Project **Financial Statement Presentation**

Topic **Classification: Definitions and Management Approach**

Introduction

1. The purpose of this paper is for the IASB and the FASB (collectively, the boards) to reconsider the classification of information within the financial statements (hereafter, the working format) proposed in the October 2008 discussion paper *Preliminary Views on Financial Statement Presentation*.

2. Specifically, this paper examines the **management approach** to classification of items in the financial statements as well as the **section** and **category definitions** proposed in the discussion paper.

Structure of the paper

3. This paper is divided into the following sections:

   (a) summary of staff recommendations (paragraph 4).

   (b) financial statement format as described in the discussion paper (paragraphs 5—14)

   (c) Issue 1: management approach to classification of assets and liabilities (paragraphs 15—23)

   (d) Issue 2: separating business activities from financing activities (paragraphs 24—34)

   (e) Issue 3: defining the financing section (paragraphs 35—55)

   (f) Issue 4: defining the business section (paragraphs 56—73).

Summary of staff recommendations

4. We recommend that the exposure draft:

(a) retain the requirement to distinguish between business activities (value-creating activities) and financing activities (funding of that value creation) in each of the financial statements.

(b) re-label the financing section to **non-equity sources of funding** and define that section narrowly as financial liabilities that have an agreed upon schedule of repayments. Items directly related to those financial liabilities, such as interest and fees, would also be classified in that section. A derivative held as part of an entity's non-equity sources of funding, regardless of whether it is an asset or a liability at the reporting date, would also be presented in that section.

(c) re-label the business section to **operating section** and retain an approach to classification within that section that is based on how a reporting entity organises its activities and uses its assets and liabilities. Consequently, additional groupings of information within the operating section (ie categories) would reflect the facts and circumstances of that entity.

(d) include application guidance to help management determine meaningful groupings of information within an entity's operating section.

Financial statement format as described in the discussion paper

Defining the financial statement sections and categories

5. The discussion paper indicates that financial information should be presented in the financial statements in two broad sections—**business** and **financing—**and that the business section should be further disaggregated into the **operating** and **investing categories**.

6. The boards decided on business and financing as the two main financial statement sections so that a user will be able to distinguish between an entity's value-creating activities (business) and the funding of that value creation (financing). A business and financing classification scheme allows users to better evaluate the underlying business of an entity, irrespective of how that business is financed. Further, how an entity is operated and how those operations are financed are two distinct management decisions. Separating those activities allows for comparison and evaluation of both decisions.

7. Based on the boards' preliminary views in the discussion paper, the financial statements **might** be presented as follows (hereafter, referred to as the *working format*):

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 income • Financing expense	***Financing*** • Financing asset cash flows • Financing liability cash flows
Income taxes	***Income taxes*** on continuing operations (business and financing activities)	***Income taxes***
Discontinued operations	***Discontinued operations,*** net of tax	***Discontinued operations***
	Other comprehensive income, net of tax	
Equity		***Equity***

Management approach to classification

8. The working format separates the different functional activities of an entity. Because functional activities vary from entity to entity, an entity would choose the classification that best reflects management's view of what constitutes its business (operating and investing) and financing activities. That **management approach to classification** should provide decision-useful information about the various aspects of an entity's activities.

9. An entity would be required to explain, as a matter of accounting policy, its bases for classifying assets and liabilities in the operating, investing and financing categories. The boards propose that disclosure would include a discussion of the type(s) of businesses in which the entity engages. Any change in the basis for classification would be viewed as a change in accounting policy and would be implemented through retrospective application to prior periods (consistent with FASB Accounting Standards Codification (ASC) Topic 250-10, *Accounting Changes and Error Corrections* (formerly FASB Statement 154) and IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*).

Business section

10. The business section of the statement of financial position would include all assets and liabilities that management views as part of the entity's continuing business activities. Business activities are those conducted with the intention of creating value, such as producing and delivering goods or providing services.

