Project	**Financial Statement Presentation**
Topic	**Analyses of Changes in Assets and Liabilities and Disclosure of Remeasurements**

Introduction

1. This paper for discussion at the financial statement presentation (FSP) working group (WG) meeting addresses the disclosure of analyses of changes in asset and liability line items and the disclosure of remeasurements.

Staff Draft proposal

Analyses of changes

2. The Staff Draft proposes that an entity disclose analyses of changes of statement of financial position (SFP) line items in the notes to the financial statements. According to the Staff Draft, analyses of changes are to be disclosed for all asset and liability line items (or group of line items) that management regards as important for understanding the current period change in the entity's financial position. The Staff Draft contains guidance on how to determine the importance of an asset or liability line item.

3. The Staff Draft proposes that the following changes should be presented in the analyses (if applicable):

   (a) Changes resulting from cash inflows and cash outflows

   (b) Changes resulting from noncash transactions that are recurring and routine (for example, credit sales and interest expense)

   (c) Changes resulting from noncash transactions that are neither recurring nor routine (for example, a business combination)

   (d) Changes resulting from accounting allocations (for example, depreciation expense)

(e) Changes resulting from accounting allowances (for example, bad debt expense)

(f) Other changes resulting from remeasurements (for example, fair value changes, foreign currency translations, and impairment losses).

Remeasurements

4. The Staff Draft proposes that an entity disclose its remeasurements within a single note for each period presented. The remeasurements are to be presented by the section, category, and subcategory headings and line item descriptions that are consistent with those used in the statement of comprehensive income. A remeasurement is defined in the Staff Draft as an amount recognized in comprehensive income that increases or decreases the net carrying amount of an asset or a liability and that is the result of:

(a) A change in (or realization of) a current price or value,

(b) A change in an estimate of a current price or value, or

(c) A change in any estimate or method used to measure the carrying amount of an asset or a liability.

What we heard during outreach activities

Field visit input

Analyses of changes

5. Companies we met with during our field visits stated that the costs to compile the information required in the analyses of changes note disclosure would be very high. They explained that they would not be comfortable disclosing this information if it was not generated in a systematic way because:

(a) The short reporting periods necessitate a systematic solution to the disclosure.

(b) System generated information is more consistent with the controls environment that the certifying officers view as compliant with internal controls standards set forth by Section 404 of the Sarbanes-Oxley Act.

(c) System generated information will provide answers users may have about the disclosures presented.

(d) Foreign exchange and multiple reporting entities necessitate an approach that involves consolidating information from multiple entities and systems that is currently not gathered in any of the systems that are in place today.

6. Most companies were supportive of the objective of the analyses of changes disclosures, but believe that a modified approach that focuses on disclosing more limited types of changes would be more appropriate.

7. The following issues were raised during the field visits:

(a) Companies said that to determine which line items are important in understanding the current period change in the entity’s financial position, they would need to prepare an analysis for each asset and liability line item on the SFP.

(b) Most companies indicated that the guidance in the Staff Draft for selecting which line items to analyze would result in them determining that an analysis of changes should be disclosed for every asset and liability line item on the SFP.

(c) Companies indicated that major system changes would be required to track and compile each major type of movement within the line items being analyzed. (They expressed similar concerns regarding a direct method statement of cash flows.)

(d) Companies questioned the benefit of disclosing all of the types of changes required by the Staff Draft relative to the expected cost. The greatest concern relates to the Staff Draft proposal to present changes resulting from cash inflows and outflows, and from noncash transactions that are recurring and routine.

(e) Many companies noted redundancies between the amounts presented within the analyses of changes and those presented in the remeasurements note, the direct method cash flow statement, and in the statement of comprehensive income as unusual or infrequently occurring transactions.

8. Some companies noted that a trend has developed in recent years within U.S. GAAP whereby many new and proposed standards require account rollforwards. These companies indicated that generally they are able to prepare rollforwards without significant difficulty or cost for accounts currently required to be disclosed (for example, goodwill, accrued warranty, and accrued restructuring) and many prepare rollforwards of other accounts for internal

purposes only. However, these rollforwards are not being prepared in the same level of detail proposed in the Staff Draft.

Remeasurements

9. During our outreach, companies did not indicate any significant concerns with respect to preparing the remeasurement note. Most companies indicated that they currently compile, or can compile, remeasurement information using existing systems and processes and, therefore, the incremental cost would be minimal. The following issues were raised during the field visits:

   (a) The most common matter raised was that despite the numerous examples provided in the Staff Draft, many companies are confused about what is and is not a remeasurement. Companies appear to be most confused over differentiating between charges recorded upon initial measurement at the time of recognition (for example, estimated warranty expense recorded at the time revenue is recognized) compared to adjustments recorded for subsequent measurement (for example, additional warranty expense recorded for an unexpected specific product recall).

   (b) Some companies noted that credit memos issued for price adjustments and error corrections, which occur frequently in certain industries such as consumer products, would meet the definition of a remeasurement. These companies questioned the value of disclosing that type of remeasurement.

