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International Accounting Standards Board

This document is provided as a convenience to observers at the Global Preparers Forum meeting, to assist them in following the discussions. It does not represent an official position of the IASB. Board positions are set out in Standards.

Note: These notes are based on the staff papers prepared for the GPF meeting. Paragraph numbers correspond to paragraph numbers used in the GPF agenda paper.

INFORMATION FOR OBSERVERS

Global Preparers Forum Meeting: July 2008, London

Project: Preliminary views of the IASB and FASB on Financial Statement Presentation

(Agenda Paper 3)

INTRODUCTION

1. By the end of June 2008, the Boards had expressed their preliminary views on most of the substantive issues that will be addressed in Phase B of the financial statement presentation project. The Boards plan to issue an initial discussion document explaining their preliminary views in the third quarter of 2008.

2. As in each project they undertake, the Boards will reach final conclusions on financial statement presentation only after completing their due process procedures, which include considering comments on both this preliminary views document and an Exposure Draft of a proposed Statement.

OVERVIEW OF PRELIMINARY MODEL

3. The preliminary views document will solicit comment on the IASB's and the FASB's (the Boards') preliminary views on a new model for presenting information in the financial statements. The model is designed to make an entity's financial statements more useful by

providing sufficiently detailed information organized in a manner that clearly communicates a complete story about an entity and its operations during a reporting period.

The Problems with Financial Statement Presentation Today

4. Equity investors, creditors, their advisors, and other users of financial statements (after this, *investors*) have described numerous inadequacies in how information is presented in financial statements today:

   - **Insufficient disaggregation—**Information in financial statements often is too highly aggregated. If financial statements do not distinguish items that respond differently to the same economic events, investors must make their own estimates of the items that have been aggregated. Obtaining the data needed to make such estimates is not always possible, and even if it is, such estimates are less accurate than information provided directly by an entity.

   - **Inconsistent presentation and lack of cohesiveness—**How information is presented in financial statements lacks consistency from one statement to the others, thus obscuring the linkages among the statements and failing to provide a cohesive financial picture of an entity.

   - **Too many alternative presentation formats—**Existing requirements permit too many alternative types of presentation, resulting in a lack of comparability from one entity to another. For example, an entity may choose to present its comprehensive income either in a single statement or split between two statements.

   - **Inadequate separation of business activities from financing activities—**Investors commonly analyze an entity's financing activities (how it obtains capital) separately from its business activities (how it uses that capital to create value). Today's financial statements make that separation difficult.

   - **Failure to present cash inflows and outflows from operating activities—**Most entities report operating cash flows using an indirect method that adjusts net income (profit or loss) to arrive at a single number representing net operating cash flows. Existing requirements also permit a direct method, which reports major classes of operating cash receipts and payments separately. However, few entities use the direct method. Investors need information about different classes of operating cash inflows and outflows because this helps them assess an entity's ability to generate cash.

   - **Insufficient information to understand the effects of accruals, deferrals, and remeasurements, including value changes—**Financial statements do not give investors clear information about the effects of accrual accounting on an entity's reported results. Accrual accounting extends the information provided by an entity's cash flows; however, recording accruals often requires more estimation and judgment than recording cash flows. In addition, accruals related to changes in prices or estimates (remeasurements) are likely to be less persistent than other accruals or cash flows. Investors need to be able to separate items that differ in terms of persistence, subjectivity of measurement, and other factors that may have different implications for an entity's future financial results.

How the Boards' Proposals Would Help Resolve those Problems

5. The following discussion provides an overview of the new presentation model the Boards propose and how it would help to resolve the deficiencies outlined above. The model would apply to all business entities.

New Format for Financial Statements

6. An entity would classify information in its statements of financial position, comprehensive income, and cash flows using a new, common format, shown in Table 1. An entity would decide the order in which to present the sections and generally would use the same order in each financial statement. Each section and category within a section would have a total.

Table 1

Statement of Financial Position	Statement of Comprehensive Income	Statement of Cash Flows
Business ◆ Operating assets and liabilities ◆ Investing assets and liabilities	***Business*** ◆ Operating income and expense ◆ Investment income and expense	***Business*** ◆ Operating cash flows ◆ Investing cash flows
Financing ◆ Financing assets ◆ Financing liabilities	***Financing*** ◆ Financing asset income ◆ Financing liability expense	***Financing*** ◆ Financing asset cash flows ◆ Financing liability cash flows
Income Taxes	***Income Taxes (related to business and financing)***	***Income Taxes***
Discontinued Operations	***Discontinued Operations, net of tax***	***Discontinued Operations***
Equity	***Other Comprehensive Income, net of tax***	***Equity***

7. The new format shown in Table 1 would help to resolve many of the deficiencies in current financial statement presentation. For example, it would help to provide a *cohesive financial picture* of an entity because the relationship between items in different financial statements would be clear, and the statements would complement each other. The format also clearly separates an entity's business activities from its financing activities, and further distinguishes between debt financing and equity financing.

