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International
Accounting Standards
Board

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

INFORMATION FOR OBSERVERS

WSS Meeting: **September 2008, London**

Project: **Presentation of financial statements**

Agenda paper 5

FINANCIAL STATEMENT PRESENTATION

Introduction

1. By the end of July 2008, the IASB and the FASB (the Boards) had expressed their 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 in the third quarter of 2008 an initial Discussion paper/Preliminary Views document explaining their views[1] on a new model for presenting information in the financial statements. This model is designed to make an entity's financial statements more useful by providing sufficiently detailed information organized in a manner that clearly communicates an integrated (or cohesive) financial picture of an entity. This paper contains a summary of the Boards' proposed model.

[1] 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.

The Problems with Financial Statement Presentation Today

2. How an entity presents information in its financial statements is vitally important because financial statements are a central feature of financial reporting—a principal means of communicating financial information to those outside an entity. The Boards initiated the joint project on financial statement presentation to address users' concerns that existing requirements permit too many alternative types of presentation and that information in financial statements is highly aggregated and inconsistently presented, making it difficult to fully understand the relationship between the financial statements and the financial results of an entity.

How the Boards' Proposals Would Help Resolve those Problems

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

Objectives Underlying the Proposed Presentation Model

4. The Boards developed three objectives for financial statement presentation based on the objectives of financial reporting and the input the Boards received from users of financial statements and from members of their advisory groups. Those objectives state that information should be presented in the financial statements in a manner that:

    a. **Portrays a cohesive financial picture of an entity's activities.** A cohesive financial picture means that the relationship between items across financial statements is clear and that an entity's financial statements complement each other as much as possible.

    b. **Disaggregates information so that it is useful in assessing an entity's future cash flows**. Financial statement analysis aimed at objectives such as assessing the amounts, timing, and uncertainty of future cash flows requires financial information that is disaggregated into reasonably homogeneous groups of items with similar economic characteristics. If items differ economically, users may wish to take that into account differently in assessing future cash flows. Therefore, disaggregated information (more line items) can assist a user in understanding an entity's financial results and in predicting its future cash flows.

    c. **Helps users assess an entity's liquidity and financial flexibility.** Information about an entity's liquidity helps users to assess an entity's ability to meet its financial commitments as they become due. Information about financial flexibility helps users to assess an entity's ability to invest in business opportunities and respond to unexpected needs.

Proposed Format for Financial Statements

5. 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 ◆ Investing 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*** on continuing operations (business and financing)	*Cash paid for* ***income taxes***
Discontinued operations	***Discontinued operations,*** net of tax	***Discontinued operations***
	Other comprehensive income, net of tax	
Equity		***Equity*** *cash flows*

6. 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.

7. 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.

8. 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.

9. 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.

Defining the Sections and Categories

10. The **business section** should include assets and liabilities that management views as part of its continuing business activities and changes in those assets and liabilities. Business activities are those conducted with the intention of creating value, such as producing goods or providing services.

a. The **operating category** within the business section should include assets and liabilities that management views as related to the central purpose(s) for which the entity is in business. An entity uses its operating assets and liabilities in its primary revenue- and expense-generating activities.

b. The **investing category** within the business section should include business assets and business liabilities, if any, that management views as unrelated to the central purpose for which the entity is in business.

11. The **financing section** should include categories for **financing assets** and **financing liabilities**. Financing assets and financing liabilities are *financial assets* and *financial liabilities* (as those terms are defined in IFRSs and U.S. GAAP) that management views as part of the financing of the entity's business and other activities.

12. The **equity section** should include items that meet the definition of *equity* in IFRSs and U.S. GAAP.

13. The **discontinued operations section** should include all assets and liabilities related to a *discontinued operation*, as that term is defined in IFRSs and U.S. GAAP.

14. The **income tax section** of the statement of financial position should include all current and deferred income tax assets and liabilities recognized in accordance with IFRSs or U.S. GAAP. An entity should present cash flows related to those assets and liabilities in the income tax section of the statement of cash flows. An entity should allocate income tax expense or benefit in the statement of comprehensive income following existing requirements of IFRSs and U.S. GAAP.

How the Financial Statements Might Change

Statement of Financial Position

15. 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 and subtotals for short-term and long-term assets and liabilities would be presented in the statement of financial position or in the notes to financial statements.

Statement of Comprehensive Income

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

17. In addition to classifying its income, expenses, gains, and losses into operating, investing, and financing categories, an entity would disaggregate those items based on their function within those categories, and further disaggregate items by their nature (within those functions) to the extent that this will enhance the usefulness of the information.

- **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, transport, and energy costs.

Statement of Cash Flows

18. 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 (a direct method), rather than reconciling profit or loss to net operating cash flow (an 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.

Reconciliation Schedule

19. The notes to financial statements would include a new schedule that reconciles cash flows to comprehensive income. This reconciliation schedule disaggregates income into its cash and accrual components and then further disaggregates the remeasurement components (for example, fair value changes). Users analyze those components separately because the components often differ in their ability to help users predict future cash flows and assess earnings quality.

Costs and Benefits

20. The Boards hope to learn about the costs and benefits of the proposed presentation 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 entities will be field testing the proposed presentation model during the comment period. The Boards will consider that input when they redeliberate 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 in the statement of financial position. Rather, an entity should present information (its **business activities**) separately from information about the funding or financing of those activities (its **financing activities**).

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

    b. Do you agree that the separation of business and financing activities in the financial statements will make it easier for users to calculate some **financial ratios** for an entity's business activities or its financing activities? Why or why not?

2. The proposed presentation model relies on a **management approach** to classification of assets and liabilities and the related changes in those items in the sections and categories in order to best reflect the way an item is used within the entity.

    a. Will a management approach provide the most useful view of an entity to users of its financial statements?

    b. Might the potential for reduced comparability of financial statements resulting from a management approach to classification outweigh the benefits of that approach? Why or why not?

3. Do you agree that 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 order of liquidity provides information that is more relevant?

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

    b. Should there be more guidance for distinguishing which entities should present **a statement of financial position in order of liquidity**? If so, what additional guidance is needed?

4. Do you agree that an entity should present comprehensive income and its components in a **single statement of comprehensive income**? Why or why not? If not, how should they be presented?

5. Will a **direct method of presenting cash flows** provide information that is more decision useful than an indirect method and is a direct method more consistent with the objectives of disaggregation and cohesiveness? Why or why not?

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

6. Will a **reconciliation schedule** increase users' understanding of the amounts, timing, and uncertainty of an entity's future cash flows? Why or why not? What are the costs and benefits of providing this reconciliation?