Operating category

11. The operating category would 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. An entity would include operating assets and liabilities in the same category Also, if an entity cannot clearly identify an asset or liability as relating to a specific category, the entity should presume that the asset or liability relates to its operating activities.

Investing category

12. The investing category includes business assets and business liabilities that management views as unrelated to the central purpose for which the entity is in business.

Financing section

13. The financing section of the statement of financial position would include only financial assets and financial liabilities (as defined in US GAAP and IFRS) that management views as part of the financing of the entity's business activities (referred to as *financing assets and liabilities*).

14. In determining whether a financial asset or liability is part of the financing of the business, management would consider whether the item is interchangeable with other sources used to fund its business activities. The financing section would normally **exclude** assets and liabilities related to transactions with customers, suppliers and employees because transactions of that nature usually relate to an entity's operations. The financing section would normally **include** liabilities that originated from an entity's capital-raising activities because capital is usually raised as a means to fund operating activities.

Issue 1: Management approach to classification of assets and liabilities

Comments from respondents to the discussion paper

15. Respondents are mixed on the role a **management approach** to classification of assets and liabilities should have in financial statement presentation. Respondents that **support** a management approach to classification (mainly preparers of financial statements) think that classifying assets and liabilities in a manner that best reflects the way the asset or liability is used within an entity produces relevant information for users of the financial statements. Those respondents think that a management approach to classification will emphasise the differences between entities and provide users with a better foundation on which to make comparisons between entities and assessments of their relative performance.

16. Respondents that **do not support** a management approach to classification (mainly users of financial statements) are concerned about the subjective nature of management's judgment inherent in that approach. Consequently, those respondents think that the management approach to classification as described in the discussion paper will reduce comparability between entities, including those that are in the same industry. Those respondents prefer an approach to classification that results in consistent and uniform classification of assets, liabilities and items of comprehensive income across entities (eg all pension obligations would be classified as financing activities).

17. Many respondents observe that the management approach described in the discussion paper does not have the same meaning as the management approach that is described in IFRS 8 *Operating Segments* and FASB ASC Topic 280-10, *Segment Reporting* (formerly FASB Statement 131). Those respondents interpret the management approach (as it is defined in the discussion paper) to have a stricter meaning than the management approach that is described in IFRS 8 and ASC Topic 280. Those respondents request that the distinction be formalised in the exposure draft.

Staff analysis

18. The staff continue to think that an approach to classification based on how a reporting entity organises its activities and uses its assets and liabilities will

provide the most decision-useful presentation of that information for users of the financial statements. That approach should help users of the financial statements understand an entity's business model, which is information that the boards are consistently told is essential for effective use of the financial statements.

19. The staff plan to address respondents' concerns about the management approach to classification in drafting the exposure draft. There is tension between the principle underpinning a management approach to classification and respondents' requests for robust section and category definitions, particularly with regard to the financing section definition. Said differently, the more specific the boards choose to be about the definitions of the sections and categories, the less opportunity there is for management to exercise judgment in how to classify assets and liabilities (and their related effects).

20. If the boards agree with the staff recommendations on how to define both the financing (Issue 3) and business section (Issue 4), the role of a management approach to classification will be limited to how information is grouped in the business section. The staff recommendations reflect the feedback provided by comment letter respondents, field test participants (both analyst and preparer) and members of constituent groups (specifically, the Joint International Group (JIG) and the Financial Institutions Advisory Group (FIAG)) that the boards should focus their efforts on creating a clear distinction between items that belong in the financing section and items that belong in the business section.

Implications of the management approach to classification for XBRL

21. Both respondents to the discussion paper and working group members indicate that the management approach to classification is not helpful in the context of XBRL. XBRL requires consistency and uniformity, particularly from the viewpoint of either a regulator or an analyst who seeks to automate both the data collection process and the comparison process (ie between entities in an industry). That automation represents significant savings in terms of both time and cost to gather and process data. To realise fully that savings, similar entities must present information in their financial statements consistently and uniformly.