   (c) Most companies expressed concern that the requirement to disclose remeasurements within the analyses of changes was redundant with the remeasurement note. The staff clarified that this would not always be the case because not all asset and liability line items are required to be included in the analyses of changes. Additionally, some remeasurements such as foreign currency translation would be reported in total in the remeasurement note, but would be reported at the account level in the analyses of changes.

Views of financial statement users

Analyses of changes

10. The analyses of changes are viewed by users of financial statements as one of the most useful aspects of the Staff Draft. Most analysts felt the information

would reduce the amount of digging and plugging they currently do to complete their models.

11. Some of the users we spoke to indicated that the analyses of changes will provide information that is very useful in understanding the changes in the SFP which is currently not available. Of particular interest is that the analyses would differentiate nonrecurring changes from recurring changes, and operating changes from nonoperating changes.

12. All analysts we spoke with were satisfied with the analyses of changes being performed for significant accounts only.

13. Many analysts felt strongly that this information must be provided quarterly in order to be useful. However, some analysts felt this information was sufficient in annual filings only.

14. Some of the users we spoke to recommended modifications to the guidance as follows:

    (a) Gross balances should be disaggregated when an account is reported net of an allowance/reserve so that the flows of each portion of the balance could be analyzed (for example, Accounts Receivable and the Allowance for Doubtful Accounts disclosed in separate columns).

    (b) An individual SFP line item that has separate components should be analyzed in several columns (for example, Accrued Expenses)

Remeasurements

15. Financial statement users expressed support for the disclosure of remeasurements as that information is useful in assessing trends and evaluating the quality of earnings and earnings sustainability. Most users indicated that having all remeasurements reported within a single note as required by the Staff Draft would be very useful.

16. Some analysts felt this was one of the most important aspects of the proposal. They appreciated the information in a single note and suggested analysts would immediately flip to this information to see what happened during the period that may/may not require an explanation or adjustments. Today, items appear in revenue or other income and users are not sure what those items are. The remeasurement note would highlight those figures. One analyst noted that

these items are sometimes highlighted during a conference call but do not appear in the financial statements.

17. There was some concern that the remeasurement note would be used to highlight items as nonrecurring (such as change in bad debt reserve estimates) that are actually viewed by most analysts as recurring.

18. Some analysts noted the redundancies between the remeasurements note and other disclosure requirements. They thought the note was not essential if it mostly repeated information (for example, impairment losses, gains on sale) that appeared elsewhere in the financial statements and is already being factored into their analyses.

19. One analyst felt there were some numbers in the note that would represent new information, or at least consistent reporting of information, (for example, losses on inventory impairment), which sometimes get buried in 'Other'. The same analyst thinks the separation of realized and unrealized remeasurements would be an important distinction to make.

20. Some analysts cautioned about the way remeasurements are being defined and the potential of giving too much weight to "remeasurements". In other words, if an item is a remeasurement, but it is recurring and persistent, they did not feel it should appear in the note. Whereas others felt that the definition of remeasurement should be any item that affects the income statement that does not result from a transaction. Therefore, the gain/loss on disposal of PP&E would not be included because it resulted from a transaction (the sale), while total bad debt expense would be included, not just the amount that is from a change in the estimates used in arriving at the period's bad debt expense.

21. All analysts agreed with the inclusion of items measured at fair value each period in the remeasurements note. However, there was significant concern over the operationality of excluding initial reserves from the definition of remeasurements but including subsequent changes in those reserve estimates.

Other input received during outreach activities

Auditors

22. During our meetings held with the Big 4 public accounting firms, the firms were supportive of the objective of the analyses of changes, but also felt that a modified approach that focused on significant unusual activity would provide more benefits at a substantially lower cost. The issues are summarized as follows:

    (a) Considerable judgment would be necessary in assessing whether their clients have selected the appropriate accounts to include in the analyses of changes.

    (b) There is a potential lack of precision regarding unexplained variances and "other" changes in the analyses.

    (c) Substantially all multinational and multi-subsidiary clients would have to implement a considerable number of controls at each business unit where account reconciliations are performed.

    (d) Additional audit costs could be significant based on the size and complexity of the company. This is because of the need to test new internal controls, the new figures to be disclosed within all of the analyses of changes, and the IT system upgrade and conversion costs at the time of adoption.

    (e) Several of their clients indicated that difficulties will arise in preparing the analyses of changes due to foreign transaction gains and losses, and post-closing adjustments that are booked centrally.

23. The public accounting firms raised similar points as the preparers regarding the remeasurement note. While some of the firms questioned the usefulness of this note disclosure, they did not perceive this requirement as being onerous in terms of preparation efforts and related costs.

Field test results and/or feedback

24. Field test findings were consistent with the observations from the field visits described above.

Financial service entity issues

Analyses of changes

25. All financial services entity analysts agreed that the analyses of changes will be very helpful to their analysis. There was consensus that information about loans and securities (trading, available-for-sale and held to maturity) is most important, by class (commercial mortgage, residential mortgage). Some of this information will be provided as part of the guidance recently issued by the FASB on credit quality disclosures.

