Project **Financial Statement Presentation**

Topic **Field test: preparer survey responses and recasting exercise**

Purpose

1. This paper summarizes preparer participants' responses to the field test survey and provides a general analysis of the results of the recasting exercise. This paper is the same as agenda paper 17D/63D, which was provided at the July 2009 joint board meeting. Paragraphs 45 and 46 discuss the status of the analyst portion of the field test. At the working group (WG) meeting we will discuss any questions or observations members may have on the survey responses and the recasting exercise. The discussion of WG papers 3-6 will include issues raised during the recasting exercise and in survey responses. The purpose of this paper and related discussion is to provide general information about the field test and results to date.

Background on field test

2. At the March 2009 joint board meeting discussion on financial statement presentation, the boards heard a staff update on the field test on the presentation model proposed in the October 2008 discussion paper *Preliminary Views on Financial Statement Presentation* (discussion paper)**.**

3. The purpose of the field test is two-fold:

   a. To determine whether the proposed presentation model improves the usefulness of the information in an entity's financial statements to users in making decisions in their capacity as capital providers

b. To understand the costs of implementing the proposed presentation model and identify any unintended consequences in applying that model.

4. The field test consists of three parts:

c. **Preparer information**: recast financial statements, preparer responses to a post-completion survey, and cost estimates to implement the proposed presentation model.

d. **Quantitative information** that will provide a description of the additions, changes, and movements of line items between the non-recast and recast financial statements.

e. **Analyst information**: responses to a survey about their review of specific recast and non-recast financial statements.

The recasting exercise

5. We asked field test participant companies to recast any two consecutive years of financial statements using the principles and application guidance provided in the discussion paper. We asked participant companies **not** to make any information systems changes to accommodate the field test; however, we asked them to employ the principles to the furthest extent possible. If there was something they were unable to complete due to cost or time constraints, they were to document those constraints as thoroughly as possible.

6. We permitted participant companies to make estimates or employ accounting shortcuts to produce the requested information. To the extent that they used estimates or shortcuts, their results were to flow through the recast financials to maintain cohesiveness.

7. In total, 31 companies completed the recasting exercise. Recast financial statements were received from 29 of the 31; 2 U.S. companies withheld their recast financial statements due to Regulation F-D concerns.

Profile of preparer participants

8. The table below indicates the broad industry classification (from the Fama-French classification system that aggregates standard industry codes) and geographic area of the participating companies (based on their primary listing authority or regulator).

Insurance	7
Pharmaceutical products	3
Banks	2
Business services	2
Computer	2
Electronic equipment	2
Entertainment	2
Steel works	2
Aircraft	1
Automobiles & Trucks	1
Construction materials	1
Consumer goods	1
Electrical equipment	1
Machinery	1
Petroleum & Natural gas	1
Retail	1
Utilities	1

United States	12
Europe	11
Japan	5
New Zealand	2
India	1

Field test survey

9. After finalizing their recast financial statements, participant companies completed a 32-question survey about their experience in applying the principles and application guidance in the discussion paper. The survey also asked the preparers to comment on how different aspects of the model might help them communicate their company's financial results to users of their financial statements. At the March 2009 joint meeting, the staff provided a brief overview of the survey responses. Twenty-eight companies completed the survey; however, some did not answer all questions. The remainder of this paper is a summary of the survey results and a general analysis of those results.

Classification

10. The survey results indicate that the preparer participants thought the financing section and the investing category were not appropriately defined. The financing section, financing asset category, and financing liability category had a clustering of responses that suggested the items were too strictly defined. The investing category results indicate that preparers thought this category was too loosely defined.

11. While the participants may not have agreed with the section and category definitions provided in the discussion paper, most (60%) indicated that they encountered relatively few issues in applying those definitions. Of the issues encountered during classification of the company's assets and liabilities, 75% reported the issues were easy to resolve.