22. While XBRL was developed primarily as a communication tool, in the hands of a regulator, XBRL is a communication tool for the purpose of compliance. Considered by itself, XBRL is flexible enough to handle the management approach to classification—tags can be extended to reflect the facts and circumstances of any entity. The problem is not so much with XBRL as how the XBRL data will be used. It is possible that the extended tags used by an entity will not be accepted by that entity's regulator because those tags do not conform to how the regulator prefers to "see" the data. Consequently, use of regulator-defined XBRL tags may reduce the information content provided by the management approach to classification.

23. In spite of the information provided in paragraphs 21 and 22, the staff **do not** suggest moving away from a management approach to classification in the FSP exposure draft. At this point, the staff simply want the boards to be aware of the potential for difficulty in translating the FSP project proposals to XBRL in a way that preserves the original intent behind those proposals.

Issue 2: Separating business activities from financing activities

Comments from respondents to the discussion paper

24. The majority of respondents believe that the separation of business activities from financing activities **does** provide decision-useful information, particularly in the statement of comprehensive income (SCI), where users find it helpful to distinguish between the operating activities of an entity and all other activities an entity may engage in.

25. Some respondents are concerned that separating business activities from financing will negatively affect the usefulness of the statement of financial position (SFP). Those respondents are most concerned about the lack of **total assets** and **total liabilities** subtotals and the possibility that similar or identical assets and liabilities will be presented in different sections (or categories) of the SFP. Consequently, those respondents think distinguishing between business activities and financing activities on the SFP may add to the complexity of that statement without making the information contained in the SFP more decision useful.

26. Many respondents indicate that the distinction between business and financing activities lacks relevance for a financial services entity, as most business activities for that type of entity are financial in nature. Consequently, the proposed presentation model may lead to an arbitrary allocation of activities between the business and financing sections for a financial services entity, leading to reduced comparability in the presentation of financial results of otherwise similar entities.

27. Several respondents are concerned that the proposed presentation model uses the SFP as the starting point for classification decisions (ie the separation of business activities from financing activities begins with consideration of how the assets and liabilities are used in the business). Those respondents think that classification decisions should begin with the SCI to provide decision-useful information. The use of the SFP as the starting point for classification decisions will be deliberated by the boards in November.

Summary of participant (both analyst and preparer) feedback from the field test

28. The survey results of the **analyst** participants in the field test indicate that the majority of analyst participants (nearly 90%) make a distinction between the operating and financing activities of the entities they evaluate. Almost 70% of the analyst participants view the separation of business activities from financing activities as one of the more useful proposals in the discussion paper. Approximately 63% thought the recast statements they reviewed clearly communicated the results of the entity's financing activities. However, only half of the analyst participants thought the recast statements did a better job than the non-recast statements in presenting the entity's financing activities.

29. Similarly, the survey results of the **preparer** participants in the field test indicate that the majority of preparers believe that the recast statements communicate their entity's financial results either the same or worse than the non-recast financial statements. Specifically, while 65% of preparer participants think the recast statements clearly identified the core operations (ie business activities) of their entity, only 46% of those preparers thought that the recast statements did a better job than the non-recast statements in communicating that information.

30. While 50% of the preparer participants thought the recast statements clearly identified their financing activities; only 25% of those preparers thought the proposed model did a better job than the non-recast statements at communicating the results of their financing activities.

Staff analysis

31. The staff continue to think that each financial statement should distinguish the operating activities of an entity from its financing activities. Distinguishing between operating activities and the activities to finance those operations is a common distinction made in financial statement analysis. That distinction separates activities that create value from those that (usually) do not. The results of the analyst portion of the field test also support making that distinction.