26. Financial services entity analysts did not think that the analysis of changes should be expanded to include all asset and liability line items on the SFP.

27. An insurance analyst noted that deferred acquisition costs, securities, and commercial mortgages are already rolled forward but that an analysis of changes of insurance liability reserves would be useful.

Remeasurements

28. Some financial services entity analysts felt that remeasurements could be the most significant aspect of the project for financial companies because almost every line on a financial services entity's SFP is remeasured.

29. One analyst said that what she really wants to know is the impact of changes in measurements that management has control over. She did not think it was particularly helpful to see changes attributable to interest rates each period in the remeasurement note since management does not have control over rate changes, the changes can be volatile, and it does not have relevance for assets that are held for collection of cash flows.

30. Some financial services entity analysts felt that presenting remeasurements would be difficult to operationalize for banks given the difficulty of separating initial and subsequent loan loss measurements in open loan portfolios. Thus, the definition of remeasurements in the Staff Draft would likely lead to the presentation of confusing information. They suggested that the remeasurement information be split so that an entity would disclose the provision on a new loan separate from a change in the provision on existing loans so that the total provision could be observed.

31. There was some confusion over the purpose of the disclosure if the remeasurements are possibly recurring, which they believed would be the case with the build up of a loan loss reserve.

32. One financial services entity analyst said that he can see potential harm in disclosing all remeasurement information in a single note. He said that a single note might signal to investors that the amounts (and lines) shown in the remeasurement note are related to one another.

33. One analyst felt that fair value remeasurements should be separated into Level 1, 2, and 3 and tied back to the SFP so that remeasurements can be understood in context of the face of the financial statements.

34. An insurance analyst said the remeasurements of the insurance liability could be very important depending on the outcome of the boards' insurance project.

35. Several analysts commented that knowing the source of the remeasurements (change in assumptions, change in mix, interest rates, etc.) would be essential in understanding the remeasurements note.

Staff observations and possible modifications

Analyses of changes

36. Substantially, all participants in our outreach activities indicated their support for disclosing additional information that will assist a user in better understanding significant, unusual, and nonrecurring changes and reclassifications in asset and liability line items.

37. However, many participants suggested that the disclosure requirement be less prescriptive with respect to the type of changes to be presented within the analyses of changes.

38. During our outreach activities, both preparers and users of financial statements indicated that information about the following types of changes would be most useful and generally is currently available:

    (a) Foreign exchange translation adjustment,

    (b) Changes in balances due to acquisitions and dispositions,

    (c) Reclassifications, and

(d) Unusual or infrequently occurring events such as impairments and settlements.

39. Preparers said that the proposal in the Staff Draft to include information in the analyses about recurring cash and noncash transactions (such as sales, material purchases, payments against accrued expenses, depreciation expense and interest expense) would provide information about recurring operations that is less useful, and in many cases will be very costly to prepare.

40. Thus, one alternative is to require specific adjustments made to SFP accounts to be disclosed in the notes to the financial statements. The required amounts would consist of those items that have been identified as informative by users as well as amounts that preparers have said they do have available without significant costs. Those items would be:

(a) Foreign exchange translation adjustments

(b) Remeasurements (including impairments and write-downs)

(c) Reclassifications

(d) Changes in balances from acquisition and disposition transactions

(e) Other items that management believes important in understanding the changes in SFP line items.

41. Another alternative would be to develop a principle to capture changes in SFP line items that are not "routine" transactions that flow through those accounts. The principle would be intended to capture the items listed in letters a-e in the previous paragraph while not providing a prescribed list.

Remeasurements

42. Based on our outreach activities, it appears that there are mixed views on whether all remeasurements should be presented in a single note or only within the analyses of changes. The boards could be asked to revisit that issue prior to finalizing the exposure draft.

43. In addition, the boards may want to consider modifying or clarifying the definition of a remeasurement, and the objective of disclosing remeasurement information. For example, the boards may want to clarify that an amount recorded as part of an initial measurement at the time of recognition is not a

remeasurement, while a subsequent measurement adjustment is a remeasurement. An example that illustrates this modification would be that when an entity records an estimate of bad debt expense at the time of revenue recognition based upon historical collection experience that expense would not qualify as a remeasurement. If that entity then records additional bad debt expense in a subsequent period due to an unexpected specific customer bankruptcy, that expense would qualify as a remeasurement.

Discussion questions—analyses of changes

1. Are there any additional points regarding the analyses of changes that the boards should consider prior to finalizing the exposure draft?
2. How, if at all, should the proposal to disclose analyses of changes be modified (see paragraphs 40 and 41)?

Discussion questions—remeasurement note

3. Are there any additional points regarding the remeasurements note that the boards should consider prior to finalizing the exposure draft?
4. Given the input received during outreach activities, do you think the exposure draft should include a proposal that remeasurements be disclosed in a separate note?
5. How, if at all, do you suggest the remeasurement definition be modified?