12. However, nearly 40% of the participants encountered difficulties in classifying income, expenses, gains, losses or cash flows into the defined sections and categories. The difficulties in classifying comprehensive income items arose regardless of whether the item was directly related to an asset, liability, or equity item on the statement of financial position. The explanations provided in the survey indicate that the difficulties arose because the statement of financial position is not disaggregated to a level that supports alignment of items across the primary statements. For example, a company maintains one trade accounts payable but it does not distinguish each account payable by nature. This same aggregation issue could also affect an entity's inability to align foreign exchange differences, post employment benefit plans, leasing liabilities, derivatives, VAT, and other cash flow items not affecting income.

13. When classifying "shared" assets or liabilities used by activities reported in more than one section or category, 43% of the preparer participants assigned the asset or liability to the section of predominant use. Eighteen percent indicated that they allocated the asset or liability between the sections or categories. Thirty-six percent stated they didn't have this type of shared assets or liabilities.

14. Fifty-six percent (or 15 out of 27 responses) of the preparers stated that the management approach to classification supported and complemented their segment disclosures. Nine companies either changed or modified their segment disclosure in their recast financial statements to align with format used in the recast financial statements. Only 3 of the 12 companies' segment disclosures did not change between the non-recast and the recast financial statements.

15. Over 60% of the line items presented in the three recast financial statements (statement of financial position, statement of comprehensive income and statement of cash flows) were in the operating category. However, the operating category, as a whole, accounted for over 90% of the monetary amounts

presented. The financing section had 12% of the total line items and about 5% of the total presented amounts. The tax section and investing category each had about 6% of the total line items presented but represented less than 1% of the total amounts presented.

Statement of financial position: classified vs. order of liquidity

16. There was no significant change in whether assets and liabilities were classified in short-term and long-term categories or presented in order of liquidity in the recast statements of financial position. Only 3 of 28 respondents indicated that they discussed which presentation format they should use for the statement of financial position. Nine participants (2 banks and 7 insurance companies) presented their assets and liabilities in order of liquidity in their recast and non-recast statements of financial position. All of those participants indicated that there was little discussion about the presentation of items on the statement of financial position "because it was obvious that we should use order of liquidity."

Disaggregation

17. Only 39% of the preparers indicated that the disaggregation guidance was appropriately defined. The guidance for disaggregation by function on the statement of comprehensive income and by measurement bases on the statement of financial position was less difficult to apply (68% and 50% respectively) than disaggregation by nature. Forty-three percent of the preparers indicated that disaggregating expense items by nature was difficult to very difficult.

18. Fifty-four percent of the preparers were of the opinion that application of the disaggregation guidance resulted in too much disaggregation overall, while 39% thought it resulted in an appropriate level of disaggregation.

19. The majority of preparers responded that application of the disaggregation guidance either distracted or did not affect their ability to communicate their company's results. The responses indicate that disaggregation was a distraction in communicating results in three areas: on the statements of comprehensive income (43% of respondents) and cash flows (50% of respondents) and the reconciliation schedule (50% of respondents).

20. Sixty-four percent of the preparers indicated that their company outsourced some of its activities for the periods covered in the recast financial statements. Outsourcing activities could have differences either in nature, measurement bases, or economic implications when compared to non-outsourced activities. However, 89% of the participants stated that they aggregated outsourced and non-outsourced expenses related to an activity or function in both the non-recast and recast statements. Only 11% indicated the outsourced and non-outsourced expenses were aggregated in the non-recast statements but disaggregated in the recast statements.

21. When the count of line items is adjusted to remove all headings and subtotals from both the recast and non-recast statements, there is a total increase of 1050 line items in the three primary statements[1] for the 27 companies or 49% more than the non-recast statements. Over half (56%) of the increase in line items occurred on the statement of comprehensive income. On average, the cash flow statement had a 12% increase in the number of line items, while the statement of financial position line items increased by 32%. This equates to an average increase of 13 line items on the statement of financial position, 5 on the cash flows statement, and 22 on the statement of comprehensive income.

22. The increase in line items on the statement of comprehensive income was primarily attributable to the inclusion of other comprehensive income (OCI) items and disaggregation by function. The inclusion of OCI items in a statement of comprehensive income accounted for 107 of the 592 (or 19%) additional line items on the recast statements of comprehensive income. This equates to an average of 4 line items on the recast statement of comprehensive income.