8. An entity's management would decide how to classify items into the sections and categories, and management would describe its classification rationale in its disclosure of accounting policies.

9. An entity would classify changes in its assets and liabilities in the statements of comprehensive income and cash flows based on how the related asset or liability is classified in the statement of financial position. For example, changes in inventory classified in the operating category in the statement of financial position would be presented in the operating category (as part of cost of goods sold) in the statement of comprehensive income, and the related cash payments to suppliers would be classified in the operating category in the statement of cash flows.

10. Ideally, the financial statements should be cohesive at the line item level. To the extent practical, an entity would disaggregate, label, and total items similarly in each statement.

Statement of Financial Position

11. An entity would further disaggregate its assets and liabilities in each category in Table 1 into short-term and long-term subcategories unless the entity believes a presentation in order of liquidity would be more relevant. An asset or liability is *short-term* if *either contractual maturity or expected date of realization or settlement is within one year*. Total assets and total liabilities could be presented in the notes to financial statements rather than on the statement of financial position.

Statement of Comprehensive Income

12. All entities would present a single statement of comprehensive income; the new model would eliminate the alternative formats that an entity may choose from today.

13. In addition to classifying its revenue, expenses, gains, and losses into operating, investing, and financing categories, an entity would disaggregate those items based on their function within those categories, their nature, or both**.**

    - **Function** refers to the primary activities in which an entity is engaged, such as selling, manufacturing, advertising, marketing, and administrative activities.

    - **Nature** refers to the economic characteristics that distinguish income and expense items that respond differently to similar economic events, such as service revenue versus revenue from sales of products; and the items that make up cost of sales, such as materials, labor, transportation costs, energy costs.

Statement of Cash Flows

14. An entity would present separately the main categories of its cash receipts and payments for operating activities, such as cash collected from customers, and cash paid to suppliers to acquire inventory (the direct method), rather than reconciling net income to net operating cash flow (the indirect method) as most entities do today. Presenting operating cash receipts and cash payments not only would provide a better disaggregation of cash flow information, but also would be cohesive with line items in the statement of comprehensive income.

New Reconciliation Schedule

15. The notes to financial statements would include a new schedule that reconciles the statement of cash flows to the statement of comprehensive income. This reconciliation schedule disaggregates income into its cash and accrual components and then further disaggregates the accrual component into accruals attributable to a change in price or estimate (for example, fair value changes) and accruals that are not. Investors need to analyze those components separately because the components often differ in their ability to help an investor forecast future profitability.

Costs and Benefits

16. The Boards hope to learn about the costs and benefits of the proposed model through the comment letters it receives on this document and through discussions with its constituents during the comment period. In addition, a number of companies will be field testing the proposed presentation model during the comment period. The Boards will consider that input when it redeliberates the issues addressed in this document during the next stage of this project, which will lead to issuance of an exposure draft of a proposed standard.

DISCUSSION QUESTIONS

1. As illustrated in Table 1, assets and liabilities and equity would no longer be the primary sections on the statement of financial position. Rather, an entity should present information about the way it creates value (its business activities) separately from information about the funding or financing of those activities (its financing activities).

    a. Do you agree with the segregation between business and financing?

    b. Do you agree that the primary sections in the financial statements should be business, financing, equity, and discontinued operations? If not, how should they be segregated?

2. As described in paragraph 8, the Boards support a management approach to financial statement presentation which will allow an entity to classify an asset and liability and changes in those items in the business and financing sections in a manner that best reflects the way the item is managed or the way the item functions within the entity.

    a. Do you agree that classification in the financial statements should be governed by a management approach? If not, please explain how items in the financial statements should be classified?

    b. Do you agree that an entity should explain, as a matter of accounting policy, its bases for classifying assets and liabilities in the operating, investing and financing categories? If not, why?

3. An entity should present a classified statement of financial position (short-term and long-term subcategories for assets and liabilities) except when a presentation of assets and liabilities in increasing or decreasing order of liquidity provides information that is more relevant

    a. Do you think this classification would help users assess the entity's liquidity or financial flexibility? If not, could you suggest a better way of conveying it?

    b. What types of entities would you expect not to present a classified statement of financial position?

4. Do you agree that an entity should present comprehensive income and its components in a single statement of comprehensive income? If not, how should they be presented? Do you agree that items of other comprehensive income items (OCI) should be presented in a separate section by indicating to which category they relate to?

5. Should cash flows from operating activities be determined through a *direct* instead of preparing a reconciliation through the *indirect* method? If so,

    a. Do you agree that the direct method is more consistent than the indirect method with the disaggregation and cohesiveness principles, (eg it disaggregates cash receipts and payments)?

b. What are the costs and benefits of using a direct method to determine net operating cash flows?

6. Do you think the reconciliation schedule would provide useful information by increasing the users' understanding of the amount, timing, and uncertainty of an entity's future cash flows? Why or why not? What are the costs and benefits of providing this reconciliation?