loans, and debt, relatively insignificant differences in the maturities of items may result in large differences in gross cash flows between enterprises or between periods that are not particularly meaningful. For example, an enterprise that issues seven-day commercial paper and rolls it over every week would report financing cash inflows and outflows four times those of an enterprise that issues one-month paper. While all gross cash flows are potentially relevant, the large reported differences in situations such as that described may not be sufficiently meaningful to require reporting of gross cash flows.

20. The existing guidance of both Boards (Statement 95 and IAS 7 *Cash Flow Statements*) permits net presentation of cash receipts and payments relating to:
    a. Short term investments not classified as cash equivalents in which
        (1) The turnover is quick
        (2) The amounts are large
        (3) The maturities are short.
    b. Cash receipts and payments on behalf of customers when the cash flows reflect the activities of the customer rather than those of the entity.

21. The Boards have decided to eliminate the concept of cash equivalents as the basis for presenting the statement of cash flows. The staff is of the view that the rationale for allowing net presentation of cash flows related to short term investments that are not classified as cash equivalents can be extended to short-term investments that are currently classified as cash equivalents. Thus, even though the beginning and ending balances of the former cash equivalents will no longer be reconciled in the statement of cash flows, the staff is of the view that net presentation of the cash receipts and payments related to former cash equivalents on the statement of cash flows should continue to be permitted.

22. For example, an entity that purchases 1 month commercial paper for $990,000 in cash and receives $1,000,000 cash 1 month later would not present a cash outflow of $990,000 and a cash inflow of $1,000,000, but only the net cash inflow of $10,000.

However, if the entity has not yet turned the commercial paper over – that is, it has only purchased the commercial paper – the entity would present the total cash outflow of $990,000 in the statement of cash flows. This is different than the current presentation in the statement of cash flows (which includes the notion of cash equivalents), as the commercial paper would be considered a cash equivalent and the net cash and cash equivalents flow would be 0, therefore no cash flows would be presented on the statement of cash flows for the initial purchase.

23. Statement 95 and IAS 7 also permit net presentation of cash flows in the following **specific** circumstances [Statement 95: banks, savings institutions, and credit unions; IAS 7: financial institutions]:

    a. Cash receipts and payments for the acceptance and repayment of deposits with a fixed maturity date

    b. The placement of deposits with and withdrawal of deposits from other financial institutions

    c. Cash advances and loans made to customers and the repayment of those advances and loans.

24. The staff is of the view that the circumstances where net presentation is currently permitted in the statement of cash flows are consistent with the netting principle described in paragraph 17b. Because the existing guidance and the netting principle are consistent, the staff considered whether the netting guidance in Statement 95 and IAS 7 should be retained. One could argue that if the financial statement presentation model is to be principles-based, it would be prudent to eliminate the existing netting guidance, particularly the more specific guidance in paragraph 21 above. On the other hand, there is the view that the guidance in Statement 95 and IAS 7 provides clarity and would maintain continuity with existing practice. The staff has identified three alternatives for dealing with the netting principle in relation to the existing netting guidance:

    a. Retain the existing netting guidance (paragraph 20a-b and paragraph 23a-c) as written in order to provide clarity to the netting principle in paragraph 17 of this memo.

    b. Eliminate the existing netting guidance (paragraph 20a-b and paragraph 23a-c) and include a question in the discussion document asking whether any aspect of the existing guidance should be retained to supplement the netting principle in paragraph 17.

c. Eliminate the **general** existing netting guidance (paragraph 20a-b) because the netting principle will capture those same criteria, but retain the more **specific** existing netting guidance (paragraph 23a-c) to provide clarity and additional application guidance.

Staff Recommendation

25. The staff recommends Alternative C—retaining the more specific application guidance in Statement 95 and IAS 7 (repeated below) but not retaining the general netting guidance in those standards (paragraph 19a-b) as the netting principle the Boards agreed to in this project should suffice. Based on that recommendation, the guidance regarding offsetting in the statement of cash flows would be as follows:

    Cash receipts and payments should not be offset (presented net) in the statement of cash flows unless there is no incremental value in the additional information provided in a gross presentation—that is, there is no benefit in a user of the financial statements knowing the two amounts; the net amount provides all of the information that is necessary.

    Net presentation of cash flows is permitted in the following circumstances for [FASB: banks, savings institutions, and credit unions; IASB: financial institutions]:

    a. Cash receipts and payments for the acceptance and repayment of deposits with a fixed maturity date

    b. The placement of deposits with and withdrawal of deposits from other financial institutions

    c. Cash advances and loans made to customers and the repayment of those advances and loans.

26. The staff is of the view that the above recommendation is consistent with the Boards desire to develop principles-based standards supplemented by additional implementation guidance as appropriate. Exactly which entities the specific guidance (a-c above) would apply to is an issue that can be resolved in the next stage of this project.

27. Implicit in the staff recommendation is the staff view that cash receipts and payments related to former cash equivalents should be presented net on the statement of cash flows based on the netting principle.

QUESTIONS FOR THE BOARDS

Q4. Do Board members agree that net presentation of cash receipts and payments related to former cash equivalents should be permitted on the statement of cash flows?

Q5. Should some or all of the netting guidance in Statement 95 and IAS 7 be retained, or does the netting principle provide adequate guidance?