32. Respondents are consistent in asking the boards to focus on clarifying the business section and financing section definitions provided in the discussion paper so that both preparers and users of financial statements are better able to understand what the boards are trying to accomplish by requiring that distinction on the face of the financial statements. Specifically, respondents ask the boards to provide clarity as to the specific elements that belong in both the financing section and the investing category. For example, determining what types of debt should be shown in the financing section in accordance with the discussion paper proposals was an issue for many of the field test preparer and analyst participants. While most preparers and analysts agreed with the discussion paper's financing section definition in principle, once they applied that definition, neither field test group thought the recast results communicated the results of the entities financing or investing activities well. See paragraphs 39—41 for more information.

33. In response to the feedback received, the staff developed simplified alternatives for the financing section and business section that **should be more understandable for the purpose of making a classification decision** (see paragraphs 35—55 for the financing section discussion; see paragraphs 56—73 for the business section discussion).

34. For this paper, the staff developed its proposals on the basis that the starting point for classification remains the SFP and that each financial statement will, at

a minimum, be cohesive at the section level. That assumption will be tested in November when the boards are scheduled to discuss the SFP in detail. In November, the staff expect to ask the boards whether the optimal presentation of information in the SFP should result in cohesiveness of that financial statement with the SCI and the SCF.

Question 1
The staff recommend the boards reaffirm the preliminary view expressed in the discussion paper that each financial statement should distinguish the business activities of an entity from activities that finance those activities. **Do the boards agree with that recommendation?**

Issue 3: Defining the financing section

Comments from respondents to the discussion paper

35. The majority of respondents think that the financing section **should not be limited to financial assets and financial liabilities** as defined in International Financial Reporting Standards (IFRS) and US Generally Accepted Accounting Principles (GAAP). Those respondents indicate that some non-financial assets and non-financial liabilities could be viewed as part of an entity's financing activities (eg pension liabilities (or a net pension deficit) and asset retirement obligations). Consequently, those non-financial assets and non-financial liabilities should not be prohibited from presentation in the financing section.

36. Some respondents request that the financing section be explicitly tied to a measure called **net debt**. Those respondents prefer that the financing section of the SFP contain all the elements that comprise net debt. For those not familiar with the concept, net debt refers to the items an entity manages as debt and the resources management views as available to service those debts. See September 2009 agenda paper 14C/67C for more information on net debt.

37. Other respondents think that the financing section should be **limited to third-party providers of funding** that have no other relationships with the entity. That approach to classification includes liabilities (and any associated derivatives) in the financing section but excludes from that section any assets or

liabilities that represent transactions with customers, employees, vendors, lessors and other related parties.

Summary of participant (both analyst and preparer) feedback from the field test

38. The survey results of the **analyst** participants in the field test indicate that there is not a consensus as to which liabilities those analysts consider to be appropriately classified in the financing section, except for the following:

    (a) over 90% consider capital leases to be appropriately classified in the financing section; additional comments indicate the majority of analyst participants would classify **all** leases as financing.

    (b) only 2% consider trade payables and other short-term operating liabilities to be appropriately classified in the financing section.

    (c) just over half of the analyst participants (58%) consider unfunded post-employment benefits and other non-financial obligations (ie asset retirement obligations) to be appropriately classified in the financing section.

39. Analyst participants thought the following items **should** have been classified in the financing section:

    (a) operating leases and any lease-related items

    (b) pension liabilities

    (c) proceeds from the reissue of treasury stock

    (d) loss on sale of receivables

    (e) interest expense related to derivative movements in the statement of comprehensive income.

    Additionally, several analyst participants indicate that some cash should be classified as an operating asset.