23. Disaggregation by function in the statement of comprehensive income resulted in a significant increase in the number of line items related to administration (84), cost of goods sold (88), and selling (56). When these functional areas were presented on the non-recast statement of comprehensive income, they were

[1] All comparatives related to line item counts that follow in this paper have been adjusted to remove the effects of headings and subtotals, unless otherwise noted. All totals are included in the definition of subtotal for the purpose of this paper.

normally single line items or aggregated with other functions in a single line item.

24. Within the functional groups, by-nature disaggregation increased most in line items related to "other" (54) and wages (47). By comparison, the non-recast statements had a total of 16 line items of "other" and 4 line items of wages in the by-nature disaggregation. Similarly, by-nature "overhead" line items increased from zero to 37 in the recast statements, and by-nature "pension" line items increased from 2 to 31. In contrast, by-nature line items for "materials" increased from zero to 12 in the recast statements.

25. The number of line items that were clearly labelled as aggregated functions or costs (for example, "selling, general, and administration") declined by 14 line items (41%) between the non-recast and recast statements of comprehensive income.

26. In follow-up discussions, most preparer participants that used the functional groups above indicated that they also use them in managing the business, but most said they do not use the by-nature information at the corporate level. The participants stated that business units, including manufacturing departments, may use more by-nature information, but not consistently from business unit to business unit.

27. One participant that has about 250 business units world-wide estimated that to incorporate the more common by-nature items used at the business unit level would add between 30-40 additional lines of by-nature information to the statement of comprehensive income. That participant observed that a user of its financial statements would have to know which by-nature information was important to which group or groups of business units for the additional information to add value.

28. Other participants indicated that once a by-nature item was disaggregated and presented in one function, they felt compelled to present it in other functional areas to maintain a sense of consistency, even though the by-nature information may not be material to that functional area.

29. The number of revenue-related line items on the statement of comprehensive income increased by 28 line items (5%) from the non-recast to the recast statements. All revenue line items were presented in the operating category.

30. The total number of expense-related line items presented on the statement of comprehensive income increased about 160% from the non-recast to the recast version (from 7 to 18 items). In comparison, the total number of income related line items increased only 70% from non-recast to recast (from 4 to 7 items). Using the same comparisons for gain and loss line items, the number of line items related to gains increased by about 272% (from 1 to 5 items) versus 193% (from 1 to 4 items) for loss related line items.

Cohesiveness

31. Sixty-seven percent of the preparers found the guidance on cohesiveness to be appropriately defined. However, most indicated some level of difficulty in applying the cohesiveness guidance, with 39% responding that it was difficult to very difficult to apply.

Liquidity and financial flexibility

32. The survey responses indicate that most of the preparers (75%) found the liquidity and financial flexibility guidance not difficult to implement. Eighty-six percent of the preparer respondents thought the recast statements communicated their company's liquidity and financial flexibility the same as their non-recast statements. However, only 29% were of the opinion that their recast statements clearly identified their company's liquidity and financial flexibility.

Reconciliation schedule

33. The "cash items" column in the reconciliation schedule was identified as adequately defined by a majority of respondents (82%) and was identified as the most useful column of the four columns on the reconciliation schedule for explaining the financial results of the company. If the preparer participant did

not find the reconciliation columns adequately defined, they were most likely to respond that the column was “too loosely” defined.

Communicating results

34. Although 65% of the preparer participants thought the recast statements clearly identified the core operations of their company, only 46% thought that the recast statements did a better job than the non-recast statements in communicating the results of core operations. Similarly, 50% of the respondents thought the recast statements clearly identified their financing activities. Only 25% thought the proposed presentation model did a better job than the non-recast statements at communicating the results of those financing activities. Overall, the majority of preparer participants believe the recast statements communicated their company’s financial results the same or worse than the non-recast statements.

35. Preparer participants identified the management approach to classification as the most useful aspect of the proposed model (32% of respondents held this view). The least useful aspects identified were the direct method presentation of cash flows (57%) and the reconciliation schedule (50%). On a scale of 1 to 5, with 1 being least useful and 5 being most useful, the management approach to classification had a weighted average of 4.2. The direct method presentation of operating cash flows and the reconciliation schedule each had a weighted average of 2.0.