40. A number of analyst participants commented on what they perceived as inconsistent treatment in presentation of debt-related transactions and transactions involving cash, short-term investments, and investments in marketable securities. The underlying argument appears to be that there is a fundamental purpose for those two groups of transactions and that purpose is universally the same regardless of management’s view of the transaction or

account. Therefore, those accounts should be presented in the same category or section.

i. For debt, the point was argued both directly and indirectly. For example, one respondent stated that all interest-bearing debt should be classified in financing, not split between operating, investing, and financing. They argue that the substance of the transaction is the entity borrowed an asset (or cash) which it will pay a usage fee (interest). The form of the transaction should not affect the classification. (Hence, all leases should be in financing.) In addition, respondents note that the interest associated with the debt should be readily identifiable. The classification of interest-bearing debt as financing and transparency of the related interest expense assists in determining the capital employed. Other arguments state that it is difficult to separate debt used to acquire fixed or intangible assets from debt used for operating (working) capital items such as the purchase of inventory. Therefore, classifying only specifically identifiable debt in operating (ie a specific loan for operating PP&E) and not classifying general debt in operating even though operating assets were obtained with that debt could be arbitrary and adversely affect comparisons between companies.

ii. A similar issue was raised regarding marketable securities. In the Steelworks financial statements, some marketable securities were shown in a section different than cash and available-for-sale securities. Some respondents appear to view the accounts for cash, short-term investments, and marketable securities as all a means of "storing excess value" (cash) that is not currently required in the day-to-day operations of the business. There is a concern that all transactions for storing cash should be classified in the same section or category and should not be subject to interpretation by management.

41. The survey results of the **preparer** participants in the field test indicate that they do not think the financing section is appropriately defined. The preparer participant responses for the financing section were split between too strictly defined and too loosely defined.

Staff analysis

42. Respondents to the discussion paper (as well as the field test preparers and analysts) had difficulty understanding what the financing section is meant to represent. Part of that difficulty stems from the use of the word *financing*.

43. Financing is a general term that carries many different connotations depending on the context in which it is used. For some, financing refers to the capital structure of an entity. From that perspective, the financing section should include both debt and equity. Others view **all** liabilities as a form of financing. Said differently, an entity's ability to postpone (or avoid) payment of a liability in cash can be thought of as a form of financing.

44. The discussion paper makes the distinction between business activities and financing activities as separating the ordinary operating activities of an entity from the capital structure of the entity (paragraph 2.49). In its most basic form, there are two components to an entity's capital structure: debt and equity. For respondents that hold that view, the financing section should reflect two separate categories: debt **and** equity.

45. However, the discussion paper also distinguishes between the business section and the financing section in a more general sense. Specifically, the financing section is referred to as including those activities that **fund value creation**. An argument can be made that value creation can also be funded internally through an entity's operating activities.

46. In the light of respondent feedback, it appears that the discussion paper definition of the financing section carries too much ambiguity to be applied consistently and uniformly in practice. The staff agree with respondents that consistency of classification and uniformity of presentation can be helpful to those that use financial statements to make comparisons between entities by establishing a common starting point to begin their evaluation process. Therefore, the staff think that the financing definition should be narrower than the definition proposed in the discussion paper.

Staff recommendation

47. The staff recommend re-labelling the financing section to ***non-equity sources of funding*** and defining that section as **financial liabilities that have an agreed upon schedule of repayments with an interest component (and that interest component is either explicit or implicit).** Items directly related to those financial liabilities, such as fees, would also be classified in that section. A derivative held as part of an entity's non-equity sources of funding, regardless of whether it is an asset or a liability at the reporting date, would also be presented in this section.

48. The implications of that definition are:

    (a) vendor financing arrangements over one year, loans, guarantees payable in cash, leases and any financial instruments held to hedge any of those items would be **included** in the non-equity sources of funding section;

    (b) the **interest** payable on any liability classified in the non-equity sources of funding section would also be classified in that section;

    (c) **pension assets and pension liabilities** (or the net pension amount), asset retirement obligations and other non-financial liabilities would be **excluded** from the non-equity sources of funding section;

    (d) **assets** associated with the treasury activities of an entity would not be presented in the non-equity sources of funding section as proposed in the discussion paper; and

    (e) **equity** would remain a separate section apart from the non-equity sources of funding section.

Basis for the staff's conclusions

49. The staff think the proposed definition of the non-equity sources of funding section will, in the SCI and the SCF, capture the financing cost information that users seek to understand while not changing radically the current format of the SFP. Many users are concerned that the discussion paper section and category definitions do not provide decision-useful information when applied to the SFP.

50. The staff considered and rejected defining the financing section as the capital structure of an entity. That alternative would have resulted in the creation of two categories within the financing section: a category for debt and a category

for equity. The staff decided not to pursue that definition of the financing section because of the implications for profit or loss (or net income) in the SCI that may result as a consequence of moving the equity section to a category within a broader financing section. Further, it was pointed out that bringing debt and equity together under the financing section could appear as though the FSP team was advocating a claims approach for liability and equity, which the boards have already considered and dismissed in their related project on liabilities and equity.

51. The staff also considered and rejected defining the financing section as **net debt**. (Agenda paper 14C/67C addresses the topic of net debt in detail.) Explicitly equating the financing section total to a net debt measure requires assets held for the purpose of serving that debt (ie financing assets) to be included within the financing section. As a practical matter, the staff think that the boards cannot define a net debt measure until their work on a) liabilities and equity and b) leases is completed. Consequently, it does not make sense to try and explicitly tie the financing section subtotal to a net debt measure at this point in the financial statement presentation project.

52. In a departure from the discussion paper, the staff decided to recommend that assets associated with the treasury activities of an entity be reported outside of the financing section. That recommendation is made for the following reasons:

    (a) many comment letter respondents interpret the inclusion of treasury-type assets in the financing section (as proposed in the discussion paper) to be a move towards equating the financing section with net debt.

    (b) other comment letter respondents do not view treasury assets (cash, cash equivalents, and marketable securities) as negative debt.

53. A schedule in the notes to financial statements that provides sources and uses information about an entity's treasury activities may provide more decision-useful information to users of financial statements than simply presenting the assets associated with those activities in the non-owner sources of funding section. The staff expect to bring the topic of a sources and uses disclosure for treasury activities to the boards as part of deliberations on the SCF and the proposed reconciliation schedule.

54. The staff acknowledge that the proposed definition for non-equity sources of funding places pension assets and pension obligations (or the net pension position) and asset retirement obligations in the business section of the financial statements. In Issue 4, the staff propose an alternative for the business section that allows management to create its own groupings of information within the business section instead of relying on prescribed groupings (ie category definitions). Consequently, management would be able to make a distinction on the face of the financial statements within the business section that separates pension assets and pension obligations (or the net pension position) and asset retirement obligations from all other operating activities if they so choose.

Questions 2—3
Q2: The staff recommend that the financing section be defined narrowly as financial liabilities that have an agreed upon schedule of repayment with an interest component (and that interest component is either explicit or implicit). Items directly related to those financial liabilities, such as fees would also be classified in that section. Derivatives held as part of an entity's non-equity sources of funding, regardless of whether it is an asset or a liability at the reporting date, would also be presented in that section **Do the boards agree with that recommendation?**
Q3: The staff recommend that the financing section be re-labelled to non-equity sources of funding. **Do the boards agree with that recommendation?**

55. If the boards **do not** agree with the staff recommendations, a series of follow-up questions will need to be answered at this meeting. Answers to questions 4—7 will provide the staff with guidance if additional work to define the financing section is required.

Follow-up questions 4—7
Q4: Do the boards want to include assets associated with treasury activities in the financing section?
Q5: Do the boards want to include non-financial assets and non-financial liabilities in the financing section?
Q6: Do the boards want to explore including equity within a broader financing section?
Q7: If the answer to Q6 is **yes**, what groupings (ie categories) of items do the boards want to see in the financing section?