36. Survey results indicate preparer participants thought the management approach to classification enhanced their ability to communicate the financial results of their company on the statement of financial position (61%) and the statement of comprehensive income (54%). However, preparer participant responses also indicate that overall, the implementation of the disaggregation guidance did not enhance their ability to communicate their company’s financial results and significantly detracted from their communications on the statement of comprehensive income, statement of cash flows, and the reconciliation schedule.

37. The liquidity and flexibility information appears to have the least impact regarding communicating results in the proposed presentation model with 82% of the preparer participants stating that incorporating the liquidity and financial

flexibility guidance did not affect their ability to communicate their results. However, the weighted average for usefulness (using the scale explained above) was 2.5. None of the preparer participants indicated that the proposed presentation model identified their company's liquidity and financial flexibility better than the non-recast statements.

38. Aligning line items across individual statements (cohesiveness) most positively affected the preparers' ability to communicate financial results in the statement of comprehensive income (61%). For the other statements, the reconciliation schedule, and the segment disclosure, the majority of preparer participants indicated that cohesiveness either did not affect or negatively affected their ability to communicate the financial results of their company.

39. The majority of the preparer participants responded that the reconciliation schedule either detracted (46%), or did not affect (29%) the communication of their company's financial results. The most useful column in the reconciliation schedule for explaining their results was the cash column; however, using the scale indicated previously that the weighted average of this usefulness was only 2.8 out of 5.

Summary

40. The majority of preparer participants believe the recast statements communicate their company's financial results the same or worse than the non-recast statements.

41. Financial statements prepared in accordance with the discussion paper reflect an average increase of about 50% of line items once adjustments for headings, totals, subtotals, and OCI items were considered. Most of the additional line items appeared on the statement of comprehensive income. The data and a review of the recast financial statements suggest that most of the disaggregation was driven by classification into the different categories and functional separation. Much of the disaggregation by nature resulted in shifting amounts from single line items of highly aggregated information into multiple line items of smaller amounts that were still highly aggregated under generic descriptions.

42. This increase in line items does not necessarily equate to an increase in the usefulness of the information presented, especially the more complex or diverse a company becomes. For example, many companies disaggregated the cost of goods from a single line item on the non-recast statements to line items for materials, labor, overheads, and other. Most of these companies have multiple product lines, engage in some level of outsourcing, and have a variety of manufacturing overheads that vary between product lines. Each of these "by-nature" accounts or line items is a highly aggregated amount that includes "materials", "labor", or "overheads". However, those generic descriptions provide no indication of the composition or economic behavior of the amounts within those groupings.

43. Without further detailed explanations of these accounts (for example, what type of materials or whether the labor is direct or indirect), the staff believe their usefulness in predicting future cash flows is limited. Therefore, the benefit of by-nature information on the face of the primary statements is not readily evident from the results of the field test to date.

44. The analysis of the recast financial statements also leads the staff to question the effectiveness of the proposed definitions of the sections and categories and the disaggregation guidance in the discussion paper. The total absolute amounts were not dispersed between the various sections and categories as the staff expected. The absolute amounts went from no designation between sections and categories on the non-recast statements to classification that was almost entirely in the operating category. About 96% of the absolute cash flows were presented in the operating category; 4% were presented in the financing section. On the statement of comprehensive income, about 92% of the absolute amounts were presented in the operating category. Taxes and financing each had 2% of the absolute amounts; OCI items represented about 4%. This could possibly indicate the classification guidance for the operating and financing categories may be too broad.

Analyst portion of field test

45. In the analyst portion of the field test, analysts and other users of financial statements will review and compare financial statements prepared using an entity's current presentation method and using the proposed presentation model. Those analysts will answer a survey that is designed to identify the information that the analyst relies on and whether the proposed presentation model presents that information in a decision useful way.

46. The analyst portion of the field test will be conducted during the month of July. (At the WG meeting, the staff will provide an update on that portion of the field test.) The staff expect to provide the results of the analysts' survey to the boards in September.

Discussion questions
Question 1: Do WG members have any questions on the recasting exercise?
Question 2: Do WG members have any questions on the field test survey responses?
Question 3: Do WG members have any questions on the analyst portion of the field test?