Issue 4: Defining the business section

Comments from respondents to the discussion paper

56. Respondents are mixed as to whether the **operating** and **investing categories** are defined so that their meanings are both understandable and operational. In particular, the majority of respondents request another label for the **investing category**. Those respondents note that the term *investing* has a variety of meanings and is currently used in the SCF in a way that differs from its usage in the discussion paper.

57. Many respondents do not support classifying assets and liabilities (and therefore items of income and expense) that cannot be clearly distinguished as operating, investing, or financing as operating by default. Those respondents consider the *operating income* subtotal to be one of the more useful subtotals in the proposed working format. Consequently, those respondents are concerned that the *operating income* subtotal may be made less useful if the operating category is a default category for items that are hard to classify.

58. Several respondents suggest that the operating and investing categories should be re-labelled as *core* and *non-core business* categories. Respondents think those labels provide a better description of the types of items to be presented in those categories within the business section.

Summary of participant (both analyst and preparer) feedback from the field test

59. The survey results of the **analyst** participants in the field test indicate that they appear to be more comfortable with the definition of the operating category than the investing category. Approximately 60% of the analyst participants agree with the definition of the operating category provided in the discussion paper and 51% agree with the definition of the investing category. Analyst participants that disagree with the definition of the operating category and the investing category think that those categories are too loosely defined.

60. Analyst participants in the field test do not agree on the presentation of several items in the operating section, primarily lease liabilities, interest on lease liabilities and income taxes. Several think lease liabilities and related interest should be a financing item instead of an operating item. Likewise, several

analyst participants think that some income taxes should be presented as part of the operating category. Specifically, taxes should be split between its operating and financing components. Other areas of concern include:

a. **Property, plant and equipment (PP&E)**. The gains and losses on disposals of PP&E and capital expenditures are not related to day-to-day operations and therefore should **not** be included in the operating category.
b. **Investments in securities**. It was unclear to some analyst participants why investments in securities are classified as operating when cash and short-term investments are classified as financing assets.
c. **Investment in associates/affiliates**. Some analyst participants do not understand the classification of investments in associates/affiliates as investing. Comments indicate that some analyst participants think too much leeway was given to management to classify an item as operating or investing.

61. **Preparer** participant responses regarding the communication of operating and investing activities in the recast statements were generally in line with the analyst participant responses. However, the preparer participants do not think the recast statements provide as much incremental benefit over the non-recast statements. Only 50% thought the recast statements did a better job at communicating their operating results and 32% thought the recast statements were better at presenting their investing activities than the non-recast statements.

Staff analysis and alternatives

62. How categories within the business section should be defined rests on what the boards want to accomplish by requiring different groupings of information within the business section. The discussion paper proposes that there are two different classes of value-creating activities (ie business activities) that an entity engages in: operating activities and investing activities. Based on feedback from comment letter respondents, field test participants (both analyst and preparer) and members of constituent groups (specifically, the JIG and FIAG), the staff developed two alternatives to the business section categories proposed in the discussion paper. Those alternatives are described below.

Alternative 1: Operating activities and non-operating activities

63. The most important information for assessing the amount, timing and certainty of future cash flows is information about an entity's operating activities (that is, what it does to produce goods or provide services). **Alternative 1** is based on the assertion that decision-useful information is provided to users of financial statements when a distinction is made on the face of the financial statements between two classes of operating activities:

    (a) those activities that form the cash conversion cycle of an entity and

    (b) those activities that are incidental to the cash conversion cycle but contribute to the working capital position of an entity.

64. Exchange transactions represent conversions and cause cash flows. Cash flows are the evidence of transactions of activities and proof of their progress. In that sense, an entity's cash conversion cycle can be viewed as a proxy for its day-to-day operations. In short, an entity's cash conversion cycle reflects how the entity ordinarily generates value.

65. **Alternative 1** proposes to present the assets and liabilities involved with an entity's cash conversion cycle under the heading ***operating activities*** in the SFP. Examples might include accounts receivable, accounts payable, inventory and fixed assets. Changes in those assets and liabilities would be presented under the same heading (ie operating activities) in the SCI and the SCF.

66. Activities that are incidental to the cash conversion cycle but contribute to the working capital position of an entity are single assets generating returns where there are no significant synergies from combining assets. Examples might include any asset that gives rise to dividends, interest, gains (or losses), rents and royalties **and** assets that are held for the purpose of receiving those payments. Alternative 1 proposes to present those types of assets under the heading ***non-operating activities*** in the SFP. Changes in those assets would be presented under the same heading (ie non-operating activities) in the SCI and the SCF.

67. Non-operating activities are non-cash resources that contribute to the working capital position of an entity through use without being consumed in the process. Those resources neither change their identity or character nor do they disappear as part of the cash conversion cycle. Their contribution through use is the

generation of cash inflows (eg a bond can generate interest and a property can generate rental payments).

Alternative 2: No defined categories

68. At the July 2009 joint meeting, the boards reaffirmed their intention to develop a financial statement presentation model that could be applied to all types of entities. However, **alternative 1** does not work well when applied to a financial services entity. The business section definition proposed in alternative 1 makes a distinction between two types of activities: one where an asset is consumed (or transformed) during the cash conversion cycle and one where an asset is not consumed (ie it is eventually settled). That distinction is not meaningful when an entity is in the business of either holding (or exchanging) claims to cash.

69. In simplest terms, a financial services entity is in the business of producing financial contracts. Financial contracts can be thought of as a set of rules that determine how and when cash flows are exchanged between the two counterparties to the contract. The staff think that one of the more interesting groupings of information within the business section of a financial services entity would be separating financial contracts that generate value from **stable** sources (ie interest and dividend income) from financial contacts that generate value from **unstable** sources (ie security price movements). That distinction should differentiate between activities that contribute to the overall long-term results of a financial services entity and the more or less fortuitous changes in values during the short-term.

70. **Alternative 2** proposes that there be no defined categories in the business section. Alternative 2 acknowledges that there are multiple ways to group information within the business section depending on the facts and circumstances of the entity. The management approach to classification is premised on the idea that the way in which management views the entity has value. Consequently, management should also have the flexibility to devise its own groupings of information within the business section that assist in communicating the relationships between groups of assets and liabilities.

Staff recommendation

71. The staff support **alternative 2**. The staff think that an entity should be required to make a distinction between different classes of value-creating activities only when that distinction communicates decision-useful information to users of its financial statements. Additionally, the staff think that it is the role of a financial statement user to re-arrange the elements of the SFP (and their related effects in the SCI and the SCF) to suit their purposes—that re-arrangement only has value to the extent it enables the financial statement user to do a better job analysing and modelling an entity's financial results.

72. To simplify the discussion paper proposals, the staff recommend that the business section be relabelled the **operating section**. Respondents to the discussion paper asked the boards to clarify whether the term *business* had the same meaning as that defined in IFRS 3 *Business Combinations* (as revised in 2008) or FASB ASC Topic 805, *Business Combinations* (formerly FASB Statement 141R), and suggested that the boards should consider a description other than *business*. The definition of a *business* in those standards was intended for a different purpose and is too restrictive for use in financial statement presentation. The label *operating section* addresses respondents' concerns and will work better when the boards consider how the classification concepts apply to not-for-profit entities.

73. The staff also recommend that **no additional categories** be defined for the operating section in the exposure draft. Rather, the staff propose the development of application guidance that management can use to determine meaningful groupings of information within an entity's operating section.

Questions 8 and 9
Q8: The staff recommend the boards re-label the business section to the ***operating section*** and that no additional categories are defined for that section. **Do the boards agree with that recommendation?** **Q9**: The staff recommend the boards include application guidance in the exposure draft to help management determine meaningful groupings of information within an entity's operating section. **Do the boards agree with that recommendation?**